

# Competition and Regulation in India 2015

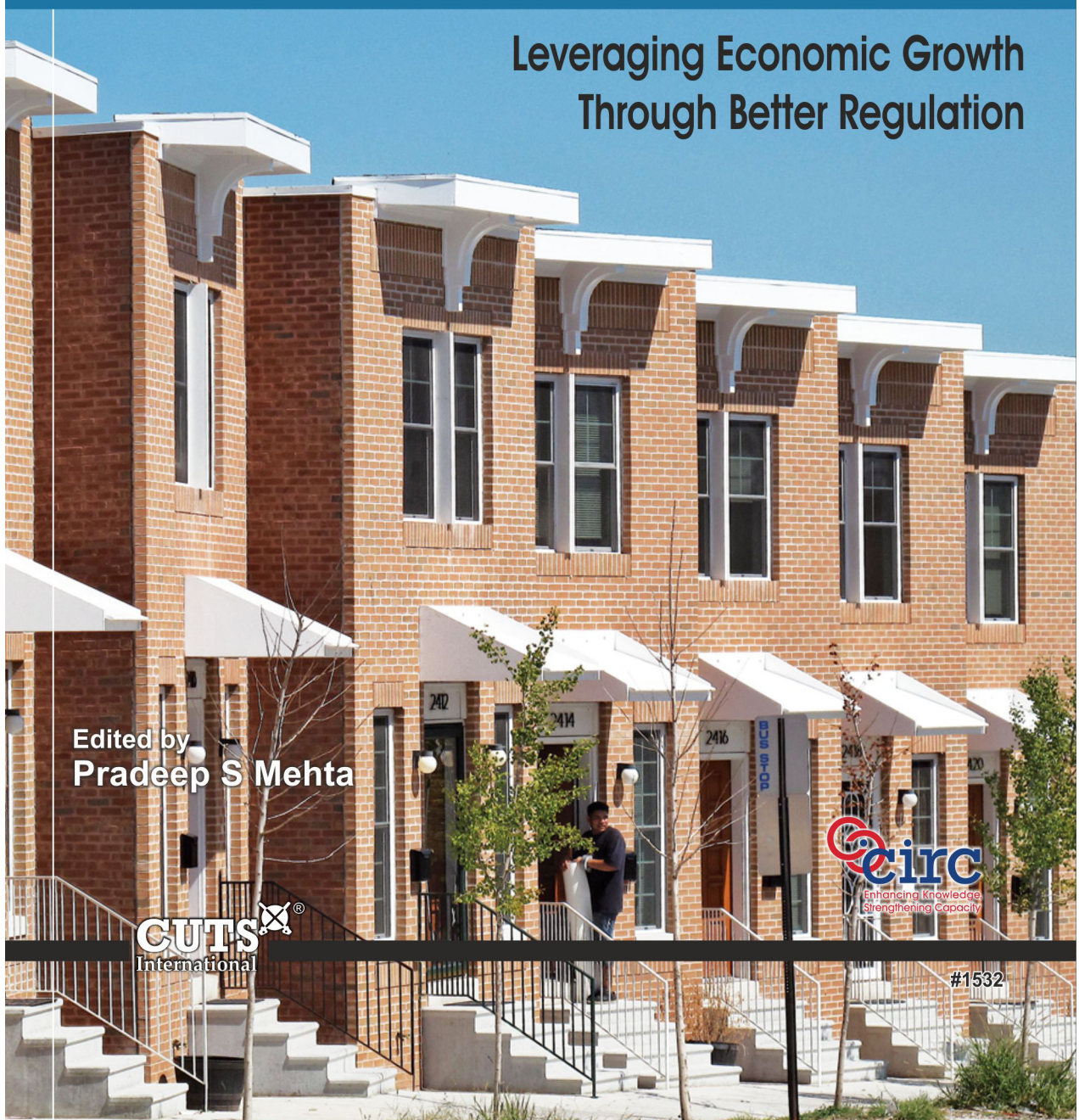
Leveraging Economic Growth  
Through Better Regulation

Edited by  
Pradeep S Mehta

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#1532





# Competition and Regulation in India, 2015

Leveraging Economic Growth  
Through Better Regulation

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Leveraging Economic Growth Through Better Regulation

Published by:



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## Foreword - I

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The India Competition and Regulation Report (ICRR 2015) is a compendium of policy research on the status of competition and regulation in India spanning across sectoral and institutional dimensions. This volume is fifth in the series of biennial reports, since 2007.

One of the main objectives of competition is to enhance consumer welfare. However, the benefits of competition are not always clear to common mass (average consumers). They are usually concerned with the price of an object and generally know what to do. Other than price, there are many aspects of competition that have other significant effects on consumers at large. Further, competition in the market is not only about enhancing consumer welfare but also concerned with public interests.

Business entities often think that competition policy and law are tools for consumers and not for them. Proper design and implementation of a competition regime enables enhancement of the welfare of the business community by addressing anticompetitive practices in intermediate sectors. Many services, such as transport, energy, telecom etc. affect both businesses and consumers. In probably all jurisdictions, it is the business entities that approach the competition authorities more for ensuring fair market practices, rather than consumers.

After almost two decades of privatisation, liberalisation and regulatory reforms, countries, especially developing countries, are facing new challenges to address their regulatory concerns, particularly in infrastructure, financial as well as social sectors. Global economy is still facing the heat of financial crisis that has highlighted the importance of effective regulatory regime for sustained economic growth and development. Further research (including political economy of regulatory reforms) is needed to understand the experience, impact, etc. of economic regulations.

The aim of CUTS initiative – India Competition and Regulation Report (ICRR) is to undertake periodic review of status 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.

To promote a culture of competition in an economy, it is critical to communicate effectively to business, how competition reforms can help promote business welfare. In view of the fact that majority of businesses in India are small and medium, it is critical to make Micro, Small and Medium Enterprises (MSMEs) a partner in the process of competition reforms. As India gears up to retrace the high growth path, the MSME sector assumes a pivotal role in driving the growth engine.

Creating opportunities for MSMEs remains a key challenge of inclusive economic growth – the present government through the adoption of ‘Make in India’ strategy would envisage a larger share of global business in India which presents opportunities for MSME integration in almost all industry sectors. The Indian MSME sector is poised for rapid growth and integration with major global value chains.

It has been established now that benefits of trade liberalisation can be better derived by countries that possess effective/reliable market regulatory framework and instruments. Competition law is one such instrument that has become a feature of liberalising market economies. Apart from the multilateral process, the process of trade liberalisation has also been driven across many developing regions through regional trade integration processes. Development of national and regional competition reforms are often part of such processes, but seem to be effective only if they are well-aligned with domestic policies/processes and have stakeholder support.

I am glad that one of the chapters of this report does an assessment of India’s trade scenario and provides an overview of country’s renewed trade strategy. It further highlights the competition bottlenecks which the country might face while trading with countries with which it does not have comprehensive trade treaties.

Globally, policymakers are increasingly valuing regulation that produces desired results as cost-effectively as possible and one of the best tools available for such business-friendly norms is conducting a participative-Regulatory Impact Assessment (RIA).

RIA is neither against regulation nor against a decrease of regulatory authority. What it stands for is smart regulation, where the regulator can develop mechanisms for enforcement of its mandate, achieve its objectives in a manner which costs the least. RIA is new to most of the regulators in India, and time is needed for full implementation. Moreover, to reach a sustainable level of RIA quality, India will need a clear strategy aimed at the institutionalisation of RIA capacities and incentives within the government machinery. However, calls for conducting such exercises in larger regulatory

environment have been growing for a while and may soon find their way into institutional discourse and become *de rigueur*.

I am delighted that CUTS is continuing with its tradition of bringing out compendium of competition and regulation in India over the years with or without the financial support and this fifth edition is equally enriching research experience. It has brought out the true scenario of competition and regulatory landscape in select relevant sectors by conducting perception survey from relevant stakeholders regarding several regulatory and competition issues, consequently providing recommendations and suggestions to improvise the current state of regulatory structure in the country.

This study is an important contribution towards enriching the available literature in the public domain and encouraging a dialogue to promote a healthy and competitive environment.

**Suresh Prabhu**  
Railway Minister  
Government of India



## Foreword - II

---

The India Competition and Regulation Report (ICRR 2015) is a compendium of policy research on the status of competition and regulation in India spanning across sectoral and institutional dimensions. This volume is the fifth in the series of biennial reports since 2007.

About 20 years after privatisation, liberalisation and the introduction of regulatory reforms, developing countries face new challenges to address their regulatory concerns. The global financial crisis, from which the world is still reeling, has highlighted the importance of effective regulatory regime for sustained economic development. There is evidently scope for further research on the nature and impact of economic regulations, especially with respect to political economy.

The objective of CUTS-led initiative 'India Competition and Regulation Report' (ICRR) is to undertake periodic review of status of competition and regulation to assess functioning of markets in the country. This is a welcome initiative, given the distortions in economic management of the country that impede the realisation of competitive potential.

The benefits of trade liberalisation are most suitably derived by countries that possess effective/reliable market regulatory framework and instruments, one of them being competition law, according to recommendations of global formulations. Development of national and regional competition reforms are often part of such processes, but seem to be effective only if they are well-aligned with domestic policies/processes and have stakeholder support. This report includes an assessment of India's trade scenario and provides an overview of country's renewed trade strategy. Further analysis is provided on trade issues with countries with which India does not have comprehensive trade treaties.

I am delighted that CUTS is continuing with its tradition of bringing out compendium of competition and regulation in India over the years. It has brought out a comprehensive set of suggestions and recommendations, compiled with the help of perception-surveys on stakeholders, to improvise the current state of regulatory structure in the country.

This study is an important contribution towards enriching the available literature in the public domain and encouraging dialogue to promote a healthy and competitive environment.

**Baijayant 'Jay' Panda**  
Member of Parliament of India  
(Lok Sabha)



## Preface

---

With the 1991 reforms, India witnessed liberalisation and started developing regulatory institutions signalling a systematic shift to bring market reforms. As a consequence of these reforms, the government's role transformed from a regulator to that of a facilitator of private investment. This created an enabling environment and provided critical infrastructure to encourage investments.

Recently, the UK-based telecom giant Vodafone stated that the present regulatory encounters are hampering economic development of the country although it has the potential to offer good long-term investment opportunities for global firms. Further, the overall regulatory environment which has developed over a period of time lacks consistent and coherent approach across sectors. Although the World Bank Report depicts India's improvement in the rankings from 142 in 2015 to 130 in 2016, the country needs to further improve in terms of the enabling nature of its business environment and removing unnecessary regulatory burdens imposed upon business and investors. Doing so would, eventually make India's environment more favourable to do business.

The fifth ICRR report is timely as it coincides with the efforts of the government to introduce the Regulatory Reform Bill which aims to bring parity across all regulatory institutions by ensuring healthy competition, orderly development of infrastructure services and protecting the interests of consumers. Also, due to jurisdictional conflict between sector regulators and Competition Commission of India (CCI), introducing National Competition Policy (NCP) could come as a well-timed answer to ensure fair and healthy competition in the market.

In 2014, the nation brought back to power, Bharatiya Janata Party, believing that it would further liberalise and improve India's position on ease of doing business to 50<sup>th</sup> position by 2017 from present 142. In 2014-15, India ranked 71<sup>st</sup> in The Global Competitiveness Index from the list of 144 countries which clearly indicates that the Indian economy has to further enhance fair and healthy competition in the relevant market. Nonetheless, advent of Modi government witnessed quick credible effort that was much needed to revive the economy.

According to Bernhard Steinruecke, Director General of Indo-German Chamber of Commerce, India has a favourable business platform to attract international

trade and commerce, however, it is essential to extemporise the ‘ease of doing’ business in the country by reducing the regulatory burden on business entities.

The present government also endorses the slogan ‘*Make in India*’ (initiative by the present government to encourage companies to manufacture in India and not just assemble) which can only be achieved by creating an investor-friendly environment, modern technology and efficient infrastructure, opening foreign direct investment (FDI) to new sectors and forging partnership between government and industry through an optimistic bend of mind.

The Report covers sectors, such as Broadcasting, Highways, Higher Education, Banking, and cross cutting sectors: bringing back competition in multilateral trade discussions, independence and competence of regulatory institutions, regulation in developing countries: growing pains of the Indian merger review regime. The chapters have been contributed by researchers and eminent academics.

Given the crucial need of a well-functioning regulatory apparatus for the economic governance for a developing country like India, it is essential to evaluate such regulatory bodies in terms of their performance, effectiveness, independence, awareness as well as usefulness. This series of India Competition and Regulation Report, 2015 brought out by CUTS, projects the true scenario of regulation and competition in select relevant sectors; conduct perception survey from relevant stakeholders regarding several regulatory and competition issues; and providing recommendations and suggestions to improvise the current state of regulatory architecture in the country.

The report is prepared under my guidance and team of young and spirited professionals at CUTS led by Udai S Mehta, working closely with Vikash Batham and Suchismita Pati and at CIRC, led by Ashwini Swain.

Our hope is that ICRR 2015 Report, similar to earlier reports, will stimulate public debate on the apposite working of the competition and sectoral regulatory mechanisms that are so large and relevant in our current policy framework.

Jaipur  
December 2015

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

## Editor's Note

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### Need to bring regulatory reforms....

Speaking at the National Workshop on Citizen-Centric Governance, the present Finance Minister, Arun Jaitley, said “Policymakers need to change their regulatory mindset asserting that role of state should be minimised and government monopoly must end wherever possible.” He further mentioned the government should aim at ‘providing a better quality of life to citizens and minimising the role of the government.’

Competition and regulation are inter weaved with each other. It is very essential to liberalise sectors and encourage entities, public and private, domestic and international to participate and compete fairly and do business in India. Ease of doing business in India can only attract investors if it provides a better regime, more lucrative and tax rates which are globally competitive.

Recently, there have been efforts from several regulatory bodies, including Telecom Regulatory Authority of India (TRAI), Director General Civil Aviation etc., who have been vigilant and working towards well designing of roles and responsibilities as well implementing them. Recently, there have been issues related to the quality of service. TRAI in order to reduce call drops introduced compensatory provisions where each call drop will fetch the mobile user Re1 into its account. This would correct the deficiency in services thereby enhancing the performance of mobile operators. Also, the draft Civil Aviation Policy introduced mentioned to further deregulate the sector that would encourage more participation thereby creating a competitive environment that would boost investments into the sector.

Further, there are several cases that depict policy distortions, the recent one being the case where Competition Commission of India (CCI) held the four general insurance companies – National Insurance, New India Insurance, Oriental Insurance and United India guilty of bid rigging in a case involving the Government of Kerala’s *Rashtriya Swasthya Bima Yojana*. However, in 2012, the Department of Financial Services had directed four insurance companies to coordinate their marketing activities. Such decisions adverse had an impact on the insurance companies as CCI slapped a fine of ₹671.05 crore. Therefore, to reduce such distortions in the near future, there is a need to legislate an overarching regulatory law to not only speed up the regulatory reform but also to standardise some basic institutional features and regulatory processes across all regulatory institutions to serve

the very basic objective of encouraging competition, improving efficiency thereby reducing costs.

A few words regarding the ICRR 2015, how and why it will help the readers. The Report series has stemmed from the vast experiences gained in a tranche of competition and regulatory projects that CUTS has been engaged in since 1990s. Given this background, CUTS International formulated a proposal to do a Status of Competition and Regulation in India report on biennial basis, i.e. the first one in 2007, followed by 2009, 2011 and latest one in 2013.

While the first two reports were supported by the British High Commission in New Delhi, the Royal Norwegian Embassy (RNE), New Delhi decided to support the third and fourth cycle of the project with funding in 2010. The Norwegians have supported the efforts to aid economic reforms in India and facilitate partnerships between India and Norwegian Institutions through research and advocacy projects. However, the present ICRR 2015 project is self-supported by CUTS.

The last Report of 2013 focussed on several issues and included competition/regulatory issues in key sectors such as coal, railways, private healthcare, financial sector, regulatory independence, and regulatory conflicts sector. Previous to that, 2011 Report covered relevant sectors such as microfinance, natural gas, real estate, retail, passenger transportation and telecom, while covering certain cross cutting sectors, such as essential facilities doctrine, review of regulatory mechanism.

The current Report ICRR 2015 contains sectors such as Broadcasting, Highways, Higher Education, Banking, India's merger regime and cross cutting sections – linkage between trade and competition, independence and competence of regulatory institutions.

The entire work on ICRR developed under my supervision. We are grateful to sectoral experts who have been keenly involved and contributed valuable insights to produce quality paper. The authors who have contributed to this report are V Sridhar, Yugank Goyal, Archana G. Gulati, Siddhartha Mitra, Honey Gupta, Amol Kulkarni and Rohit Singh. The editorial assistance was provided by Madhuri Vasnani, while the layout was done by Mukesh Tyagi and Rajkumar Trivedi. We are grateful to them as well.

Udai S Mehta, Ashwini Swain, Vikash Batham along with Suchismita Pati have closely worked under my overall guidance. All of them worked hard to produce an excellent report. In conclusion, readers are requested to peruse the Epilogue which lays out the relevant parts of the future reforms agenda for the country.

**Pradeep S Mehta**  
Secretary General, CUTS International, Jaipur

# Acknowledgements

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CUTS along with CUTS Institute for Regulation and Competition (CIRC) is implementing a project entitled, 'Report on Competition and Regulation in India'. The goal of the project is to review the prevailing state of regulation and competition in few select economic and social sectors in India.

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 authors for writing different chapters of the report:

- Independence and Competence of Regulatory Institutions: Select Cases from India (*Yugank Goyal*, Assistant Professor, O P Jindal Global University)
- Bringing Back Competition in Multilateral Trade Discussions (*Amol Kulkarni*, Senior Policy Analyst, CUTS International)
- Regulation in Developing Countries: Growing Pains of the Indian Merger Review Regime [*Archana G. Gulati*, Adviser (FA), Head, Combination Division, Competition Commission of India]
- Competition and Regulation in Higher Education in India (*Siddhartha Mitra*, Professor, Department of Economics, Jadavpur University)
- Competition and Regulation in Highways Sector in India (*Honey Gupta*, Junior Fellow, CUTS Institute for Regulation & Competition)
- Competition and Regulatory Issues in Banking Sector in India with a Focus on Bank Licencing (*Rohit Singh*, Assistant Policy Analyst, CUTS International)
- Competition and Regulation in Broadcasting (*V Sridhar*, Dean & Professor, Information Management, Management Development Institute)

We are also thankful to Abhishek Kumar, Alok Ray, D P Gupta, Eleanor Fox, Mahesh Uppal, Manas Kumar Chaudhuri, Milindo Chakrabarti, Nisha Kaur Uberoi, Nitya Nanda, Philippe Brusick, Rajeev D Mathur, Sampath Kumar, Siddhartha Mitra, Subir Gokarn for reviewing different chapters and providing valuable insights.

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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.

Finally, any error that may have remained is solely ours.

## Abbreviations

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AICTE	:	All India Council of Technical Education
AIR	:	All India Radio
APTA	:	Asia Pacific Trade Agreement
ARPU	:	Average Revenue Per User
ASEAN	:	Association of South East Asian Nations
BCI	:	Bar Council of India
BIC	:	Bank Investment Company
BIS	:	Bureau of Indian Standards
BOT	:	Built Operate Transfer
BR	:	Banking Regulation
CAM	:	Conditional Access Modules
CAR	:	Capital Adequacy Ratio
CAS	:	Conditional Access System
CCEA	:	Cabinet Committee on Economic Affairs
CCI	:	Competition Commission of India
CECA	:	Comprehensive Economic Cooperation Agreement
CEPA	:	Comprehensive Economic Partnership Agreement
CERC	:	Central Electricity Regulatory Commission
CGPA	:	Combined Grade Point Average
CHIS	:	Comprehensive Health Insurance Scheme
CNN	:	Cable News Network
COMPAT	:	Competition Appellate Tribunal
CRR	:	Cash Reserve Ratio
DCB	:	Development Credit Bank
DIPP	:	Department of Industrial Policy and Promotion
DoT	:	Department of Telecommunication
DPO	:	Distribution Platform Operators
DTH	:	Direct-To-Home
EC	:	European Commission
EFTA	:	European Free Trade Association
EU	:	European Union
EoT	:	Extension of Time

FDI	:	Foreign Direct Investment
FMCG	:	Fast Moving Consumer Goods
FSDC	:	Financial Stability and Development Council
FSLRC	:	Financial Sector Legislative Reforms Commission
FTA	:	Free Trade Agreement
FTP	:	Foreign Trade Policy
GATS	:	General Agreement on Trade in Services
GDP	:	Gross Domestic Product
GER	:	Gross Enrollment Rate
GST	:	Goods and Services Tax
GTB	:	Global Trust Bank
HAM	:	Hybrid Annuity Model
HDFC	:	Housing Development Finance Corporation
HITS	:	Head-end In The Sky
IAS	:	Indian Administrative Service
ICICI	:	Industrial Credit and Investment Corporation of India
ICN	:	International Competition Network
ICTSD	:	International Centre for Trade and Sustainable Development
IDBI	:	Industrial Development Bank of India
IDFC	:	Infrastructure Finance Company
INSAT	:	Indian National Satellite
IPRs	:	Intellectual Property Rights
IPTV	:	Internet Protocol Television
IRDA	:	Insurance Regulatory and Development Authority of India
ISRO	:	Indian Space Research Organisation
LABs	:	Local Area Banks
LARR	:	Land Acquisition, Rehabilitation and Resettlement
M&A	:	Merger and Acquisition
MDRs	:	Major District Roads
MFI	:	Micro Finance Institutions
MIB	:	Ministry of Information and Broadcasting
MNC	:	Multinational Corporation
MoRTH	:	Ministry of Road, Transport and Highways
MRTPs	:	Monopolies and Restrictive Trade Practices
MSOs	:	Multi-Service Operators
NABARD	:	National Bank for Agricultural and Rural Development



NBA	:	National Board of Accreditation
NAAC	:	National Assessment and Accreditation Council
NDPL	:	North Delhi Power Ltd
NHAI	:	National Highways Authority of India
NHDP	:	National Highway Development Project
NOFHC	:	Non-Operating Financial Holding Company
NOTEF	:	Non-refundable One Time Entry Fee
NPA <sub>s</sub>	:	Non-performing Assets
NTBs	:	Non-Tariff Barriers
NTDCP	:	National Transport Development Policy Committee
NTMs	:	Non-Tariff Measures
OBC	:	Oriental Bank of Commerce
OTA	:	Over-The-Air
OTT	:	Over-The-Top
PFC	:	Pre-filing Consultation
PMGSY	:	Pradhan Mantri Gram Sadak Yojana
PMJDY	:	Prime Minister Jan Dhan Yojana
PNGRB	:	Petroleum and Natural Gas Regulatory Board
PPP	:	Public Private Partnership
PRFDA	:	Pension Fund Regulatory Development Authority
PSBs	:	Public Sector Banks
PSUs	:	Public Sector Undertakings
PWDs	:	Public Works Departments
RBI	:	Reserve Bank of India
RCEP	:	Regional Comprehensive Economic Partnership
RDC	:	Road Development Corporation
RIA	:	Regulatory Impact Assessment
RIO	:	Reference Interconnect Offers
RoB	:	Rail over Bridges
RoW	:	Right of Way
RRBs	:	Regional Rural Banks
RSBY	:	Rashtriya Swasthya Bima Yojana
RSC	:	Railway Safety Commission
RTAs	:	Regional Trade Agreements
RTI	:	Right to Information
RuB	:	Rail under Bridges
RWA	:	Risk Weighted Assets
SAA	:	Simultaneous Ascending Auction
SAFTA	:	South Asia Free Trade Area
SAR	:	Self-Assessment Report
SATCOM	:	Satellite Communication

SBI	:	State Bank of India
SCBs	:	Scheduled Commercial Banks
SEBI	:	Securities and Exchange Board of India
SERC	:	State Electricity Regulatory Commission
SEZs	:	Special Economic Zones
SHDP	:	State Highway Development Project
SLR	:	Statutory Liquidity Ratio
SMEs	:	Small and Medium Enterprises
SoEs	:	State-Owned Enterprises
SPS	:	Sanitary and Phytosanitary
STB	:	Set Top Box
TAMP	:	Tariff Authority for Major Ports
TBT	:	Technical Barriers to Trade
TPP	:	Trans Pacific Partnership
TRAI	:	Telecom Regulatory Authority of India
TRIPs	:	Trade Related Aspects of Intellectual Property Rights
TTIP	:	Trans-Atlantic Trade and Investment Partnership
UGC	:	University Grants Commission
UNCTAD	:	United Nations Conference on Trade and Development
UTI	:	Unit Trust of India
UTPs	:	Unfair Trade Practices
UTs	:	Union Territories
VCR	:	Video Cassette Recorders
VGF	:	Viability Gap Funds
WTO	:	World Trade Organisation

## CHAPTER 1

# An Overview

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### **Prevailing Business Regulatory Environment in India: Need for Improvement**

India started developing regulatory institutions with the introduction of reforms in 1991. But the regulatory environment which has developed over a period of time does not seem homogeneous across sectors and India ranks low in terms of the enabling nature of its business environment with unnecessary regulatory burdens imposed upon business and investors. The returns from economic reforms accrued slowly due to the lack of appropriate implementation measures that were required to ensure sustainability.

Time and again, India took important steps to improve its regulatory frameworks like in early 2000. However, regulatory barriers to competition are still high and rule-making in India is complex due to the different layers of government. However, things have changed positively if not significantly off late (Refer to Box No 1.1). It is understood that the government plays an important role in developing and maintaining an environment conducive for enhancing productivity and competitiveness of business enterprises. The role of government is thus, multi-pronged – as articulator, enabler, facilitator, regulator, gap-filler and buffer. For assuming such role, government will be required to develop policy frameworks, pass legislations, enact rules and monitor compliance with these. Such actions should be able to provide due inputs into a thriving business environment.<sup>1</sup>

It is necessary to examine the regulatory and policy actions of the government to avoid any undesirable result or failure to match with the needs of the time. Amidst celebrating two decades of economic liberalisation reforms, this is an opportune time to undertake such systemic examination and unleash a new wave of reforms. The Narendra Modi-led government is constantly working to improve business environment in India and has taken a lot of micro steps in the last one and half year. The good thing is that the States are also contributing to certain extent.

**Box I.1: Snapshot of Recent Reform Measures  
Undertaken by the Indian Government<sup>2</sup>**

- Deregulating diesel prices, paving the way for new investments in this sector;
- Raising gas prices from US\$4.2 per million British thermal unit to US\$5.6, and linking pricing, transparently and automatically, to international prices so as to provide incentives for greater gas supply and thereby relieving the power sector bottlenecks;
- Replacing the cooking gas subsidy by direct transfers on a national scale;
- Increasing FDI cap in defence to 49 percent, and targeting 100 percent FDI in investment;
- Instituting the Expenditure Management Commission, which has submitted its interim report for rationalising expenditures;
- Passing an ordinance to reform the coal sector via auctions;
- Securing political agreement on the goods and services tax (GST) that will allow legislative passage of the constitutional amendment bill;
- Instituting a major programme for financial inclusion — the *Pradhan Mantri Jan Dhan Yojana* under which over 12.5 crore new accounts have been opened till mid-February 2014;
- Continuing the push to extending coverage under the *Aadhaar* programme, targeting enrollment for 1 billion Indians; as of early February 2014, 757 million Indians had been bio-identified and 139-Aadhaar linked bank accounts created;
- Eliminating the quantitative restrictions on gold;
- Passing an ordinance to make land acquisition less onerous, thereby easing the cost of doing business, while ensuring that farmers get fair compensation;
- Facilitating Presidential Assent for labour reforms in Rajasthan, setting an example for further reform initiatives by the states; and consolidating and making transparent a number of labour laws; and
- Passing an ordinance increasing the FDI cap in insurance to 49 percent;
- Commencing a programme of disinvestments under which 10 percent of the government's stake in Coal India was offered to the public, yielding about ₹22,500 crore, of which Rs 800 crore accrued from foreign investors;
- Passing the Mines and Minerals (Development and Regulation) (MMDR) Amendment Ordinance, 2015 is a significant step in revival of the hitherto stagnant mining sector in the country. The process of auction for allotment would usher in greater transparency and boost revenues for the States.

The government's attempts to improve the ease of doing business have yielded good result with the country jumping 12 ranks to 130 in the latest ranking compiled by the World Bank (WB). The WB Doing Business reports, started in 2002, review business regulations and their enforcement across 189 countries. The report further mentioned that India is one of the countries that have made the most improvement, capturing the initiative of the government in a separate section.

Recently, President Pranab Mukherjee presented India's position as one of the few bright spots in an otherwise gloomy global economic scenario. He said that with moderating inflation, strong currency reserves, lower current and fiscal deficit and stable tax policy, the prospects of Indian economy appear bright.<sup>3</sup>

**'Make in India': A step in right direction** — Initiatives to increase domestic manufacturing and address manufacturing challenges began during the previous government reign with the setting up of a National Manufacturing Competitiveness Council which started new programmes focussed on quality and clusters. However, the *Make in India* campaign has taken the focus on manufacturing one step further. This has been complemented with a Skill India campaign with the aim of developing trained manpower that will enable *Make in India* to work. *Make in India* initiative launched last year aimed at making India a global manufacturing hub. It was a promise to lower barriers to doing business and promote investments. Under the initiative, the government has, in the last one year, announced several steps to improve the business environment by easing processes to do business in the country, and attract foreign investments.

The response to this initiative in the last year has been overwhelming. The sentiment was endorsed by industry associations as illustrated by the statement from Didar Singh, Secretary General, Federation of Indian Chambers of Commerce & Industry (FICCI) who said "Make in India has been well received by the industry both in India and abroad and has started yielding results too. Also, we have seen a significant increase in FDI ever since the campaign was announced". The pick-up in investments is starting to show in the country's industrial production numbers as the official data show India's industrial production rose an average 2.7 percent year-over-year in the seven month period from October to May 2015.<sup>4</sup>

Nothing spectacular one may say, but it is a significant step up from the measly 0.6 percent increase during the comparable period a year earlier. Telecom giants like Xiaomi, Huawei, etc. have already set up manufacturing units in India, while iPhone and iPad manufacturer Foxconn is expected to open a manufacturing unit soon.

However, creating a sustained and successful business environment will be possible only when the administrative and regulatory machinery is efficient as India has been very stringent when it comes to procedural and regulatory clearances. A business-friendly environment will only be created if India can signal easier approval of projects and set up hassle-free clearance mechanism.

### **Effective Competition Regime**

There is broad agreement that competition makes a positive contribution to economic development. Therefore the existent barriers to competition are sources of apprehension. In addition to the bold steps undertaken by the country through economic liberalisation and business regulatory reforms, a dedicated legislation dealing with competition promotion in markets in the form of Competition Act, 2002 has complemented these efforts of the government.

Competition is increasingly understood to enhance production, efficiency and consumer welfare in almost all economic sectors across the world. Policymakers also seem to embrace competition as a process by which the most productive firms win. Over the past few years in India, industries such as telecommunications, IT, pharmaceuticals and automobiles have had to adapt to competitive market discipline — and consumers have benefited in terms of choice, price, and product satisfaction.

The competition regime in India is shaping up well ever since the operationalisation of the Competition Commission of India (CCI) in 2009. In the half-decade since it became functional, the CCI has acquitted itself creditably in enhancing the competitiveness of the domestic industry.<sup>5</sup> Given its mandate to regulate almost every aspect of Indian business and its capacity to impose financial penalties, it certainly has the potential for being the most powerful regulator of the Indian economy.<sup>6</sup>

Responding to continuous demand and support from civil society organisations (CSOs) in India over the years, the competition regulator has co-opted the cause of the Indian consumer, by complementing the country's consumer protection laws making the consumer more empowered and vigilant against market abuses. Initiating investigations against price-fixing by onion traders, domestic airlines and LPG gas traders, curbing anticompetitive practices of several Indian chemist associations of limiting the sale of drugs in India, and educating the Indian consumer of her rights, through several advocacy initiatives, the competition regime has kept the Indian consumer at the heart of its enforcement priorities.<sup>7</sup>

However, the competition legislation, in itself, is not sufficient to sustain a well-functioning competition regime and it has to be complemented with a dedicated National Competition Policy (NCP), which India is yet to have. The draft NCP is residing with the Ministry of Corporate Affairs since November 2011, but has unfortunately been ignored by successive governments. Competition in the market place can be distorted by anticompetitive practices of firms as well as government policies that result in anticompetitive outcomes that hinder the market process and unduly influence the ability of firms to compete fairly.<sup>8</sup>

Thus, the relevance of a strong NCP for India to deal with government policies cannot be overstressed. This is especially so because of the presence of various policies followed by different states of the country. Similarly, there is the complicating presence of different sectoral regulators with divergent objectives. If a unified competition culture is to be achieved, there is need for some harmonisation. This would constitute a substantial step forward in the direction of establishing a strong and integrated competition regime for the country, and is certainly the need of the hour. It has been estimated that the NCP in Australia resulted in substantial economic benefits.

### **Regulatory Impact Assessment could be a Game Changer**

While we talk about improving business regulatory environment and effective competition regime, a very crucial component of regulatory reform process is to select the appropriate form and extent of the regulations that governs the diverse sectors and industries. It has become an important goal for regulators to regulate better. Improving the quality of regulation has shifted its focus from identifying problem areas, advocating specific reforms and eliminating burdensome regulations, to a broader reform agenda that includes adopting a range of explicit, overarching policies and tools.<sup>9</sup>

Regulatory Impact Assessment (RIA) is a systematic tool used to analyse the objectives of a regulatory proposal, the risks to be addressed by the regulation and the options for delivering the objectives. It is a formal method for assessing the costs and benefits, both economic and non-economic, apparent as well as hidden of regulatory proposals and the overall aim is to ensure greatest net public benefit.<sup>10</sup>

It further helps in improving quality of regulations, consequently reducing the room for red tape, which will ameliorate the investment sentiments and improve the country's social and economic condition. Globally, RIA has helped create laws that are pro-growth and transparent. It is high time that India should start adopting and implementing it. Taking a cue from other jurisdictions, RIA has been recommended for India by several expert

committees. These include the erstwhile Planning Commission's Working Group on Business Regulatory Framework, Financial Sector Legislative Reforms Commission, Damodaran Committee Report, the Tax Administration Reform Commission and most recently, the Ajay Shankar Committee. In the European Commission, for instance, impact assessment is done for all major policy decisions, including even treaty negotiations and budget changes. In the US, RIA is done for thousands of rules each year, and the most important are reviewed for accuracy by an expert team in the office of the president. Some 18 US States have also adopted RIA. The Australian government uses RIA at federal level and in all States. Today, over 65 countries have adopted some form of RIA in making new laws and rules.<sup>11</sup>

The economic benefits of better regulation are substantial, since in countries similar to India the annual cost of government regulation accounts for 10-20 per cent of GDP. This means even small improvements in regulatory efficiency can have large payoffs in national income.<sup>12</sup>

RIA is new to most regulators in India, and time is needed for full implementation. To reach a sustainable level of RIA quality, India will need a clear strategy aimed at the institutionalisation of RIA capacities and incentives within the government machinery. Such a strategy rests on a series of RIA practices: clear targeting strategies, development of multi-level consultation strategies, more attention to data collection and quality, investment in training etc.

### **Need to Link Competition and Regulatory Reforms with Sustainable Development Goals**

The concepts of sustainable development is realised to full effect when the government and business actions affects economic, environmental and social concerns in a positive way. Sustainable and inclusive development is the core concept underlying the post-2015 sustainable development agenda and includes the idea of economic transformation. Appropriate industrial and trade policies are definitely necessary but not sufficient on their own to achieve sustainable and inclusive growth and development. With the recent adoption of the Sustainable Development Goals (SDGs), it is critical to ensure that all of the useful tools that can be used towards their attainment be fully understood. While general economic policies, which basically include fiscal and monetary policies, are generally expected to be pivotal in the attainment of the SDGs, they should also be complemented by other policies that are relevant for the attainment of the SDGs. Competition policy and law should complement these policies if governments are to achieve such development. India's growth path should align with SDGs.



The big question whether the competition and regulatory reforms contribute towards achievement of any of the 17 goals identified as SDGs. There is definitely direct links to some goals and few indirect links as well. Competition and regulatory reforms not only provide for effective development of a competitive market but also find the most effective way of integrating objectives such as social and consumer protection, safety among others. SDG Goal 8 and 9 has straight-forward linkages with competition reforms.

Goal 8 is about promoting sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all. This goal encompasses two distinct objectives which might not necessarily happen simultaneously; inclusive and sustainable economic growth on one hand and employment on the other. Whilst economic growth is generally dependent on fiscal and monetary policies a government can pursue, it can also be shown that competition policy has an important role to play. Competition policy is expected to create more competition, where firms strive to keep abreast of others by innovation, efficiency and investment in better production methods, which would result in more output and economic growth. Empirically, it has been established that the implementation of competition laws have a relationship with economic growth.

Competition policy, when implemented effectively also has a bearing on employment creation. Decisions which promote competition and result in more firms entering the market would also boost employment. Goal 9 is about building resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation. Competition policy can be a useful tool in the attainment of this goal through its impact on sustainable industrialisation and innovation.

As already mentioned, competition policy can help remove entry barriers and create a conducive environment for business to thrive, which would enhance industrialisation. By constantly checking on firm behaviour, competition policy also helps ensure that existing firms, which are relatively weaker, are protected from market exit through exclusionary practices by the dominant firms, which would also help in industrial sustainability.

Competitive markets allow a nation's resources to be used to best effect in the production of goods and services. For example, both theoretical and empirical research in recent years has emphasised the productive and dynamic efficiency gains from competition.<sup>13</sup> Competition gives firms continuing incentives to make their production and distribution more efficient, to adopt better technology, and to innovate.<sup>14</sup> These sources of productivity improvement lead to growth and poverty reduction and innovation.

## **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. 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.

Four reports (2007, 2009, 2011 and 2013) 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 and the 2013 report dealt with how faulty regulatory design impedes efficient economic regulation, deals with interplay between competition and regulatory design, and makes suggestions to achieve better economic regulation.

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 rigorously 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 focussed 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 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.

### ***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 provided an opportunity for a comprehensive review of regulatory process, and more importantly, regulatory design of Indian economy.

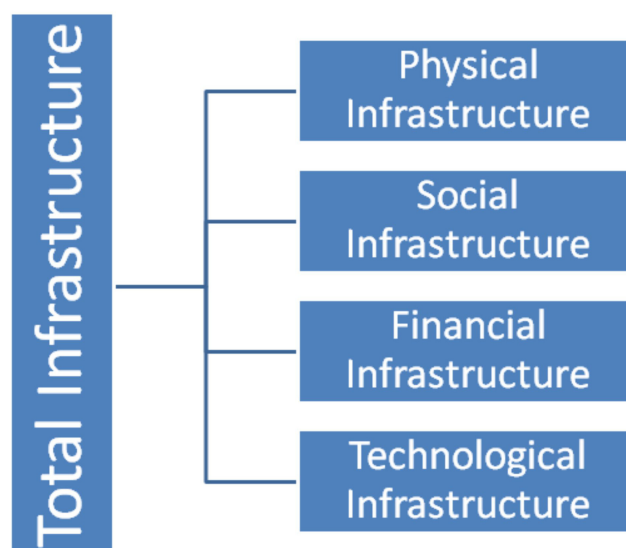
This report was a step in this direction. It reviewed the design of regulatory process of key economic sectors of Indian economy. Indian economic sectors are dominated either by public or private sector firms. Such dominance in the sector is the key feature which determines the state of sector, prevailing 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-sector dominated sectors was selected. As a result, the sectors selected for the 2013 report were 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 regulatory conflicts were also included in the report.

Summary of the Competition and Regulation Reports		
Year	Areas covered	Outcomes
2007 <a href="http://www.cuts-ccier.org/icrr/icrr07.htm">http://www.cuts-ccier.org/icrr/icrr07.htm</a>	Generic issues of competition policy and law, along with telecommunication, electricity, healthcare and education	Highlighted the need for a 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 <a href="http://www.cuts-ccier.org/icrr09/icrr09.htm">http://www.cuts-ccier.org/icrr09/icrr09.htm</a>	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 <a href="http://www.cuts-ccier.org/icrr2011/">http://www.cuts-ccier.org/icrr2011/</a>	Sector for review consisted 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 address reforms in power and coal sectors, reform regulatory governance and create an Indian Regulatory Service, and implement NCP
2013 <a href="http://www.cuts-ccier.org/icrr2013/">http://www.cuts-ccier.org/icrr2013/</a>	Sector for review consisted railway, coal, finance and private healthcare. Cross-cutting issues of regulatory performance and regulatory conflicts were also assessed	Highlighted the need to get the regulatory design correct. It emphasised that an aptly designed regulator has the right tools, to efficiently manage innovation and navigate the sector to benefit the market players and build their confidence, ensure value to consumers and ultimately contribute to the growth of economy

## Overview of the 2015 Report

The government in our country has set an ambitious development agenda and commenced the implementation of reforms to unlock investments. Nevertheless, the pace of reforms will need to be stepped up to bridge the yawning infrastructure gap, improve FDI and unlock private investments and make Indian firms globally competitive.

In connection to the above sections, and to ensure that the reforms are inclusive and sustainable, not only the physical infrastructure but other social, financial and technological infrastructure needs improvements and the ICRR 2015 report selects one sector in each of these infrastructure categories and for analyses.



- Physical infrastructure – Highways
- Social infrastructure – Higher Education
- Financial infrastructure – Banking
- Technological infrastructure – Broadcasting

At the sector level, many sectors have remained unexplored from a regulatory point of view. Optimal, sound and financial infrastructure is key to sustainable development. In the regard, sectors which deserve attention are the social (higher education) and financial sector (banking). Both play a significant role in the Indian economy from the point of view of human and financial capital formation and demand generation respectively. Another competition concern that needs to be given priority is introduction of competition in natural monopolies through public-private partnerships (PPPs). This is particularly relevant in the case of sectors such as highways. Of particular

importance are the negotiation and renegotiation of contracts underlying PPPs which should be tailored to maximise social welfare. This has become much more important in light of the recently released recommendations of the Kelkar Committee on reinvigorating the PPP model.

This report delves into the mentioned issues through a study of the Highways, Higher Education, Banking and Broadcasting sector. The report also touches upon crucial cross cutting linkages such as Trade & Competition, Independence and Competence of regulatory institutions and a review of the Indian merger regime. The remaining part of this chapter highlights what to expect from the above mentioned sector studies. Scope of individual chapters has been briefly discussed and summary of key findings has been provided.

The next chapter discusses results of survey carried out to assess the perception of relevant stakeholders pertaining to issues regarding regulation and competition. The survey was administered online and covered a total of 15 states in the country.

The survey findings revealed that the overall competition scenario in the country was found to be above average. This was visible owing to choices available to consumers in various products and services at nearly affordable prices. Consumers were also able to conveniently get access to large number of utilities. The survey results reflected that stakeholders were still bit ignorant about the nature of market practices vis-a-vis competition and regulatory aspects, which may lead to the exploitation of stakeholders as they are exposed to such practices unknowingly.

The survey also revealed that one of the issues which one has been able to improve drastically over the years has been the awareness level of consumers about the existence of regulatory authorities. However, when it comes to issue of effectiveness of such agencies in regulatory decision making, these agencies have not been very effective in many instances.

**Chapter 3 on *Independence and Competence of Regulatory Institutions: Select Cases from India*** talks about the deficiencies in the regulatory architecture of India. The paper shows that one of the reasons for failures of regulatory performance is the lack of independence and competence of the regulatory agencies. After an initial theoretical backdrop, the paper offers an insight into several regulatory agencies and problems emerging from poor regulatory designs and political entrenchment. In Part 2 of the chapter discusses broad theories of regulation and its purpose. It further elaborates on the concept of independence and competence, with reference to Indian regulatory state and dissects select regulatory agencies in India and highlights the problems therein.



One of the key issues that have continued to be debated after the emergence of regulatory state is that of the performance of regulatory agencies. Regulatory agencies, as governments in miniature, are not subjected to direct checks and balances that governments are, as the government's places the annual report of the regulatory institutions in the Parliament on behalf of the regulators. More importantly, while citizens can observe performance of their governments and vote the latter out of the power in next elections, such direct forms of accountability cannot be employed in governing regulatory agencies. Therefore, it is imperative that appropriate frameworks be set in place which can observe, measure and accordingly act on regulatory performances.

The paper illustrated that institutional design is one of the most powerful ways in which the issues could be addressed. Poor regulatory framework breeds poor performance. Many of the agencies analysed (NHAI, RSC, TAMP, CERC, PNGRB, etc.) in the paper clearly reflects how the design of statutes itself is the root cause of incoherence, incompetency and politically entrenched interests. There is a need for more transparent regulation for appointment of Chairmen and Members, and appropriate frameworks to attract professionals, subject experts, etc. from outside the ranks of civil servants and judiciary. Particularly, there is an appalling lack of academicians in regulatory processes, which needs attention. In addition, the regulatory agencies should be given fiscal/operational independence, so that their dependence on the government reduces. This needs to be coupled with providing clarity and certainty of the legislative provisions through a comprehensive review of the various related laws, legislations, etc.

Indian case exemplifies too little autonomy and regulatory agencies becoming puppet in the hands of the politicians who keep their control over the industries through bureaucratic agents. This not only compromises quality and independence, but also puts accountability concerns in the forefront.

**Chapter 4 on *Bringing Back Competition in Multilateral Trade Discussions*** does an assessment of India's trade scenario and provides an overview of country's renewed trade strategy, as explained in the new Foreign Trade Policy. It posits that India's focus in the bilateral and regional trade related negotiations is aimed at addressing the non-tariff barriers (NTBs) to trade, of which competition concerns appears to be the underlying theme. The chapter conducts a detailed analysis of competition related issues in India's trade related agreements and finds inconsistent and inadequate coverage of competition issues.

It further highlights the competition bottlenecks which the country might face while trading with countries with which it does not have comprehensive trade treaties. The chapter highlights insufficiency of existing mechanisms at multilateral level to deal with competition related issues. It concludes



with a call for bringing back competition issues to multilateral trade discussions.

While this chapter focuses on interrelation of trade and competition from India's perspective, it provides important lessons for other emerging economies as well, which are facing similar problems with respect to interaction of trade and competition issues. The chapter concludes by saying that the coverage of competition in trade-related discussion has rather been inconsistent and inadequate in nature, which might merely pay a lip service to the cause of competition. Even when resources are invested, the benefits might not be as envisaged, owing to lack of understanding and dealing with underlying issues with respect to competition, thereby missing the woods for trees.

In addition, the regional trade agreements (RTAs) negotiated between developed economies are being viewed as creating new standards for trade between developing economies and such economies. Such high standards could invariably be applied to exclude economies, and could act as NTBs to trade, resulting in unsustainable trade regime.

Absence of global minimum standards on competition, which could be incorporated by reference to such bilateral and regional discussions on trade could have led to such complete ignorance of sustainable trade agenda, with covered and excluded economies.

**Chapter 5 on *Regulation in Developing Countries: Growing Pains of the Indian Merger Review Regime*** highlights the problems faced by a young competition authority in the context of India's nascent merger review regime. It draws attention to the fact that the competition regulator's attempts to strengthen the quality of merger review are not necessarily welcomed by vested interests. This is not unique to a competition regulator or to India as literature on regulation in developing countries has always highlighted problems of concentration and convergence of economic and political power and regulatory challenges in the shape of information asymmetries and capture along with limited capacities.

The chapter emphasises that for the system to work, the efficiency and impartiality of the authorities/regulator, must be coupled with willingness on the part of even powerful stakeholders to comply equally (rather than expecting to be treated preferentially). This combination exists in the developed world and has proven to be more conducive to a healthy investment environment than an easy going approach to regulation. The compliance culture of the advanced nations arises from efficient implementation of regulation coupled with strong deterrence by way of punishment for both noncompliance by the regulated and complicity on part of the regulators.

Such a system when firmly and consistently enforced in a merger review regime would also enhance trust and reduce the anxiety on the part of merging parties much like the queuing public. The regulator on its part should continue to make rules of the game clearer as it gains experience and trust. It should also continuously build capacities to meet the valid stakeholder demand for speedy merger review. This would lead to outcomes that are positive, both for the investment environment in the country and for the consumer who is the ultimate focus of any regulation.

**Chapter 6 on *Competition and Regulation in Higher Education in India*** highlights that the greatest challenge before India's education planning is to expand the education system without sacrificing excellence. This can be done by increasing competition in the quality space and through entry of new providers, with such entry regulated so that low quality providers do not even temporarily enter the higher education sector. Competition would enhance quality while entry would be associated with a scaling up of private higher education.

Competition in the quality space implies that excellence would continue to be pursued. However, a strong impediment to effective competition in the quality space is asymmetric information, which means that parents and prospective students do not have the same information about the quality of education being provided that education providers themselves have. If consumers of higher education are deficient in information regarding the mentioned quality then effective competition in the quality space among higher education providers does not materialise. To redress the asymmetry in information, an accreditation authority which provides accurate information on the quality of education is very necessary.

The study finds that higher education providers have to meet regulations of too many bodies. For example, an affiliated college has to meet four sets of regulations – the regulations of the affiliating university, those of the professional council concerned with the course being taught, regulations embedded in the Central/State Act responsible for setting up of the affiliating university and lastly the regulations of the UGC. Further, regulations governing the entry of potential higher education providers into the sector contain many barriers to entry

**Chapter 7 on *Competition and Regulation in Highways Sector in India*** explains that the road and highway networks in India have increased in length and gained complexity. Larger networks call for a different approach in planning, operation and management. Additionally, part of this network expansion in India's road infrastructure is being created through infusion of private capital and efficiencies.

Introducing private sector participation does not eliminate the need for regulation; it only underscores the role of effective regulation and regulatory institutions. It is crucial that necessary regulatory structures evolve that help define the roles of public, private and public-private together in a manner that result in unambiguous formal and informal rules of the game, more balanced sharing of risks, dispute resolution and ensure fair returns to private investment while protecting consumer interest.

The infrastructure delivery should improve through better governance. Coordination is required with various agencies at appropriate levels for pre-construction activities, land acquisition, rehabilitation and resettlement, trees, environment safeguards, utilities, railway over/under bridges and canal crossings. At the same time, asset preservation beyond its creation is extremely vital. Road and highway maintenance, which is already a huge challenge, is only going to expand with the increasing footprint. India devotes far less effort than it should to maintenance relative to new construction.

A clear demarcation of administrative responsibility between capital works and maintenance of each class of road, dedicated funding, sophisticated data recording and reporting mechanisms and innovative contracting arrangements can prove to be helpful in preserving these national assets.

Addressing reasons for potential decline in private participation and reinvigorating the inevitable PPPs is crucial and fortunately an increasing priority for the present government. The positive vibes from the government like setting up of National Infrastructure Investment Fund (NIIF), 5/25 mechanism for re-financing (project loan to be refinanced every 5 years, but repaid over 25 years), innovative PPP formats, easier exit norms for highway project developers and a facilitating mechanism for quick environment clearances should give a much needed fillip.

Fortunately for India, a significant part of the logistics network is yet to be built. So the country can make up for past inadequacies and use the opportunity to shape its future road and highway infrastructure network to an increasingly desirable state that helps develop both widespread access and capacity.

**Chapter 8 on *Competition and Regulatory Issues in Banking Sector in India with a Focus on Bank Licencing*** builds on the issues the sector is beleaguered with. These may be attributed to existence of different regulations for different players, thus disturbing the level playing field between them, competition hurdles presented by the regulator and the absence of transparency and accountability in the whole licensing regime.

There exist several issues regarding the operations of the banks in India. These might be attributed to regulatory arbitrages, ownerships and the operational frameworks. These issues hinder fair competition between the public and private banks which is adverse to consumer interests. While the public sector banks (PSBs) enjoy certain leverages and benefits as compared to their private counterparts, they also bear extra burden levied upon them by the government. Thus, it is essential that the government ownership should not lead to differential treatment of private and public banks. PSBs should run professionally and compete with private sector counterparts even when they are owned by government.

Different banks in India are governed by different banking legislations. The presence of multiple legislations, creates a non-uniform regulatory scenario for the market players which deeply stifles competition. It is recommended that the benefits enjoyed by SBI and its associates and PSBs must be withdrawn and there should be a standard legislation for all banks in India, irrespective of their ownership type. Tools such as RIA<sup>15</sup> and Competition Impact Assessment (CIA)<sup>16</sup> may help in evaluating the effects of the proposed and existing regulations to formulate the most optimal design.

The introduction of financial services through the likes of new private banks, payment banks and small banks is expected to enhance competition in the sector. The likely impact of the competition might be seen on the deposit rates and credit rates, and some players might go on adopting unsustainable rates. It might also result in innovations on products and ways of catering to consumers which might bring down the operational costs. Considering the technology upgradations and innovations, to keep up with the competition, would have financial implications on every player and may result in lowering of margins.

**Chapter 9 on *Competition and Regulation in Broadcasting*** covered critical issues in Television (including analog and digital cable TV services, Direct-To-Home (DTH) satellite TV services, Internet Protocol Television (IPTV) services, Head-end In The Sky (HITS) and Over-The-Air (OTA) terrestrial TV services) and Radio services.

One of the key regulatory and policy issues of satellite communication, especially for DTH operators, is to provide television channels bundled with broadband using high frequency spot beams in the Ka band (18-27 GHz). Ka band based Satellite Broadband is being provided at Gigabits/sec speed in the Americas, Europe and Russia (Hughes, 2015). In India, this frequency has not yet been allocated and not even mentioned in NFAP 2011 with regard to DTH services. It is time that the satellite communication policy is revised to open up this band, which is extremely useful for the provisioning of HD TV as well as broadband connectivity, especially in remote parts of the country.

Under the FM radio spectrum allocation higher spectrum price in Phase II was cited as one of the reasons for loss of profitability of FM Radio stations, especially in regions in category 3 and 4. Hence the objective of Phase III FM Radio augmentation is to increase coverage in smaller towns and rural areas of the country. There is also a need for promoting private FM radio in border areas to draw people to listen to Indian radio channels and to check cross border propaganda. The high prices paid by the bidders in the first stage of Phase III auction, will force them to be operational first only in large cities to earn much needed ad revenue.

The paper concludes by mentioning that the cable digitization, entry of DTH as a competing and substitutable platform for Cable TV, launch of Phase III auctioning of spectrum for FM Radio and the entry of OTT broadcasting have revolutionised Indian broadcasting sector. The chapter provides a two-sided market analysis of this important industry. The broadcasting industry is embracing digitisation in various forms, at production, distribution and consumption. Internet is going to be an important channel of broadcasting and poses threats to conventional methods of distribution through cable TV, DTH and FM Radio. It remains to be seen whether the two will coexist or either one will dominate. However, competition in the broadcasting industry is set to intensify in the years to come.

## Conclusion

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

- Regulatory agencies should be given fiscal/operational independence, so that their dependence on the line ministry reduces
- India needs to further strengthen the governance of state-owned enterprises, simplify regulations, and reduce administrative burdens on firms. Government must act to drive successful implementation of single window clearances mechanism to gain traction with investors and provide an apt platform for entrepreneurs to grow and drive domestic capabilities
- There is a need for transparency in appointment of Chairmen and Members of the regulatory bodies, and appropriate frameworks to attract professionals from outside the ranks of civil servants and judiciary
- India should innovate, reinvent and implement a regulatory governance system following international good practices such as regulatory impact assessment, public consultation, and administrative simplification in priority sectors
- Bilateral and RTAs should adequately cover competition related issues

- Introduce an economy-wide programme of regulatory/competition impact assessments in different sectors to promote better market operation
- The infrastructure delivery should improve through better governance. In order to expedite the pace of the projects, the government should facilitate all clearances at a single point and perhaps, facilitate the establishment of a professional body
- A number of competition distortions or impediments arise owing to our policy framework in different areas of economic governance. There is a clear call for competitive neutrality or a level playing field between state-owned and private businesses

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## Endnotes

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- 13 Uchida and Cook, in Cook et al. (2007) p. 311
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- 15 [http://www.cuts-ccier.org/BHC-RIA/pdf/Draft\\_RIA\\_Toolkit\\_\(for\\_public\\_comments\).pdf](http://www.cuts-ccier.org/BHC-RIA/pdf/Draft_RIA_Toolkit_(for_public_comments).pdf)
- 16 [http://www.cuts-ccier.org/Compeg/pdf/CUTS\\_Competition\\_Impact\\_Assessment\\_Toolkit-A\\_Framework\\_to\\_Assess\\_Competition\\_Distortions\\_Induced\\_by\\_Government\\_Policies\\_in\\_the\\_Developing\\_World.pdf](http://www.cuts-ccier.org/Compeg/pdf/CUTS_Competition_Impact_Assessment_Toolkit-A_Framework_to_Assess_Competition_Distortions_Induced_by_Government_Policies_in_the_Developing_World.pdf)

## CHAPTER 2

# Perception and Awareness Reporting

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### 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 the 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, 2011 and 2013. Findings of the current survey 2015 will be useful in comparing the findings of the previous 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 August-December 2015, 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.

In addition, the questions were also designed to assess popular perceptions about the level of competition and efficacy of regulatory practices 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.

Moreover, questions were asked under four self-explanatory heads: 'level of competition' in which respondents were asked about their perception of product variety and choice; 'nature of market practices' to gauge perceptions about the pro or anticompetitive practices in the market; 'awareness of stakeholders on competition and regulatory scenario and last but not the least 'nature and impact of government policies' to gauge how supportive or distortive policies are towards enhancing competition in the economy.

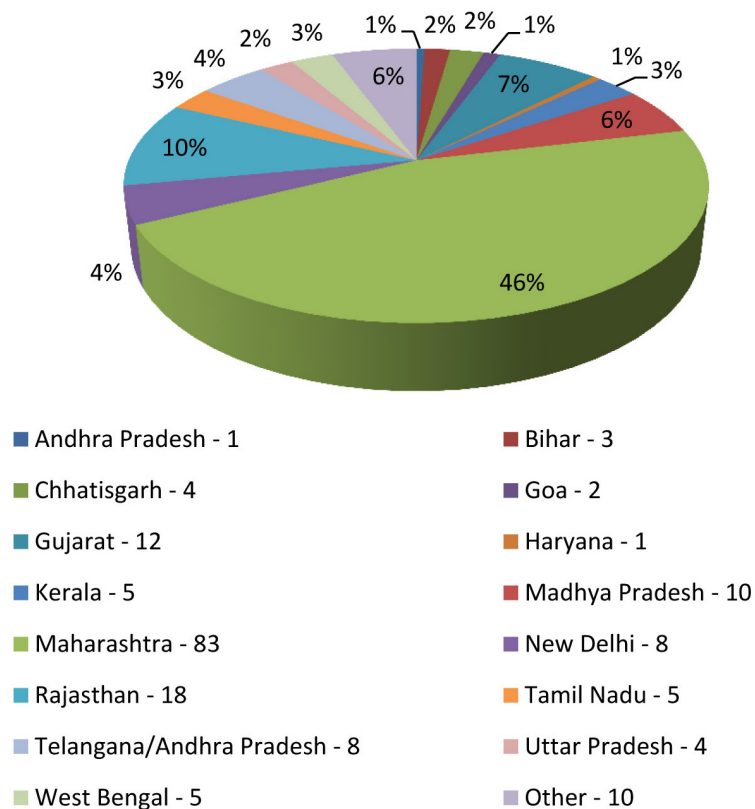
## Data and Survey Design

The statistical analysis was based on the data/inputs gathered from administered structured questionnaires to a random stratified sample across various states in India. The consumers from 15 states responded to the questions though their number varied from state to state (Table 2.1). The survey was administered online with these stakeholders. Total number of responses received were 179 from the general category of stakeholders including civil society, academia and the media. Out of the selected states, maximum response (46.37 percent) was observed from Maharashtra whereas lowest response was received from both Andhra Pradesh and Haryana (0.56 percent) respectively.

Table 2.1: Response of Consumers in States		
State	Response (Number)	Response (Percentage)
Andhra Pradesh-1	1	0.56
Bihar-3	3	1.68
Chattisgarh-4	4	2.23
Goa- 2	2	1.12
Gujarat-12	12	6.70
Haryana- 1	1	0.56
Kerala-5	5	2.79
Madhya Pradesh- 10	10	5.59
Maharashtra-83	83	46.37
New Delhi-8	8	4.47
Rajasthan-18	18	10.06
Tamil Nadu-5	5	2.79
Telangana/Andhra Pradesh-8	8	4.47
Uttar Pradesh-4	4	2.23
West Bengal-5	5	2.79
Others-10	10	5.59



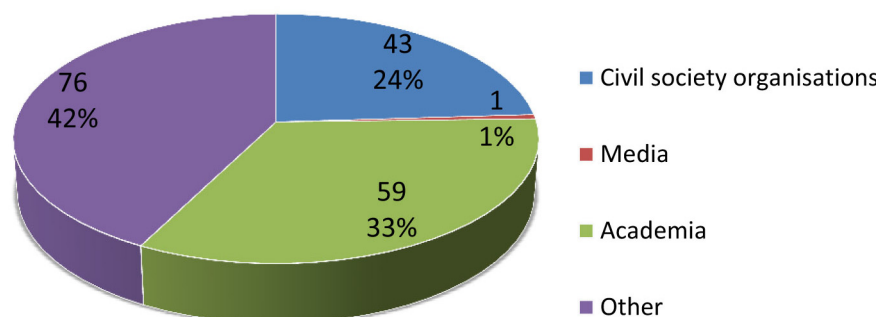
**Figure 2.1: Response of Consumers in States**



### Composition of Survey Respondents

The composition of stakeholders participating in the survey is presented in Figure 2.1. In the current year, the respondents comprise representatives of civil society organisations (CSOs), academia, media and other experts/practitioners. Nearly 24 percent of respondents were from CSOs, 33 percent from academia and only 1 percent represented media.

**Figure 2.2: Composition of Stakeholders**



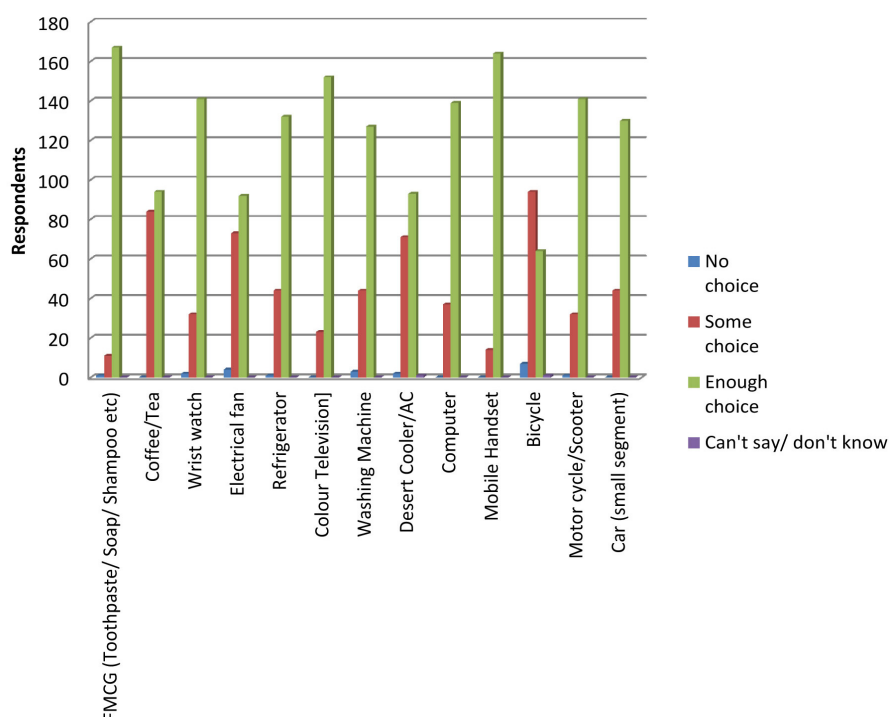
## Level of Competition

Markets work effectively when buyers have a choice of products, suppliers and when firms can freely enter and exit the market. However, in markets where there are few competitors or barriers to entry, firms might be able to ignore their customers and set excessive prices or deliver poor quality service. In such markets, there might also be fewer incentives to innovate and develop new products to attract customers, unless there is a threat of new entrants.

Against this background, this section of the survey attempted to gauge the level of competition in the market.

A significant share of respondents indicated that there are enough choices available in the market across range of products that include fast moving consumer goods (FMCGs), consumer electronics, mobiles, automobiles etc. For example, approximately 93 percent of respondents were of the opinion that there were ample choices in the FMCGs category in the market. Likewise, more than 90 percent indicated that there were enough choices under mobile handset category. This is consistent with the survey findings of 2011 and 2013 that showed high competition in various product categories in the Indian market (refer Figure 2.3).

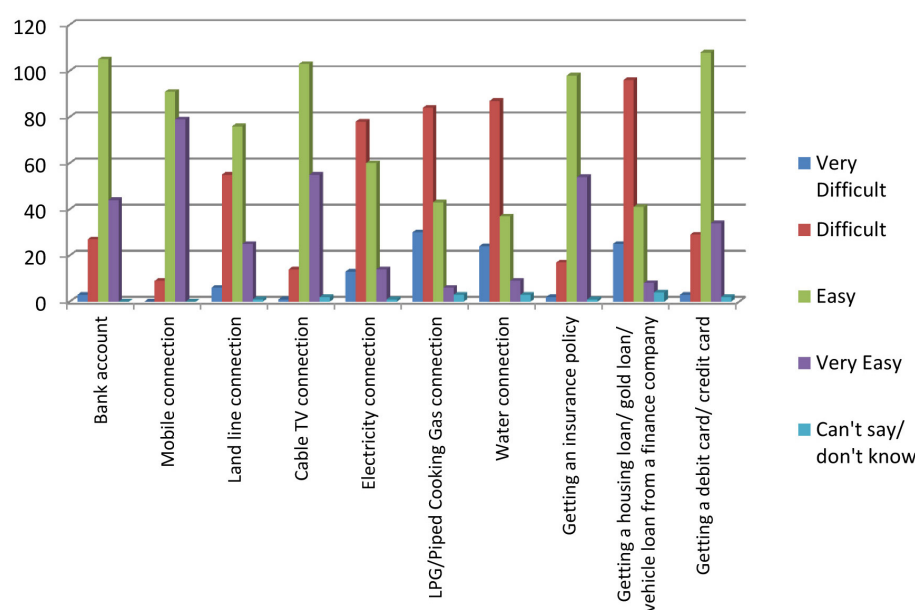
**Figure 2.3: Prevalence of Respondents' Choice in Various Products**



Similarly, stakeholders were asked about the ease of getting various essential services/utilities. And the responses received were varied. While the stakeholders were able to get some essential services easily, they faced difficulties in getting other essential services. For example, getting access to services like bank accounts, mobile connection, DTH connection, debit/credit card was pretty much easy, the key utilities, such as electricity connection, (Liquefied Petroleum Gas or LPG) and water connection were not easily available to general consumers (almost 50 percent of respondents mentioned that it was difficult to acquire access to the mentioned three utilities).

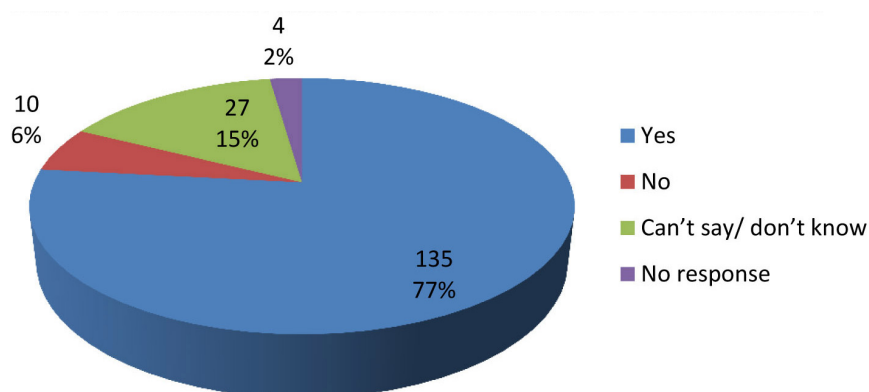
Furthermore, stakeholders were asked about the reasons for not getting some specific services/utilities with ease. And a significant share of the respondents opined (41 percent) that the lengthy/complex procedural requirements as well as uncooperative behaviour of officers (30 percent of the respondents) had caused difficulties in getting the said services.

**Figure 2.4: Ease of Getting Essential Services/Utilities**



In addition, respondents were questioned about the need for standardised basic products and services in the financial sector. Around 77 percent agreed to this need. This requirement has been the demand of the consumers over the years as has been evident from the last India Competition and Regulation Report (ICRR) surveys where responses were on the same lines. Only six percent hold a different view on the query raised.

**Figure 2.5: Need for Standardised Basic Products and Services in Financial Sector?**



On the issue of ease of switching suppliers from select services comprising telecom, cable TV and LPG supplier it has been observed that consumers were able to switch service providers without much difficulty except in the case of LPG connection where 50 percent respondents were of the opinion that they faced certain amount of difficulty in switching services. Generally, this is an indication of prevalence of fair competition in market.

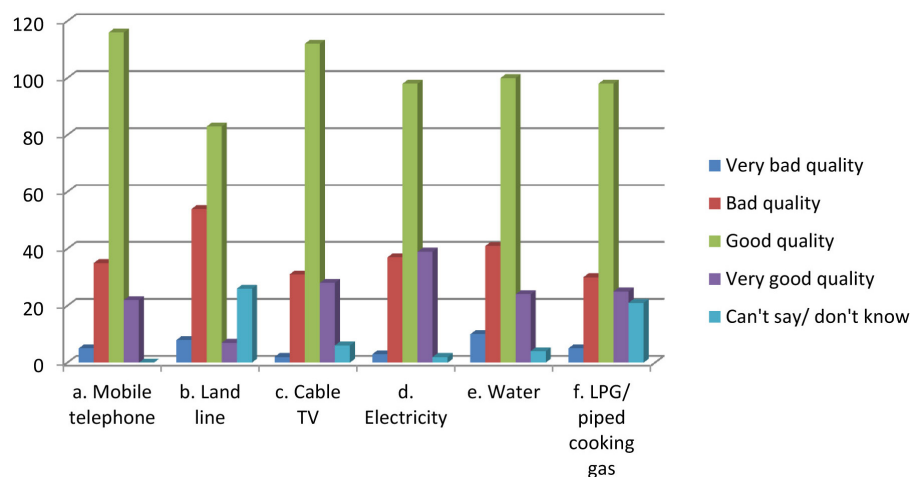
**Table 2.2: Analysis of Quality of Services from Various Utilities Companies**

Services	No Option to Change Supplier	Very Difficult	Difficult	Easy	Very Easy	Not Sure/ Not Aware
a. Mobile service provider	1 %	6 %	20 %	52 %	17 %	4 %
b. Land line service provider	7 %	8 %	37 %	23 %	1 %	23 %
c. Cable TV operator	8 %	9 %	18 %	48 %	13 %	5 %
d. LPG supplier	7 %	12 %	50 %	14 %	1 %	15 %

## Quality of Services

On being queried about the quality of services, majority of respondents were satisfied with the quality of service received from various utility companies, more than 100 percent of the total respondents said that they received good to very good quality of service from mobile service providers. About 80 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, as given in Figure 2.6.

**Figure 2.6: Quality of Services**



On being queried about the reliability of public sector finance companies (such as SBI, LIC etc.) to transact money as compared to private companies (ICICI, HDFC etc.), around 51 percent of the total respondents said they felt safer with public sector companies.

However, in comparison to previous ICRR survey results where about 80 percent considered it to be safe to deal with public sector companies, the trust level has increased over the years among consumers in the private sector financial companies.

Comparing the public sector financial service providers, another important question that was raised from respondents whether public sector service providers are safer than private. Nearly 51 percent expressed their firm belief in public sector financial service providers whereas 32 percent expressed their disbelief in the same. Around 15 were either not sure or unaware of preference of their choice.

## Nature of Practices

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

Further, on being inquired about the various promotional schemes run by sellers to attract consumers, 71 percent of respondents believe that though some promotional schemes run by sellers were good, others were designed to dupe consumers (10 percent were of the opinion that schemes from the companies do not deliver promised reward to the customers). This finding

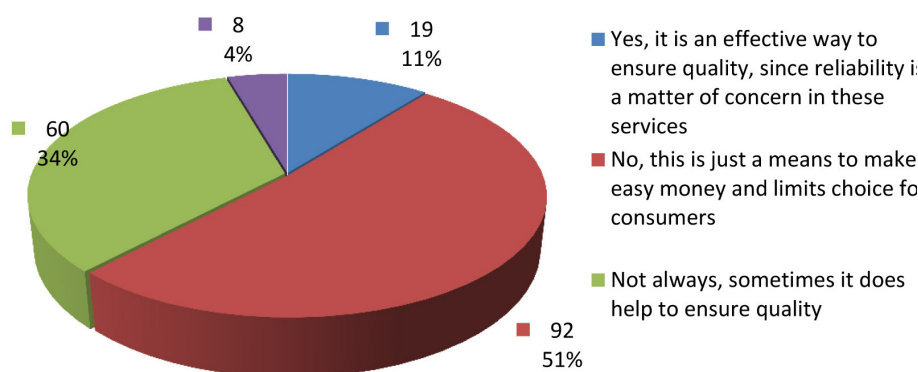
indicates weak market regulation across the country. This is because the sellers/producers are exploiting the general consumers with the false promises merely to increase their sales.

Usually, the practice of tied-selling is prevalent in the market. This practice basically means that the doctors ask patients to get various diagnostic tests done from certain specified laboratories; schools ask their students to buy uniforms from the recommended shops/sellers and so on. Therefore, the stakeholders were asked whether or not such practice was appropriate. An overwhelming 51 percent of the respondents stated that the practice was inappropriate. This was merely a way to make easy money and hence provided limited number of choices for consumers. Around 34 percent of respondents indicated that the practice was not always unacceptable because such practice sometimes helped in ensuring quality. Only 11 percent of respondents opined that the practice was an effective way to ensure quality as reliability was a matter of concern in these services.

Likewise, the stakeholders were asked about their opinions on the present restrictions on advertisements from professionals like doctors, lawyers, and charter accountants. Similar to the previous India Competition and Regulation Report (ICRR) or survey results, 35 percent respondents opined that instead of outright ban on advertising certain professions (medical, accounting, legal), certain parameters should be defined for fair advertising that rule out any misleading claims and unfair practices. Whereas, 29 percent believed that such restrictions protect the public from misleading information.

It has been observed that certain industries in India are characterised by one or two dominant firms. The dominance of such firms leads to the restriction of competitive markets. Firm that controls at least half of the market in which it operates has no significant competition.

**Figure 2.7: How Appropriate is Tied Selling Practice?**



Its competitors are mostly small firms who compete with each other for the remaining market share. This indicates that it is high time to review such restrictive policies because market efficiency will be compromised in the absence of free competition

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? Interestingly, half of the respondents were of the opinion that the emergence of dominant position is a matter of concern. 22 percent were of the view that such dominance does not affect as market forces ensure enough competition and 14 percent mentioned that such dominance was an outcome due to presence of natural monopoly owing to the nature of the industry/technology *per se*.

### **Awareness on Competition and Regulatory Issues**

An effective competition regime creates an environment which maximises the welfare of consumer as well as producer by bringing in allocated, static and dynamic efficiencies. Competitive markets bring greater choices and affordability to consumers, however, anticompetitive practices in the market place can mar the benefits. In this section of the survey, a range of questions were asked to stakeholders regarding their level of awareness on such competition and regulatory issues in India.

Moreover, on being asked whether they are aware of the Competition Commission of India (CCI) or not, an overwhelming 71 percent of respondents stated that they are totally aware of the same. This is a good sign from the previous ICRR survey results undertaken in 2013 when only 48 percent said that they are aware of the CCI.

These findings indicate toward the improved visibility of the CCI as it has made several visible contribution to the economy as the only cross-sector regulator in India tasked with ensuring competitive markets, it has cracked down on cartelisation, abuse of dominance and monopolistic mergers and acquisitions, even by mighty private firms and state-owned behemoths. However, establishment of regional/state level benches of Commission might be an effective way to further increase awareness and get access to the consumers.

Furthermore, stakeholders were asked whether the existing regulatory mechanisms, such as CCI, consumer forums, and other regulatory agencies are effective for addressing anticompetitive and other unfair practices. Only 14 percent answered that such mechanism were always effective, more

than whereas 55 percent responded that they were sometimes effective. However, 7 percent of respondents disagreed completely.

Besides, on being inquired of the role of the regulator, 65 percent mentioned that a regulator role is to develop and implement rules that create a competitive environment in the market.

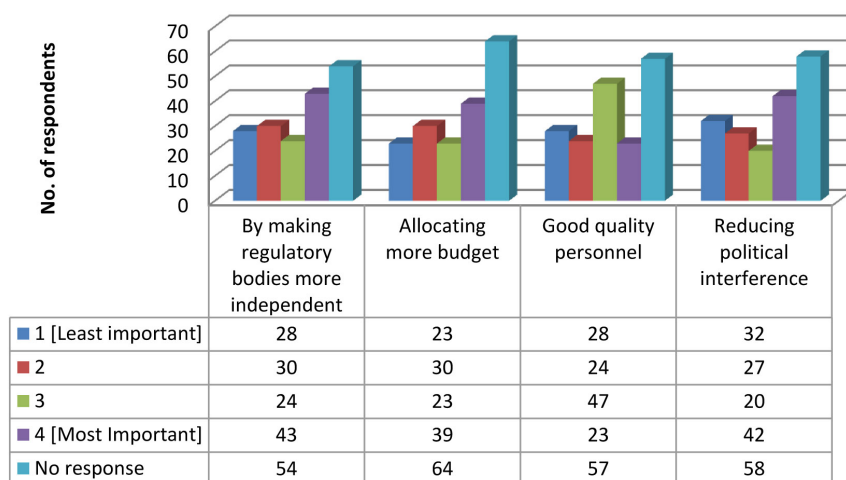
The respondents were further inquired of the capability of independent regulators in enforcing regulatory orders at the local levels. The findings reflect that 59 percent of the respondents believe so at times but not always the independent regulators have been effective in enforcing regulatory orders. But 16 percent were of the opinion that they are always effective in enforcing such orders.

The stakeholders were further asked about their views on improving the quality of regulation. They provided four different measures, namely, 1) making regulatory bodies more independent, 2) allocating more budget, 3) good quality personnel, and 4) reducing political interference. They were asked to choose these measures on the basis of priority. Almost 24 percent of respondents ranked two options, i.e. making regulatory body more independent and reducing political interference as the most important measures to enhance quality of regulation.

Around 23 percent said allocation of more budgets to regulatory bodies will further improve the quality of regulatory decision making. These findings show that more independence of regulatory bodies and reduced political interference matter the most than budget and other resources. Again, these

**Figure 2.8: How to Improve Quality of Regulation?**

(on a scale of 1-4, where 1-least important and 4-most important)





findings are congruent with the findings of 2013 Perception Survey, which shows that around 31 percent of the respondents felt that reducing political interference was the topmost priority for improving the quality of regulation in the country.

## Nature and 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 the price control of select patented products. The stakeholders were asked about their views on such price fixing. An overwhelming 56 percent of the total respondents said that such price fixing mechanism of essential medicines was indeed reasonable to protect the interest of consumers from high prices. It was even higher percentage than the 2013 survey where about 45 percent respondents mentioned it was a right practice.

Table 2.3: Nature and Impact of Government Policies/Measures	
Response of Stakeholders	Number of Stakeholders
Yes, controlling the price of all essential drugs is the best option considering that it is the doctors and retailers that play an important role in purchase decisions	101
No, price control is not required at all; government should instead encourage competition with appropriate monitoring of prices	27
No, 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	27
Not sure/ not aware	16
No response	8

Similarly, the survey findings show that 35 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 2013 Perception Survey. Furthermore, 49 percent opined that it was fair while 7 percent were either not certain or not aware.

The respondents were also asked whether the government's policy of giving purchase preference to public sector undertakings (PSUs) in government procurement was right or not. About 23 percent of the total respondents agreed with such policy as this compensate PSUs of social objectives as they can match and compete with the private sector.

However, 30 percent of the respondents disagreed with this policy as it creates uneven playing field and distorts the market process. And 13 percent of respondents revealed that the government should instead give Public Sector Undertakings (PSUs) autonomy and allow them to operate.

Recently, several retired senior bureaucrats have come under the scanner for accepting key positions in government bodies after their retirement, but the trend is not limited to the bureaucracy alone. Over the past few decades, retired judges of the Supreme Court and high courts have gone on to head or serve as members of commissions, tribunals or quasi-judicial bodies. While some of these former bureaucrats and judges have done stellar work in their new stints, experts and observers have contended that some of these appointments are nothing more than post-retirement sinecures.

The respondents were also asked about their views on provision of appointing retired bureaucrats and judges as regulators. 46 percent of the respondents indicated that such appointments were inappropriate as it ceases the appointments of more deserving professionals and reduces regulatory effectiveness. Though, 30 percent responded agreeing that such practice will allow regulators to maintain a congenial relationship with government and enhance regulatory effectiveness in the country.

Finally, the respondents were asked whether policy directives/fees and charges announced by a Ministry/Department affected the functioning/ autonomy of a regulator or not. Nearly 35 percent of the total respondents said that these actions interfered in the functioning of the regulator and reduced their independence and autonomy. About 29 percent felt that these actions sometimes amounted to interference but other times helped in the development of the sector. Around 12 percent stated that policy directives do not affect the functioning of a regulator.

## **Conclusion**

Perception and awareness survey is a key component of ICRR and carries out in each cycle to gauge the perception of stakeholders on prevailing competition and regulatory scenario in India. The highlights of the current survey results are:

### ***Level of Competition***

Overall competition scenario in the country was found to be above average as expressed by the views of informed stakeholders participating in the survey showing neither too good nor too bad, but fair. This was visible owing to the choices available to consumers in various products and services at nearly affordable prices. Consumers were also conveniently able to acquire access large number of utilities. However, services that were still being managed by the public sector utilities, were a bit difficult to get access too, as compared to services being provided by the private sector. 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.

### ***Nature of Market Practices/Awareness***

The results reflect that the stakeholders are still bit ignorant about the nature of market practices on competition and regulatory aspects. Many of the respondents were still not aware of issues pertaining to anticompetitive practices. It is quite evident from the survey results, wherein approximately 35 percent of the respondents felt that tied selling was not always inappropriate and sometimes it was good, as it ensured quality. However, they were unaware of its long-term disadvantages on the makers and the consumers. Similarly, 22 percent of respondent's were of the opinion that dominance of firms does not affect the consumers. This is a matter of concern as it might lead to the exploitation of stakeholders as they are unprotected to such practices unknowingly.

### ***Effectiveness of Regulatory Authorities***

One of the issues, which one has been improving drastically over the years, has been the awareness-level of consumers about the existence of regulatory authorities. However, when it comes to the effectiveness of such agencies in regulatory decision making, the survey reveals that in many cases, these agencies have not been very effective. The effectiveness of these agencies is essential for fair competition to prevail in the market and for that they need to be independent and autonomous.

By and large, the level of perception and awareness among stakeholders on competition and regulation in India is quite high. Though the sample size comprises of policy makers, 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 really know the true meaning of competition and regulation? If yes, then 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 gauge the exact level of perception on competition and regulation via survey i.e. representative of the entire populace across the country.



## CHAPTER 3

# Independence and Competence of Regulatory Institutions: Select Cases from India

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### Introduction

Regulatory agencies highlight the rise of a very interesting and new form of accountability. As Levi-Faur describes this political move: “Democratic governance is no longer about the delegation of authority to elected representative [sic] but a form of second-level indirect representative democracy – citizens elect representatives who control and supervise ‘experts’ who formulate and administer policies in an autonomous fashion from their regulatory bastions.”<sup>1</sup>

Sending credible signals by creating independent regulatory agencies, States commit to sustenance of stable, evenly applied and technically guided frameworks that enable the investors to take comfortable cognisance through long-term perspectives of their investments and returns. Both the theoretical and practical application of such claims has been richly covered in the literature.<sup>2</sup>

Yet, a large body of literature shows that the regulatory institutions of Global South have not performed in line with the expectations, due to the poor implementation and institutional design of the agencies.<sup>3</sup>

This paper attempts to explore the deficiencies in Indian regulatory state. In the 1990s, like many other developing countries India adopted economic reforms, which meant privatisation of state-owned enterprises (SoEs) and deregulation of sectors which were hitherto reserved for the public sector, especially in the infrastructure and services area, and thus promote healthy competition. This also meant that the regulatory/control role performed by the government should be hived off to arms-length independent or autonomous regulators. Large number of sectors, such as insurance, telephone, civil aviation were opened up to private investment, both greenfield and brownfield, rather than by privatisation of SoEs.

However, the Indian regulatory state has not delivered what it promised. The paper shows that the failures of regulatory performance are rooted at some level, in lack of independence and competence of the regulatory agencies. After an initial theoretical backdrop, the paper offers an insight into several regulatory agencies and problems emerging from poor regulatory designs and political entrenchment. In part 2, we discuss broad theories of regulation and its purpose. Part 3 elaborates on the concept of independence and competence, with reference to Indian regulatory state. Part 4 dissects select regulatory agencies in India and highlights the problems therein. Part 5 concludes and proposes a way forward.

### Theories of Regulation

In their influential work, Levy and Spiller (1994) invoke the framework of transaction cost economics and explain why modern nations need regulatory agencies.<sup>4</sup> Their structure enables us to see that regulation needs to be understood by its scope for limiting the arbitrary administrative action of political actors, thus enabling conditions for favourable investment. A framework of regulatory governance therefore, is important to develop powers of regulators, its separation from different branches of government and when would the society need a model of independent regulatory agencies.

This idea helps us understand as to why governments would deliberately delegate authority to ‘non-majoritarian’ institutions (regulatory agencies). They do so to signal credible commitments to investors by suggesting that setting of tariff will be taken care of by expert regulators and governments will not interfere in it. Think about utilities for instance, whose tariff is an important political issue – governments would like to keep tariff as low as possible to gain political mileage from voters, while these tariffs may not make economic sense, thus discouraging prospective investors from entering in the market.

By delegating the responsibilities to regulators, governments give credible commitments to keep the regulators independent from their influence. Similarly, they delegate to address information asymmetry since specialised body is better able to govern a complex industry. Further, the delegation also absolves government from taking blame for unpopular policies.<sup>5</sup>

It is no wonder that Prosser famously labels regulators as ‘governments in miniature.’<sup>6</sup> At the same time, the very power and responsibility of regulators call for a deeper introspection on how to design their accountability and legitimacy. This is not only because governments may have an incentive to ‘regulate’ regulators, but also because industries may attempt to capture the regulators in former’s own interest. This accountability is, therefore, a natural source of complementing Levy and Spiller’s (1994) investor-focussed approach to a more citizen-focussed emphasis.<sup>7</sup>

In addition, given the naivety of public interest theory, and caution afforded to us by private interest theories, there is a need to address the challenges through ideas emanating from institutionalist theories. The design of independent regulatory agencies, with experts offering non-partisan and coherent policies is indispensable for effective governance of a regulatory state. Given the entrenched political and business interests prevailing in interactions between the regulated, regulators and regulatees in developing countries like India, construction of regulatory agencies need to be effective (governments are actually delegating the power in substance), independent, competent and unambiguous in its goals and objectives.

## **Regulatory Performance**

One of the key issues that have continued to be debated after the emergence of regulatory state is that of their performance. Regulatory agencies, as governments in miniature, are not subjected to checks and balances that governments are. More importantly, while citizens can observe performance of their governments and vote the latter out of the power in next elections, such direct forms of accountability cannot be employed in governing regulatory agencies. Therefore, it is imperative that appropriate frameworks be set in place which can observe, measure and accordingly act on regulatory performances.

For the organisational structure that the regulatory agencies have assumed, there are some general implications that certain designs of these structures will have for their own performances. In other words, characteristics of institutional features of the regulatory agencies will inform our understanding of how should their design be carved out to make them perform better. For instance, since the idea of regulatory institutions emerges from delegating state's authority to non-majoritarian agencies, the question of independence becomes paramount. In similar vein, since choice of these agencies relies on taking policy decisions which could be politically sensitive, by experts rather than politicians, competence of these experts can have significant impact on the performance of regulatory agencies.

These specific design aspects of independence and competence form the most important considerations that Indian regulatory agencies need robust incorporation of. We dig deeper into the issues.

## ***Independence***

A significant body of literature has explored and identified the need for regulatory agencies to operate independently. The reason governments agree to abandon their regulatory competencies is to signal credibility of their policy commitments.<sup>8</sup> Investors need to be credibly committed that their

investments will not be victims of state's authority, but the regulation will be done by range of specialised agencies, insulated from political process.<sup>9</sup> Unless the independence of regulatory agencies is not guaranteed, investors will be deterred and performance of the sector will suffer. Regulatory agency which is influenced by the state in its operations is only a cosmetic exercise of delegation of regulation – something that defeats the very purpose it is set up.

Stern and Holder (1999), in their influential work, in discussing main issues impacting regulatory governance, evolve a set of six criteria for appraising the performance of regulatory frameworks (for infrastructural industries).<sup>10</sup> One of these criteria is 'autonomy' from political intervention. They mention that "Autonomy, and consequently the reduced likelihood of regulatory decisions being politically motivated, should certainly enhance the predictability of regulated industries, as well as promoting accountability and transparency (as regulators alone will be answerable for their decisions). Autonomy is most secure with an independent regulator operating under a primary law which, among other things, (a) sets out key powers and duties, and (b) establishes its financial security."<sup>11</sup>

Indian regulatory agencies have a long way to go in this respect. Lack of political will to shed power and delegate the authority to regulate, to specialised agencies is manifested in the reluctance of ministries to disassociate themselves from functioning of the agencies. The regulatory agencies in India remain subservient to their line ministries, with statutory provisions of Ministerial intervention in appointing and removing regulators. This militates against the very idea of independence from political influences. There is little doubt that an appointee through political patronage will not be able to take decisions purely on merit, particularly when there is significant political cost that her decision may inflict on the incumbent government. Similarly, upon devising policies contradictory to the expectations of the Ministry may easily attract the brunt of politicians in removing or not elevating the regulators.

### ***Regulatory Appointments and Issue of Competence***

Research shows that competence has a significant effect on the performance of organisations.<sup>12</sup> Yet, Indian regulatory agencies are characterised by lack of transparent selection procedure to appoint good regulators. In a conscious ill-conception of laws, almost entire regulatory framework is run by civil servants of India. The civil servants do not necessarily have a technical expertise in handling the regulatory matters of a given industry. More importantly, having worked in government, there is little that can be expected of them to undertake reforms.



Further, it is difficult to imagine them not being subservient to the benefactor government under which they were/are patronised. It is antithetical to the essence of the rise of regulatory institutions, which were intended to end the bureaucratic control over state sponsored products and services. The whole idea behind the creation of regulatory agencies is to free decision making from the state, and yet, the agencies are headed by those who have been agents of state with an assumption that a change in their de jure status from being employed to retired will suddenly cultivate a new person altogether, devoid of political patronage that s/he has been a part of for last forty years.

Since dominance of retired civil servants compromises both competence and independence, there is a need to understand this more closely. When Deepak (2014) mentions, 'lifelong bureaucrat is an Indian innovation,' he refers to the new sub-culture of adorning regulatory agencies with retired IAS officers.<sup>13</sup> Once selected as a civil servant, the IAS officers have treated regulatory agencies as ever-greening instruments of their career, without regard to their experience or competence. Surely, this has consciously been the policy of the government. Effectively, most regulatory agencies are headed and membered by retired civil servants, who have served the government in New Delhi. Their choice as regulators ensures that respective Ministry rests its control in functioning of the agency.

A recent article by Jayant Sriram makes this case amply clear,<sup>14</sup> in which calls this 'retirement roulette,' where everyone wins, regardless of the qualification and expertise. When regulatory agencies have become retirement parks for bureaucrats who come with very different skill set, there is little that can be expected in terms of the agencies' performance. Having spent all their career working for the government, the likelihood that the bureaucrats will decide anything without government's consent is a rather low. Therefore, the surprise that exit of chairman of the Pension Fund Regulatory and Development Authority (PFRDA), Yogesh Agarwal is speculated to stem from the fact that Agarwal was not an IAS officer.<sup>15</sup> This only hint at close nexus of ministry with related sector regulators (in this case, finance).

Post liberalisation India has seen a regulatory capture of a different kind, in addition to the one already theorised.<sup>16</sup> This capture is by the retired civil servants, who are heading nine of the twelve economic regulators opened in last twenty years. In twenty states, the Chief Information Officer – custodian of the Right to Information Act – is the state's former Chief Secretary. The regulatory institutions aim to curb arbitrary decision making by the government, and yet, the 2G scam and Coalgate has again reminded us of how weak and incompetent these institutions are. The agencies are still sites of political discretion, with handing out telecom licenses arbitrarily,

natural gas pricing increasing allegedly at the behest of corporation and electricity sector – which is under crippling debt – still unregulated in many states due to political reasons.<sup>17</sup>

## **Analysis of Select Regulatory and Government Agencies**

A brief analysis of major regulatory agencies illustrates what ails each one of them, and draws a broad pattern of problems in accountability and competence. In addition, it also explain some government agencies (which do not work at arm's length from the government, unlike their regulatory counterparts) to illustrate how the culture in regulatory agencies remain the same. NHAI, RSC and TAMP will fall into this category. The government agencies provide services and are not merely facilitators to private parties for their operations.

### ***National Highways Authority of India***

National Highways Authority of India (NHAI) is vested with, as name suggests, developing, maintaining and managing national highways falling broadly under infrastructure regulation of the Central Government. The Chairman, full-time and part-time members are clearly stipulated to be appointed by Central Government<sup>18</sup> as well as have significant influence from the government in their removal.<sup>19</sup> The Central Government has all the powers for vesting any national highway in the Authority,<sup>20</sup> supersede the Authority,<sup>21</sup> and for making rules.<sup>22</sup>

The political clientelism exists in infrastructure spending in India, and NHAI is not immune to it, particularly when instance of subcontracting public infrastructure works is marred with corruption at multiple levels.<sup>23</sup> The 'autonomous' agency falling under Ministry of Road, Transport and Highways (MoRTH), after being headless for two years was 'awarded' former Secretary of Department of Industrial Policy and Promotion (DIPP), in June 2011,<sup>24</sup> with majority of members being IAS officers. The website does not mention any link towards 'careers' for prospective applicants for any post.

### ***Railway Safety Commission***

Interesting as it might sound, the Railway Safety Commission (RSC) falls under the Ministry of Civil Aviation. This may come as good news since regulators will have insulation from Ministry for Railways.<sup>25</sup> Yet, many problems remain. The Central Government is vested with the charge of appointing the Commissioner,<sup>26</sup> and even approving her powers.<sup>27</sup> The Railway Act 1989 specifically mentions that the Commissioner needs to be a civil servant,<sup>28</sup> which does not come with any specific requirement of a technical expertise.

### ***Tariff Authority for Major Ports***

In order to develop private sector participation in major ports sector, the tariff fixing Authority was created in 1997, thereby insulating tariff setting function from the government as well as private operators. The relevant statute clearly mentions the Chairperson can be a serving or former Secretary to the Government of India or any equivalent post in the central government.<sup>29</sup> Yet, the provision could be considered better than most other agencies since it requires the Chairperson to have experience and knowledge in functioning of port, and the Authority's member needs to be an economist in field of transport or foreign trade.<sup>30</sup>

The Act has a provision, which ensures that the proceeding of the Authority cannot be invalidated on the basis of a defect in selection/appointment of Chairperson or member.<sup>31</sup> This could be viewed a means for Ministry to ensure that *de facto* power of tariff setting that remains under its purview, is not tampered with.

Interestingly however, there is a growing concern that due to increasing competition between ports, the artificial tariff setting may reduce efficiency. Indeed, during 1997, non-major ports handled only 10 percent of total national port traffic, and this figure has now 42 percent.<sup>32</sup> Given the intense competition between major and non-major ports therefore, is also unfair for the major ports be governed by tariff setting policy of the government and letting non-major ports free to determine their own tariff based on market forces. The inter-ministerial task force set up by Planning Commission proposed that tariff regulation of major ports be done away.<sup>33</sup>

In fact, the Tariff Authority for Major Ports (TAMP) has been proactive not only in invoking its powers but also been a reason for Ministry to attracting the ire of Planning Commission, when the latter recently objected to Ministry's move of enhancing powers of TAMP.<sup>34</sup> Finally, the flexibility in tariff setting became the characteristic of the new tariff guidelines effectuated in 2013.

This case sheds light on how often, given the entrenched existence of regulatory agencies, they remain fossilised in time, even when their redundancy is distinctly observed. Such entrenchment is possible and is symptomatic of lack of accountability and independence of these agencies, and reflects their constituents in form of civil servants who – despite their incompetence – want to maintain their status quo.

### ***Central Electricity Regulatory Commission***

Central Electricity Regulatory Commission (CERC) is one of the most important regulatory agencies in the country, not only for its scope but also

its impact. There is a need for a detailed look into its institutional design and functioning. Even though there exists CERC with detailed guidelines on appointment, the Selection Committee is vested with the task of appointing Chairperson and Members of CERC which consists of several government officials. Its present Chairman (and even the previous ones) was squarely chosen from the ranks of civil servants. The Central Government still influences the overall development of the industry through National Electricity Policy. The institutional framework is drawn in Electricity Act 2003, yet, significant dilution of independence is apparent in the clauses of the Act. The statute is ill conceived<sup>35</sup> and there is little doubt that the Act provides no solution to larger structural problem.<sup>36</sup>

The Act stipulates eleven functions of the Commission, which despite being expansive enough, have confused the Commission to the extent that they have resorted to taking clarification from the Ministry of Power.<sup>37</sup> At the same time, the Act lays down clear procedure for appointment and chairman and members of Commission, which institutionalises state's involvement by bringing in Minister of Power's recommendation necessary for selecting the top officers.<sup>38</sup> In addition, CERC's and State Electricity Regulatory Commission's (SERC) budget is determined by the government. This has material impact on regulators' ability to take independent decisions.<sup>39</sup>

Given the close nexus between politicians and regulators, under-cutting of regulatory authority was rampantly observed.<sup>40</sup> In Karnataka in particular, government was regulating parallel to the agency allowing investors to bypass the agencies for cost increases.<sup>41</sup> The state government continued to play a hugely intervening role in the agency, by monitoring rate filings, proposals and appeals and issued order concerning tariffs undermining the regulator's authority.<sup>42</sup> In New Delhi, while the roles were clearly demarcated, the expectations were unstated and ambiguous, leaving several hotly contested issues between government and regulator.<sup>43</sup>

There are also reasons to believe that tariff setting – which appears to be the main goal of electricity regulatory agency – is also not free of political influence. In three cases of Karnataka, Delhi and Orissa studied, Dubash and Rao convincingly show how regulators indeed factor in public sentiment while deciding on issues related to tariff.<sup>44</sup> Such clandestine efforts to inform tariff setting lead to lowering of transparency and public trust.

In electricity sector, the problem of competency is highlighted in the enormous lack of knowledge inventory with SERCs and CERC as regards accounting.<sup>45</sup> One of the reasons is that most electricity companies are state-owned and many have still not begun publishing their Annual Reports on time. There is little benchmarking that can be done in the absence of reliable data. Indeed, industrial organisation as an academic discipline is

not one of the coveted fields of study in India largely because research is difficult in the lack of data.

Employing competent individuals in regulatory commissions is also hinged on various government departments. An intricately related problem is that the pool from where most of the recruitment for regulatory agencies is done is the same: the group of retired and elite Indian Administrative Service (IAS) officers.<sup>46</sup> In addition, electricity boards in India have serious staffing problems. The recruitment structure is rigid and hiring procedures and salary limits place a significant hurdle to attract competent individuals. Commissions need to take approval from the government department(s) for recruiting personnel in their agency.

If CERC defines a new post in their office, the internal approvals from Legal and Finance department is not enough. They have to get the consent of Department of Personnel and Training in the government. The *de facto* restrictions on where can the recruitments be made from also ails the performance of the sector – usually many officers in Commission come from other government departments on deputation, and leave after certain period to their ‘parent’ departments. This kind of practice not only create disincentive in personnel for institutional belongingness but also leaves little scope for learning and executing.

To make matters worse, much of this hiring takes place from the public utility itself. Regulatory staff therefore share, close networks and links with the public utility, and ‘bring to their job a mindset shaped by career within the public utility.’<sup>47</sup>

### ***Petroleum and Natural Gas Regulatory Board***

Set up in 2006, the Board is mandated to regulate the refining, processing and distributing petroleum products and natural gas in the country. The first problem is that the Act governing the agency vests control of the Board only in downstream sector, specifically excluding production of crude oil and natural gas.<sup>48</sup>

While earlier, the production was sole prerogative of the public sector units, increasingly, with companies like Reliance and Essar being prominent production players in the market, ignoring the production appears to be a major regulatory oversight. Even without the private companies in picture, the public sector dominates the production segment, with no regulatory constraints. Fuel is politically sensitive an issue, and that there is political motivation in keeping the public sector production outside the purview of regulation, cannot be denied.

The issue of independence of the Board is clearly in question. The Central Government has statutory intervening powers within which it can dictate policy to the Board and the Board has to comply, in matters relating to authorisation from the Board to the party attempting to engage in infrastructural distributional network, *inter alia*.<sup>49</sup> Even employment of personnel and competent professionals in the Board requires consent from the government.<sup>50</sup>

The Central Government is specifically vested with powers to appoint a Secretary to the Board,<sup>51</sup> thus diluting the independence of the Board even further and makes the agency subservient to the government. Chapter VIII is dedicated to explaining the powers of Central Government. It specifically mentions that government will direct the Board, and that it will have final say on whether the question is one of policy or not.<sup>52</sup> Even while deciding the tariff, the Board needs to base their decision on, *inter alia*, Central Government's policy as applicable.<sup>53</sup>

The story of appointment of key personnel of the Board is not different here either. The entire appointment of Chairman and Members is prerogative of the Central Government. There is a provision for the government to constitute a Search Committee to fill the key posts of the Board, but the Search Committee consists of (a) Planning Commission Member, Secretaries to the Ministry of Petroleum and Natural Gas, Ministry of Finance, Ministry of Commerce and Industry and Ministry of Law and Justice.<sup>54</sup> The Member (Legal) has to be qualified to be a Judge of a High Court or belongs to a certain category of Indian Legal Service (another class of civil servant).<sup>55</sup>

The financial dependence of the Board lies entirely with the Central Government, which not only makes grants to the Board, but also constitute a committee which will recommend the government on budgetary requirements of the Board and fix its budgetary ceiling.<sup>56</sup> Indeed, there is no doubt that in an industry as important as crude oil and natural gas, government's involvement is imperative for ensuring accountability, but this can be manifested in legislature more appropriately than by executive. The intervention by the executive is heavily embedded in operations and functions of the Board, offering a depressing image as regards competency and independence.

### ***Telecom Regulatory Authority of India***

Telecom regulation is usually hailed as a great success in India.<sup>57</sup> Yet, even though Telecom Regulatory Authority of India (TRAI) has shown remarkable performance at multiple levels, it remains far from ideal. The Authority remains subservient to the Ministry of Telecom, and its obedience to Central Government has surfaced in more than one occasion.

Firstly, it has been noted<sup>58</sup> that crises of falling foreign direct investment (FDI) in telecom during 2003 was a result of partisan politics that took place during power change at New Delhi in 2004. While earlier ruling party, National Democratic Alliance (1998-2004) clearly passed orders and recommendations that protected the interests of companies running on CDMA technology (largely provided by Reliance and Tata), the subsequent United Progressive Alliance (2004-incumbent) party chose to explicitly make policy recommendations that benefitted GSM technology (run on platforms of Bharti Airtel, Vodafone and foreign operators).<sup>59</sup> TRAI's diminished role during this period only shows its rather weak institutional structure in the presence of more powerful and intervening political forces.

The second case is that of 2G spectrum scam of 2011 that had politicians and government officials undercharging mobile telephony companies for frequency allocation licenses, with the shortfall being estimated at US\$28bn. This was done through government's allocation of 2G spectrum arbitrarily to favoured companies at the cost of public exchequer. In doing so, A. Raja (the then Minister of Telecommunication) blatantly ignored the recommendations of TRAI, showing how TRAI has a mere advisory rather than authoritative role under the Ministry.

*Inter alia*, TRAI had recommended a no-cap regime for the number of licenses in a given area, the Department of Telecommunications (DoT) Press Release of September, 2007 mentioned that the applications for issue of licenses would be accepted only up to October 01, 2007, thus putting an arbitrary cap on the number of licenses. Further, the cut-off date was then advanced arbitrarily to September 25. Amongst bureaucrats implicated in the scam, Pradip Baijal, Chairman of TRAI from 2003-06 has been alleged to have implemented policies that benefited certain telecom companies.<sup>60</sup> Post retirement, he joined Neosis, a consulting firm promoted by Nira Radia, one of the prime accused corporate lobbyist in the case.<sup>61</sup>

In fact, the lack of active engagement of TRAI in 2G case shows how 'toothless' regulators are in India, with appointment processes ridden with conflict of interests and insufficient and incompetent manpower.<sup>62</sup> The usual tale of appointment of regulators in TRAI follows the same entrenched framework, with appointment done by the Central Government. TDSAT chairman can only be Judge of Supreme Court or Chief Justice of High Court, and Member(s) could only be chosen from amongst Secretary or Additional Secretary rank.<sup>63</sup> Just as in case with most other regulators, the budgetary grants of TRAI are decided and disbursed by the government.<sup>64</sup>

### ***Competition Commission of India***

Set up in 2003, the Competition Commission of India (CCI) is vested with ensuring fair competition in India. The appointment of Chairman and



Members is done by the Central Government, which constitutes a Selection Committee consisting of Chief Justice of India, Secretary in Ministry of Law and Justice and Ministry of Corporate Affairs (in addition to two experts),<sup>65</sup> thereby entrenching the CCI within the government networks. In fact, recently the Ministry of Corporate Affairs issuing a directive to CCI to investigate rise in air fares because parliamentarians were breathing down, when it was an operation issues and not a policy issue. The institutional design remains poor due to the two main regulatory issues: (a) jurisdictional tensions between CCI and sector regulators in their overlapping duties of promoting competition, and (b) lack of guidelines with CCI on issuing penalties.

Many laws have ambiguous provisions on jurisdiction matters: For e.g. the Electricity Act requires the electricity regulator to check anti-competitive practices, while CCI has market wide remit.

Other sector regulatory laws require the regulator to promote consumer interest and competition in the sector, for instance the TRAI (telecom), IRDA (insurance), SEBI (capital markets), PRFDA (pension funds) and PNGRB (petroleum and natural gas). Recently, the case of aviation fuel cartel where the Delhi High Court gave an interim order that the PNGRB has the remit and not CCI is a case in point.

Competition Act 2002 does make an effort in resolving the jurisdictional conflict, where both CCI and the sector regulators are advised to cooperate when dealing with issues that appear to have an impact on the jurisdiction of the other.<sup>66</sup> Yet, several cases highlight that these conflicts are pervasive.<sup>67</sup> When, for instance, Reliance Industries Ltd filed a complaint to CCI alleging cartelisation of Indian Oil Corporation Ltd, Bharat Petroleum Corporation Ltd and Hindustan Petroleum Corporation Ltd for supply of aviation fuel to Air India, the three companies filed a suit in the Delhi High Court challenging the competence of the CCI to hear the matter claiming that the case was matter for PNGRB; the sector regulator. The High Court gave an interim order that CCI did not have jurisdiction over the matter despite the fact that the PNGRB legislation did not give the sector regulator exclusive jurisdiction on the matter.<sup>68</sup>

Similarly, in the electricity sector, CCI issued notices after finding three power distributors; BSES Rajdhani Power, BSES Yamuna Power and North Delhi Power Ltd (NDPL) guilty of abusing their dominant positions.<sup>69</sup> However, the Delhi Electricity Regulatory Commission, the state electricity regulator objected to CCI's intervention claiming that such matters to be exclusively under their domain pursuant to the Electricity Act, 2003. In the banking sector, it has been known how RBI has often argued to bring banking merger and acquisition (M&A) questions to Reserve Bank of India



(RBI) rather than CCI. The government reflected its persuasion in its notification of March 2011, excluding CCI from playing a role in mergers in the banking sector.<sup>70</sup>

The second problem with design of CCI is the lack of clear framework based on which penalty could be levied. Section 27 (b) stipulates that the penalty not be more than 10 percent of the average turnover of last three years (and further in some cases, three times of the profit if that is higher than the ten percent of turnover value). There are also leniency clauses<sup>71</sup> which enable the Commission to reduce the penalty in event the entity cooperates and makes full disclosure of its violations. Even here, there is no specific guideline on how much should the reduction be, or on what basis should its quantum be decided.

### **Conclusion: What can be Done?**

The chapter illustrated the compromise in several agencies in India. Locating these illustrations in the theoretical backdrop, it gives a sense of direction which Indian regulatory state is headed, and therefore flags the reasons behind deteriorating performance of regulatory institutions in the country.

Institutional design is one of the most powerful ways in which the issues could be addressed. Poor regulatory framework breeds poor performance. Many of the agencies studied clearly shows how the design of statutes itself is the root of incoherence, incompetency and politically entrenched interests. There is a need for more transparent regulation for appointment of Chairmen and Members, and appropriate frameworks to attract professionals from outside the ranks of civil servants and judiciary. Particularly, there is an appalling lack of academicians in regulatory processes, which needs attention. In addition, the regulatory agencies should be given fiscal independence, so that their dependence on the government reduces. This needs to be coupled with providing clarity and certainty of the legislative provisions through a comprehensive review of the various related laws. A Regulatory Reform Bill is pending with the government which covers these institutional reform issues.

Unfortunately, both the independence and competency is often compromised in developing nations, due to poor institutional design. Although Levy and Spiller (1994) mention the risk from the regulator being too independent and too autonomous, there is little independence that is achieved by regulators in most countries. Indian case exemplifies too little autonomy and regulatory agencies becoming puppet in the hands of the politicians who keep their control over the industries through bureaucratic agents. This not only compromises quality, but also puts accountability concerns in the forefront.

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- 28 Section 8, *Ibid*
- 29 Section 47 A of Major Ports Trust Act 1963
- 30 Section 47 A 4(a) and 4(b), *Ibid*
- 31 Section 47 G (b), *Ibid*
- 32 [http://www.arthapedia.in/index.php?title=Tariff\\_Authority\\_for\\_Major\\_Ports\\_%28TAMP%29](http://www.arthapedia.in/index.php?title=Tariff_Authority_for_Major_Ports_%28TAMP%29) See also, [http://articles.economictimes.indiatimes.com/2011-04-22/news/29463122\\_1\\_major-ports-minor-ports-indian-ports-association](http://articles.economictimes.indiatimes.com/2011-04-22/news/29463122_1_major-ports-minor-ports-indian-ports-association)
- 33 [http://www.infrastructure.gov.in/pdf/Report\\_Port\\_Regulatory\\_Bill.pdf](http://www.infrastructure.gov.in/pdf/Report_Port_Regulatory_Bill.pdf)
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- 38 Section 70, Electricity Act, 2003.
- 39 Kodwani (2012), supra na.
- 40 Dubash and Rao (2008), supra n.
- 41 *Ibid*
- 42 *Ibid*
- 43 *Ibid*
- 44 *Ibid*
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- 46 Prayas, 2003. A Good Beginning But Challenges Galore. Prayas, Pune. Dubash also elaborates on this. In particular he mentions how when in Delhi, the appointment was made outside the regular pool of IAS, this was firstly due to a strong bias of senior political figure in Delhi and secondly this led to resentment from within Delhi's IAS ranks.
- 47 Dubash and Rao (2008), supra n.
- 48 Section 1(4) of the Petroleum and Natural Gas Regulatory Board Act 2006.
- 49 Specifically, Section 17 (4), *Ibid.* states, "Subject to the provisions of this Act and consistent with the norms and policy guidelines laid down by the Central Government, the Board may either reject or accept an application made to it, subject to such amendments or conditions, if any, as it may think fit."
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- 51 Section 10 (1), *Ibid*
- 52 Section 42 (1), (2) and (3), *Ibid*
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- 58 Mukherjee (2008), *supra n.*
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- 67 For detailed study, see Sampson and Sampson, CUTS 2012.
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## CHAPTER 4

# Bringing Back Competition in Multilateral Trade Discussions

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### Introduction

This chapter begins with an assessment of India's trade scenario and provides an overview of country's renewed trade strategy, as explained in the new Foreign Trade Policy (FTP). It highlights the interrelation between non-tariff barriers (NTBs) to trade and competition related concerns.

This is followed by a detailed analysis of coverage of competition-related issues in India's trade-related agreements which reveal inconsistent and inadequate coverage, a matter of concern. Same trend is witnessed in other new generation trade agreements which are analysed in the chapter. The chapter then highlights the adverse impacts of regional trade agreements (RTAs) on non-party countries, and undertakes a comprehensive analysis of the Trans Pacific Partnership (TPP) agreement, which points out that it perhaps creates a separate regulatory regime for parties and non-parties and dangers of such scenario to competition.

This is followed by a review of multilateral discussions on competition taken place at a global level, and how the global scenario has changed since. The growth of divergent domestic competition regimes has been noted. The chapter concludes with pointing out to the inadequate attention provided to competition related issues at domestic, regional and multilateral level, and with emphasis that restarting multilateral discussions on competition will be beneficial for emerging and developed economies.

While this chapter focuses on interrelation of trade and competition largely from India's perspective, it provides important lessons for other emerging economies as well, which are facing similar problems in interaction of trade and competition issues.

## **India's Deteriorating Trade Scenario**

In August 2015, the total merchandise exports from India stood at US\$21,266.31mn and the total merchandise imports by India stood at US\$33,744.28mn. The exports and imports reduced by close to 21 and 10 percent, respectively, when compared with August 2014. The decline in merchandise exports and imports has been secular during the first five months of the financial year 2015-16. During the mentioned period, such exports and imports have registered a negative growth of close to 16 and 12 percent (in US\$ terms), respectively, when compared with similar period in the previous financial year.<sup>1</sup>

This is after the country adopted a path-breaking FTP<sup>2</sup> and a detailed FTP Statement<sup>3</sup> in April 2015. The government aims to increase India's exports of merchandise and services from US\$465.9bn in 2013-14 to approximately US\$900bn by 2019-20 and to raise India's share in world exports from 2 percent to 3.5 percent.

The FTP consciously looks inwards and outwards to achieve this goal. Looking inwards, it emphasises on the need of a 'whole of the government' approach, mainstreaming states and Union Territories (UTs), and various government departments in the process of international trade. It acknowledges the need to address in-house challenges like infrastructure bottlenecks, high transaction costs, complex procedures, constraints in manufacturing, and inadequate diversification in our services exports.

The FTP highlights the need for creating a strong domestic manufacturing base, with a focus on engineering goods, electronics, drugs and pharmaceuticals. In addition, it aims to make special economic zones (SEZs) more competitive, better placed for manufacturing and export of services. Further, the FTP highlights government's initiatives like simplification of procedures and digitisation of various processes involved in trade transactions. It also highlights government's intent to put in place institutional mechanisms for stakeholder communication, monitoring and review of developments under FTP.

## **India's Trade Promotion Agreements**

Looking outwards, the FTP undertakes a comprehensive assessment of India's trade with its existing and potential trading partners. It provides an overview of the trade promotion agreements the country has entered into with different countries and regions. It highlights that while there has been a significant increase in overall trade, in both exports and imports with countries/regions with which India has executed trade promotion agreements, imports have increased at a faster pace.



The FTP acknowledges that India has been unable to take advantage of its trade promotion agreements and highlights issues which need to be addressed. These include conservative rules of origin of India's trading partners, inverted duty structure, unavailability of preferential trade data etc.

Further, it recognises that India's future bilateral/regional trade engagements will be with regions and countries that are not only promising markets but also major suppliers of critical inputs and have complementarities with the Indian economy. The FTP goes on to spell out areas of focus for trade engagements with different trade partners. These are summarised in Table 4.1.

<b>Table 4.1: India's Focus Areas with its Existing And Potential Trading Partners</b>	
<b>Country/Region</b>	<b>Focus Area/Issues of Concern</b>
United States	<ul style="list-style-type: none"> <li>• Access to skilled professionals</li> <li>• Intellectual property rights (IPR) related issues</li> <li>• Labour and skill related policies of US government</li> </ul>
European Union	<ul style="list-style-type: none"> <li>• Stringent sanitary and phytosanitary standards</li> <li>• Complex system of quotas and tariffs and trade remedial actions against Indian products</li> <li>• Data security related constraints posed by EU regulations</li> </ul>
China	<ul style="list-style-type: none"> <li>• Market access issues and removal of NTBs on India's exports of pharmaceuticals and agricultural commodities</li> <li>• Market access for Indian IT Services and other service sectors</li> <li>• Addressing unfair trade practices (UTPs) by Chinese companies</li> </ul>
Africa continent	<ul style="list-style-type: none"> <li>• Capacity development, technical assistance and provision of services such as healthcare and education</li> <li>• Agro-processing, manufacturing, mining, textiles, FMCG, infrastructure development and construction</li> </ul>
Latin American and Caribbean region	<ul style="list-style-type: none"> <li>• Project exports through easy access to credit facilities</li> </ul>
Commonwealth of Independent States region	<ul style="list-style-type: none"> <li>• Promote investment in the exploitation of raw materials</li> <li>• Promote export of products of India's strength and to help facilitate investments in some of these countries to build value chains, for example, in the pharmaceutical sector</li> </ul>
<i>Source: India's Foreign Trade Policy Statement (2015)</i>	

## **Competition and Non-Tariff Barriers to Trade**

The issues highlighted by FTP and prioritised by the country in its trade related negotiations seem to be in the form of NTBs to trade.

NTBs to trade are usually understood as government laws, regulations, policies or practices that either protect domestic industry or products from foreign competition or artificially stimulate export of particular domestic products. Quantitative restrictions, tariff quotas, voluntary export restraints, orderly marketing arrangements, export subsidies, government procurements, import licensing, antidumping/countervailing duties and technical barriers to trade (TBT) are some examples of such NTBs.

NTBs also include a wide variety of operating practices ranging from bureaucratic delays in processing request for permits, political squabbles, 'buy national' campaigns, infrastructure headaches and unethical business practices. However, it must be realised that not all such barriers to trade are intentional.<sup>4</sup>

Further, such measures are often justified from the perspective of public policy, i.e., the need to protect human health and safety, to protect infant (domestic) industries and the environment.<sup>5</sup> Countries have different policy and legislative regimes, divergent institutional and regulatory capacities, distinct objectives and priority areas, owing to different stages of development. Such factors could lead to unintentional NTBs to trade.

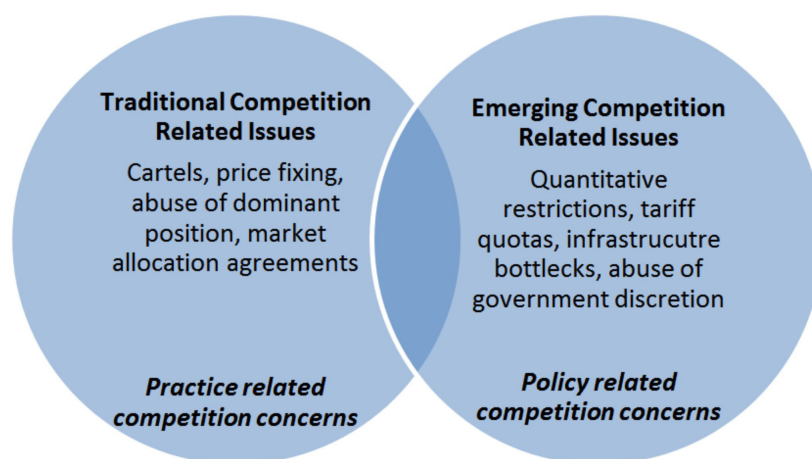
### ***Traditional and Emerging Competition Barriers***

Often, the NTBs and competition-related issues are interlinked and overlap one other's domain. While core competition issues comprise cartels, price fixing, market allocation arrangements, big rigging, abuse of dominant position, competition is also restricted by unnecessary NTBs to trade, such as quotas, procedural constraints, and complex regulatory regimes, as indicated above.

It could be argued that while practice induced distortions to competition (such as anti-competitive agreements), and their impact on trade have been hitherto studied, however, limited understanding of policy induced distortions to competition, and its impact on trade exists. Perhaps, this is a result of policy induced distortions to competition being covered under the banner of NTBs to trade, and did not get the kind of independent attention they deserve.

Anderson et al (2015) notes that important synergies or complementarities exist between trade liberalisation initiatives and the application of measures that suppress anti-competitive practices or arrangements. Both anti-

competitive practices of firms and state-orchestrated arrangements that restrict competition can undermine the gains from trade in myriad ways. Perhaps, the clearest examples of such effects involve international cartels that allocate national markets among individual producers, abuses of a dominant position that limit access to facilities that are necessary for the importation of goods or services, and import cartels or anti-competitive vertical market restraints that exclude foreign suppliers from a market.<sup>6</sup>



### Competition Concerns in International Trade

It could be argued that a vicious cycle might emerge between policy and practice related competition concerns to trade. For instance, in a scenario when official tariffs and NTBs are clearly defined and implemented, the incumbent players might attempt to prevent competition by implementing practice induced barriers. Alternatively, in a scenario when competition regimes are efficient and it is difficult to implement practice related competition barriers, incumbent governments might adopt policy related competition bottlenecks with the intention to protect domestic industry.

These policy related barriers could be in form of NTBs to trade, amongst others, and they directly or indirectly impact ability of entities to compete with each other and place an entity at a disadvantageous/advantageous position, when compared with others. For instance, market entry and access could be restricted by investment related policies in certain sectors or intellectual related practices by market players, in others. Unavailability of skilled labour, lack of regulatory clarity and transparency also affect competition.

Such NTBs to trade which affect competition are not faced by India alone, but other countries as well. Literature suggests that as a result of increase in liberalisation and reduction of tariffs, a fear of increase in NTBs and unfair trade and anti-competition practices by market players remained.

Countries usually offer strong defence for their policies, for imposing such policy induced barriers to competition. These include arguments like: sovereign right to regulate, need to fund domestic infrastructure, etc. This was observed in the Mexico Telmex case, wherein the telecom regulator mandated the operators to charge for calls terminated in Mexico, no less than the Telmex-set fee for termination, and the rules decreed a market-sharing system in support of the high price.

This was alleged to be contrary to Mexican international commitments under WTO General Agreement on Trade in Services (GATS) and its Telecommunication Annex. Mexico argued that the practice was not anti-competitive, it raised the state action doctrine to regulate, and that the action was necessary to protect Mexican investment in domestic infrastructure. Such arguments were rejected by the WTO panel, which observed that a member “cannot unilaterally erode its international commitments.” GATS commitments, by contrast, are international; they are designed to limit the regulatory powers of WTO members.<sup>7</sup>

With the intention of addressing and minimising such barriers, and promoting trade between specific countries and regions, countries usually enter into bilateral and RTAs.<sup>8</sup> Such agreements have traditionally covered issues like tariff reduction, trade liberalisation, basic non-tariff measures (NTMs) etc. However, lately, the scope of such agreements has been expanded to cover issues like competition, intellectual property, investment, labour, environment, government procurement, transparency, regulatory coherence and dispute settlement. Expansion in scope of trade related arrangements seems to stem from the realisation that sustainable increase in trade might not be possible, without addressing issues with respect to competition, environment, labour etc, and that such issues are at the core of policy coherence, institutional reforms and ensuring sustainable trade and investment regime.

However, there is need to review if such agreements adequately cover and address issues related to competition. Also, it will be pertinent to review the impact of such agreements on competition between members to such agreements and non-members.

## **Coverage of Competition Issues in Trade Related Agreements**

### ***Competition Issues in India's Trade Agreements***

While competition is one of very important issues which determines trade between countries, it would be interesting to understand the significance accorded to competition related issues in India's trade related agreements. Table 4.2 lists different trade related agreements, which India has entered into.

<b>Table 4.2: India's Key Trade Related Agreements</b>	
<b>Partner Country/Region</b>	<b>Year</b>
India Ceylon Trade Agreement	1961
India DPR Korea Trade Agreement	1978
India Maldives Trade Agreement	1981
India Mongolia Trade Agreement	1994
India Sri Lanka Free Trade Agreement (FTA)	1999
India MERCOSUR Preferential Trade Agreement (PTA)	2004
Asia Pacific Trade Agreement (APTA)	2005
Comprehensive Economic Cooperation Agreement (CECA) between India and Singapore	2005
Agreement on South Asia Free Trade Area (SAFTA)	2006
India Afghanistan PTA	2006
India Bhutan Trade Agreement	2006
India Bangladesh Trade Agreement	2006
India Chile PTA	2006
India Association of South East Asian Nations (ASEAN) <sup>9</sup> Agreements	2009
India Korea Comprehensive Economic Partnership Agreement (CEPA)	2009
India Nepal Trade Treaty	2009
Agreement on Economic Cooperation between India and Finland	2010
South Asian Association for Regional Cooperation Agreement on Trade in Services	2010
CECA between India and Malaysia	2011
India Japan CEPA	2011
Source: Department of Commerce, Ministry of Commerce and Industry, available at <a href="http://commerce.nic.in/trade/international_ta.asp?id=2&amp;trade=i">http://commerce.nic.in/trade/international_ta.asp?id=2&amp;trade=i</a> , last accessed on 15 October 2015	

In addition to these agreements, India has entered into several framework agreements and memorandum of understandings with its trading partners, including countries with which it already has entered into trade related agreements. India is negotiating several arrangements with existing and potential trading partners.<sup>10</sup>

A comprehensive analysis of reference to competition in India's select FTAs has been provided in the **Annexure**. Such review has led to the following interesting findings:

*Inadequate Provisions to Achieve Promotion of Competition*

The agreements have variety of provisions relating to competition. These include objective to promote competition; power to request investigation of origin of goods; prevention of abuse of dominant position by service providers; consultation and cooperation to maintain competition and enable competition enforcement; prevention of transfer of technology; taking measures against anti-competitive practices; provisions relating to non-discrimination; procedural fairness; transparency; and adoption of competition rules. While some agreements have specific provisions relating to competition, others do not. The coverage of such provisions is inconsistent amongst agreements.

For instance, only five agreements reviewed have promotion of competition as one of their objectives. These are agreements with Sri Lanka, Chile, Afghanistan, SAFTA, and South Korea. However, agreements with Sri Lanka, Chile and Afghanistan do not have any other provision referring to competition. There is no guidance on how such objective is envisaged to be met. For instance, the SAFTA agreement requires parties to consider adoption of rules for fair competition to support and complement the agreement for mutual benefit.

*Divergent Powers in Different Agreements*

The agreement with MERCOSUR<sup>11</sup> region provides authority to one party to request other party to investigate of origin of goods imported, if such goods compete with the goods of requesting party and such party has grounds to suspect that such goods enjoy preferential tariff without complying with rules of origin. Such provision does not find mention under any other trade related agreement, not even with other blocs/regions, like SAFTA or ASEAN. One wonders the reason for such exclusion as such provision seems important to ensure effective competition and preventing non-eligible entities from gaining benefits of preferential tariffs.

Determination of origin of goods is becoming important in largely interconnected world, with lesser goods being manufactured at a particular place and within a particular country, and advent of global value chains. It is highly difficult to determine which goods are eligible for PTA benefits. Complicated rules of origin (RoO) are already an area of concern, as highlighted in India's FTP. Concerns have also being raised that an efficient manufacturer may lose out to an inefficient one only on account of preferential treatment of non-efficient manufacturer.<sup>12</sup>

### *Difference in Standards of Consultation and Cooperation*

While agreements entered into by India post 2009 usually have provisions in relation to consultation to prevent anti-competitive practices and cooperation for enforcement of competition related provisions, such provisions are usually absent from pre-2009 agreements like MERCOUR, Chile, Afghanistan and SAFTA agreements. The only exception in this regard is the 2005 agreement with Singapore which provides for consultation amongst parties to eliminate business practices in services and cooperation for sharing for non-confidential information. Agreements with South Korea (2009) and Malaysia (2011) have similar provisions.

However, agreement with South Korea is quite broad and covers consultations to eliminate anti-competitive practices that affect trade or investment. It also has specific provision with respect to strengthening cooperation and coordination on competition law enforcement, and consultation between competition authorities on various matters relating to competition, including capacity building, exchange of information, notification procedures and principles of comity. No other agreement has such detailed provisions with respect to cooperation, capacity building and information building. One cannot disagree with the need for having such provisions but wonders if their exclusion from other agreements intentional?

The 2011 agreement with Japan has provisions for promotion of cooperation for effective enforcement of competition laws in each party, as one of its objective and thus has a specific provision of cooperation for controlling anticompetitive activities, but subject to their respective available resources.

In addition, it is the only agreement that has provisions with respect to preventing discrimination in application of competition laws and regulations to similarly placed persons on the basis of nationality; adoption of procedural fairness while implementation of administrative and judicial procedures to control anti-competitive activities; and promotion of transparency in implementation of competition laws and regulations and its competition policy.

While all these are very important provisions to ensure effective enforcement of competition related provisions, their absence from the agreements entered prior to 2011 indicates the manner and pace in which jurisprudence with respect to interplay between competition and trade has been developing. This is also evident by the fact that most trade related agreements under negotiation have provisions with respect to competition, intellectual property and other related issues, as highlighted above.<sup>13</sup>

### ***Coverage of Competition Issues in Other Recent Trade Related Agreements***

The trend of including competition issues in trade related agreement is not limited to India, and Teh (2009) finds that despite the reluctance of many developing countries to enter multilateral negotiations on competition policy, 50 of the 68 RTAs with developing countries as members have a competition policy provision or chapter. The principal objective of these provisions is to prevent the gains in market access arising from the RTA from being eroded by anticompetitive behaviour that is condoned or tolerated by RTA partners. The main obligations thus involve adoption or application of competition laws to curb anticompetitive behaviour and closer co-operation among competition authorities of RTA partners.<sup>14</sup>

For instance, the 2013 trade agreement between *European Free Trade Association (EFTA) states*<sup>15</sup> and *Bosnia & Herzegovina* makes agreements to prevent, restrict or distort competition, and abuse of dominant position, incompatible with the agreement. Similarly, the *free trade agreement between Canada and South Korea*, which came in force in January 2015 have detailed provisions with respect to competition policy, monopolies and state enterprises.<sup>16</sup>

The agreement requires parties to take measures to proscribe anti-competitive business conduct, cooperate on issues of competition law enforcement policy, including mutual legal assistance, notification, consultation, and exchange of information relating to the enforcement of competition laws and policies in the free trade area. The agreement also provides for checks and balances in establishment of monopolies and state owned enterprises. Similar provisions are present in the *FTA between Canada and Honduras*, which came into effect in October 2014.<sup>17</sup>

The *FTA between Australia and China*, which came into force in June 2015, has provisions with respect to cooperation and coordination in enforcement of competition laws and policies subject to each party's confidentiality requirements. It also provides for checks and balances on practices of monopoly suppliers of service and exclusive service suppliers.

While under the *agreement between EU and SADC EPA states*<sup>18</sup> (the negotiations for which were concluded in July 2014), the parties have agreed to cooperate on competition matters, no specific declarations with respect to competition appear to have been made. The parties have the option to enter into negotiations on competition in future.

The *trade agreement between Japan and Australia*, which came into effect in July 2014, provides for cooperation between parties on promotion of competition by addressing anticompetitive activities, subject to respective laws, regulations and available resources. The agreement has detailed provisions to maintained confidentiality of information shared on competition related matters.



The *2013 agreement between EU, Colombia and Peru*, mandates the parties to maintain competition laws, and authorities responsible and appropriately equipped for the effective enforcement of their respective competition laws. It further mandates cooperation amongst competition authorities on best efforts basis, and allows exchange of information, subject to respective domestic legislations. The agreement also envisages initiatives on strengthening technical and institutional capacities for implementation of competition policy and enforcement of competition laws, training of human resources and exchange of experiences.

The *2014 agreement between EU and Moldova* also require parties to maintain operationally independent authority with adequate human and financial resources in order to effectively enforce the competition laws.

While the *free trade agreement between Hong Kong, China and Chile*, which came into effect in October 2014, does not require parties to establish competition authorities, it provides that where such authorities are present, the parties are required to encourage respective authorities to cooperate in the area of competition law, including through technical assistance as appropriate, consultation, notification and exchanges of information, as permitted by the domestic laws and regulations and overall policy of each party and within the scope of the responsibilities of each regulatory authority.

The ASEAN Economic Community Blueprint 2015, as entered into between ASEAN countries in 2007, endeavoured to introduce competition policy in all ASEAN Member Countries by 2015, and establish a network of authorities or agencies responsible for competition policy to serve as a forum for discussing and coordinating competition policies. Pursuant to the blueprint, ASEAN Regional Guidelines on Competition Policy were developed in 2010 and guidelines for developing core competencies in competition policy and law for ASEAN were released in 2012. The Handbook on Competition Policy and Law in ASEAN for Business were issued in 2013.

The *ASEAN Economic Community Blueprint 2025*, as entered into between ASEAN members in November 2015, builds upon the ASEAN Economic Community Blueprint 2015. The 2025 blueprint requires establishment of effective competition regimes by putting in place competition laws for all remaining members that do not have them. It further focuses on strengthening capacities of competition-related agencies in members by establishing and implementing institutional mechanisms necessary for effective enforcement of national competition laws, including comprehensive technical assistance and capacity building.

Another objective is to foster a ‘competition aware’ region by greater exchange of information and advocacy efforts. Establishment of competition

enforcement cooperation agreements to effectively deal with cross-border commercial transactions has also been envisaged. Importantly, the blueprint aims to ensure alignment of competition policy chapters that are negotiated by ASEAN under various FTAs with competition policy and law in ASEAN to maintain consistency on the approach to competition policy and law in the region.

Another region which has made impressive efforts to integrate trade and competition related issues is COMESA<sup>19</sup>. The *COMESA treaty* prohibited anti-competition agreement. It was agreed that regulations to regulate competition within members will be issued. The COMESA Competition Regulations were issued in December 2004, which required member states to establish COMESA Competition Commission to monitor and investigate anti-competition practices and mediate disputes between members concerning anti-competitive conduct, etc. The COMESA Competition Commission became operational in January 2013, and exercises jurisdiction to cross border transactions which are beyond the jurisdictional scope of national competition laws.

### ***Inconsistent and Inadequate Coverage of Competition Issues***

The review of India's trade agreements and those recently executed by other countries reveal inconsistent and inadequate coverage of competition issues. While some bilateral agreements merely provide for a broad level agreement on competition promotion, other agreements, specifically which are regional in nature, comprehensively cover competition related issues.

It appears that while the countries understand the significance of competition in trade related matters, lack of nuanced understanding, capacity, and a guiding framework, could have resulted in less than necessary coverage of competition related issues in the trade agreements.

And this inconsistency appears notwithstanding the agreements executed amongst developed or developing countries or between developed and developing countries. However, one needs to understand that the capacity and understanding of competition related issues between developed and emerging economies is different and consequently the competition language in the trade agreement, might benefit one party more than the other, without any checks and balances.

Even when such provisions are present in the trade relation agreements, their effective enforcement and promotion of competition/prevention of anti-competitive practices is arguable, especially by developing countries. Such agreements also are usually silent on certain salient issues regarding dispute resolution on competition related issues, choice of law, and the forum for redress of competition related disputes.

This trend does not augur well to tackle NTBs to trade. Consequently, it seems that other mechanisms are needed to accord requisite importance to competition related issues in trade negotiations between countries.

### **Competition Barriers through Trade Agreements to Which India is Not a Party**

India's FTP highlights that there are trade related bilateral and regional agreements, such as Trans Pacific Partnership<sup>20</sup> (TPP) and Trans-Atlantic Trade and Investment Partnership (TTIP), and EU-ASEAN agreement, to which India is not a party. It acknowledges that new features of the global trading landscape such as mega regional agreements and global value chains will profoundly affect India's trade. These agreements add a completely new dimension to the global trading system and are bound to challenge India's industry in many ways, for instance, by eroding existing preferences for Indian products in established traditional markets such as the US and EU and establishing a more stringent and demanding framework of rules. The FTP recognises that Indian industry needs to gear up to meet these challenges for which the Government will have to create an enabling environment.

#### ***The TPP***

The TPP provides for significant reduction and elimination of tariffs and other barriers to trade amongst the parties. Such preferential tariffs will not be available to exports from other countries to TPP countries and consequently result in uneven playing field between TPP and non TPP countries. The agreement further prohibits *import licensing* conditioned on performance requirements (such as domestic content requirements), as well as requirement to establish contractual relationship with domestic distributors as a condition of importation. Exports from other countries might still need to comply with such conditions and consequently will be at a disadvantage. The agreement further promotes transparency and notification/publication of relevant rules and procedures, however, amongst parties only.

The *RoO* chapter in the TPP includes provisions on product specific rules, which limit the type or amount of non-TPP materials that can be used, or if such materials have been substantially transformed into a 'TPP product.' These rules ensure that only businesses that make significant investments and source significant amounts of materials and components in the TPP countries are eligible to receive lower duties. The agreement further requires a TPP country to treat materials from one TPP country in the same way they treat materials from any other TPP country when these materials are used to make a TPP product. Such 'cumulation' rules are expected to

promote production and supply chains among TPP countries, and to reduce incentives to shift production to producers outside the region.

Consequently, the manufactures will have little incentive to produce in non-TPP countries and to expand their value chains outside the TPP region, to excluded countries like India. The agreement imposes strict limits on the *production processes* that can be conducted and for *products in transit* outside the TPP region in order for a product to still be eligible for TPP tariff preferences. It creates a common TPP-wide system of showing and verifying that goods made in the TPP region meet the rules of origin and provides customs authorities with the tools they need to verify claims. Consequently, the TPP creates an altogether separate regulatory regime, or a 'preferential gate-pass' for trade amongst TPP countries. Non-TPP countries will not be eligible for such gate-pass, and thus might find it difficult to trade with TPP countries.

However, it could be reasonably posited that the TPP countries might find it extremely complex to administer different regulatory regimes for TPP and non-TPP countries and might require non-TPP countries, over time, to comply with conditions set under the TPP agreement.<sup>21</sup>

Further, the *sanitary and phytosanitary (SPS) measures* under the TPP mirror the US regulatory procedures. The TPP commitments permit an importing country to conduct an audit of an exporting country's food safety regulatory system to determine whether the exported food meets the importing country's requirements. It might not be long that TPP countries demand similar rights while trading with non-TPP countries.

The *TBT* chapter of TPP provides for participatory approach for development of technical regulations, standards, and conformity assessment procedures by government bodies. It also provides 'national treatment' to one another's conformity assessment bodies. Through the *competition policy* chapter, TPP members have agreed to adopt or maintain national competition laws that proscribe anticompetitive business conduct and work to apply these laws to all commercial activities in their territories. To ensure that such laws are effectively implemented, TPP parties are required to establish or maintain authorities responsible for the enforcement of national competition laws.

It also provides an independent right to seek redress to private party for injury caused by a violation of a party's competition law or, a right to request that a party's competition authority initiate an investigation and to seek redress after the finding of a violation of competition. Such rights might not be available when traders from other countries trade with TPP countries.

The *intellectual property chapter* of the TPP include commitments related to protection of undisclosed test and other data generated to obtain marketing approval of pharmaceuticals and agricultural chemicals. The agreement establishes stringent penalties on trade secret theft and empowers border officials to act on their own initiative to identify and seize imported and exported counterfeit trademark and pirated copyright goods. It enhances the data protection and other standards with respect to intellectual property on pharmaceutical products, which might harm development of generic drugs in non-TPP countries.

The TPP also includes new stand-alone commitments promoting the development and strengthening of *supply chains* among its members, to the exclusion of other members. The agreement has specific comprehensive chapters on investment, financial services, telecommunications, electronic commerce, government procurement, state owned enterprises, intellectual property, labour, environment, cooperation and capacity building, competitiveness and business facilitation, development, small and medium enterprises, regulatory coherence, transparency and anti-corruption, administrative and institutional provisions. Such first of its kind comprehensive coverage makes TPP much more than merely a trade facilitation agreement and results in deeper integration between member states. This is expected to have three-fold impacts on non-members.

Firstly, the TPP creates a *parallel regulatory regime* disregarding the existing relationship and arrangements between TPP and non-TPP members, resulting in differential competition and compliance regime for different sets of investors. While TPP might create new economically gainful trade between TPP parties, it also has the potential to result in 'trade diversion' from efficient non TPP parties to not so efficient TPP parties, on the back of preferential tariff or favourable rules. This is not expected to be economically gainful. This could be particularly harmful to India which does not have a FTA with US, which is its largest export destination.<sup>22</sup>

Secondly, the *TPP provisions might make a creeping entry into other agreements* being negotiated between TPP members and non-TPP members. For instance, India is negotiating a Regional Comprehensive Economic Partnership (RCEP) with 15 countries<sup>23</sup> of which some are TPP members,<sup>24</sup> and the latter could push for inclusion of TPP standards in RCEP.<sup>25</sup>

And finally, in future, lured by the opportunity to get greater access to TPP parties, a non-TPP party might be interested to join the TPP. Such a move could potentially be harmful for many domestic industries of such countries – such as India's generic pharmaceutical industry. The TPP will guide how such countries run their public sector units, set labour or environmental regulations, and a slew of other non-trade related policy

fields, without any negotiation on the applicable rules. It has been argued that this effectively means that were India were to join TPP in future, it would be surrendering our policy sovereignty to the US without the realistic prospect of economic gain in return.<sup>26</sup>

Bergsten (2015) argues that India will lose as much as USD 50 billion of current exports because of increasing discrimination against it by other countries if it remains outside the new global trade network, including TPP.<sup>27</sup>

If not managed properly, the high standards and conditions created by such agreements to which India is not a party have the potential to act as NTBs for trade between India and parties to such treaties. This could result in loss of market access to Indian traders. Like India, other developing countries could also be forced to face such NTBs while trading with countries which whom they are not party to trade related agreements.

### ***Negative Welfare Impact***

A study conducted by CUTS International highlighted negative welfare impact on India on account of mega-regional agreements to which it is not a party:

<b>Table 4.3: Welfare Impacts on India (percentage change from BASE)</b>				
	<b>TPP</b>	<b>TTIP</b>	<b>EU-ASEAN</b>	<b>ALL 3 PTAs</b>
Aggregate welfare (US\$mn)	-322	-408	-336	-757
Welfare as percentage of GDP	-0.03	-0.03	-0.03	-0.06
Source: Chatterjee and Cote (CUTS), <i>Mega Regional Trade Agreements and the Indian Economy: An analysis of potential challenges and opportunities</i> , World Commerce Review, September 2015				

The study further argues that the influence of mega RTAs may result in the creation of a dual regulatory regime in developing countries, one for mega RTA members and another for the rest of the world. As indicated earlier, several experts support this view.<sup>28</sup>

Under these circumstances, large exporters will likely have the resources to adopt the complex regulatory standards in these markets while small exporters will face much more difficulties in adhering to these standards. This may be detrimental to a large number of small and medium enterprises (SMEs) in India that play a pivotal role in the Indian economy. The situation will not be dissimilar to SMEs of other economies.

The CUTS study concludes that domestic reforms can address gaps in specific trade regulations where there is potential for streamlining and stimulating trade competitiveness, and a multilateral trade liberalisation would result in an aggregate welfare for India of more than US\$20bn (or close to 1.6 percent of India's GDP).

### ***Conflict of Interests***

It has also been argued that mega-regional agreements to which emerging economies like India are not party might overrule genuine concerns of such excluded parties, such as those in the area of intellectual property rights.<sup>29</sup> They might target the domestic legal provisions which prevent patent ever-greening and reduce the patentability threshold of an invention. In addition, they might provide for seizure of 'confusingly similar goods' that are in transit. Such measures could impede the legitimate trade in generic drugs, a highly sensitive issue for emerging economies like India. It has been argued that instead of attempting to discuss a mutually accepting framework on intellectual property, the EU and US may focus on enforcing their IP rights in third countries.<sup>30</sup>

To recall, in 2010 India and Brazil requested consultations with the EU in line with the proceedings provided by the WTO against the seizure of generic drugs in transit through the EU. Experts suggest that dispute was on account of different regimes with respect to international trade, intellectual property and competition in these jurisdictions.

As a result, the bilateral and regional trade regime seems unable to deal with competition related issues with parties to such agreements and with parties excluded from such regime. Thus, there is a need to rethink the strategy deal with competition related issues in bilateral and multilateral context.

### **Need for Reviving Competition Discussions at Multilateral Level**

From the earlier discussions, the following appears to be clear:

1. The scope of competition related impediments which adversely impact trade directly or indirectly has been steadily increasing. Little understanding exists amongst countries about the relation between 'new' competition issues and trade.
2. The coverage of competition related issues in trade agreements has been insufficient. While countries are increasingly acknowledging the generic inter-relation between trade and competition and thus the need to incorporate competition related issues in bilateral and RTAs, the lack of understanding and capacity to deal with specific competition



constraints might result in such inclusion of competition related issues, futile. Such agreements often do not cover issues related to choice of law, dispute resolution on competition issues.

3. Regional and ‘new generation’ trade promotion agreements are more comprehensive than ever before and cover issues with respect to environment, labour, regulatory coherence, etc and result in deeper integration between the parties to such agreement. The countries excluded from such agreements would most likely be differentially treated and be disadvantaged from competition point of view.

Given the above, it might be necessary to restart discussion of competition related issues at the multilateral level. However, this will not happen for the first time, and it would be pertinent to learn from past failed attempts to include competition in multilateral discussions.

### ***A Recap of Developments at WTO***

The Havana Charter of 1947 envisaged that the proposed International Trade Organisation (which was not formed and instead the General Agreement on Tariffs and Trade was initiated in 1947, the precursor to the WTO) would have power to prevent restrictive business practices that restrain competition and affect gains from trade. However, the Havana Charter did not succeed although the momentum led to the adoption of “The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices” also referred to as the UN Set of Principles And Rules on Competition by UNCTAD in 1980.

Subsequently, the interface between trade and competition policy emerged as an area of interest in the Uruguay Round of WTO negotiations. A Working Group on the Interaction between Trade and Competition Policy was set up at the first Ministerial Conference of the WTO members, held in Singapore in December 1996. The Doha Ministerial Declaration of the WTO members outlined the work of Working Group – that it will ‘focus on the clarification of: core principles, including transparency, non-discrimination and procedural fairness, provisions on hardcore cartels; modalities for voluntary cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity building.’<sup>31</sup>

In addition, the Doha Declaration recognised ‘the case for a multilateral framework to enhance the contribution of competition policy to international trade and development, and the need for enhanced technical assistance and capacity-building in this area.’<sup>32</sup>



Based on the work of the Working Group, the Draft Ministerial Text of the WTO members at the Cancun Ministerial Conference stated that, ‘The objective of the negotiations shall be to establish an agreement to secure better and more equitable conditions for international trade, by facilitating effective voluntary cooperation on anticompetitive practices which adversely affect international trade, in particular hardcore cartels which have an impact on developing and least-developed countries’ economies, and assisting WTO Members in the establishment, implementation and enforcement of competition rules within their respective jurisdictions.’<sup>33</sup>

However, at the July 2004 General Council meeting of the WTO Members, a consensus couldn’t be reached to discuss a multilateral agreement on issues relating to interaction between trade and competition policy, along with issues of interaction between trade and investment policy and transparency in government procurement. Consequently, it was decided to exclude these issues from the Doha work programme.<sup>34</sup>

Developing and least developed countries opposed the idea to discuss multilateral agreement on trade and competition policy, on account of their limited experience of enacting and implementing competition laws and policies at national level. It was argued that a multilateral agreement on competition was likely to tilt the balance in the favour of developed economies, and the developing economies would not be eligible for exemptions/concessions hitherto accorded to them.

However, much water has flown under the bridge since then. Currently, more than 130 countries have enacted competition laws or policies, of which most are emerging economies.<sup>35</sup> It has been noted that such national competition laws embody a host of different assumptions about the role of economics; the proper scope and nature of competition law prohibitions, rules, and remedies; procedural issues; and the influence non-competition policy concerns should have on competition law enforcement decisions.<sup>36</sup> Without a strong international framework on competition, such divergent domestic competition regimes could treat similarly placed entities differently.<sup>37</sup>

### ***Existing Multilateral Agreements***

In addition to specific discussion on competition issues at WTO, these issues also covered in several WTO paper/agreements, however, rather unsatisfactorily:<sup>38</sup>

- The WTO Reference Paper on Basic Telecommunications Services of 1997 intends to address competition concerns in telecommunications networks wherein exclusive services were provided by limited number of entities. These issues have become

important in the present context with emergence of digital finance and e-commerce markets, which are essentially network industries. It is not clear if the principles enshrined in the Reference Paper are adequate to cover emerging competition concerns in network industries. Also, there have always been concerns with respect to implementation of principles of principles in Reference Paper. Experts also wonder the need to have similar competition related papers in infrastructure sectors like energy.

- The WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) also covers issues with respect to competition, and recognises that appropriate measures might be needed to prevent abuse of IPRs by rights holders. Anderson et al (2015) highlight that the agreement does not define the basis on which practices may be deemed to be anti-competitive, i.e. the evaluative standards to be employed. The agreement also provides little guidance regarding the remedies that may be adopted in particular cases, beyond making clear that any measures adopted must be consistent with other provisions of the Agreement. These gaps heighten the technical challenges for WTO Members in putting the provisions to good use and also raise potential international coordination problems. Further, it has been lately suggested that US and Switzerland intend to introduce non-violation complaints norm under the WTO TRIPs agreement.<sup>39</sup>

This will enable WTO members to raise disputes against another member's actions or policies, even if there is no violation of a WTO agreement. Developing countries like India are vehemently opposing this approach. Lack of importance accorded to core competition principles at WTO level often result in such impasse amongst trading countries.

The above discussion points out that existing multi-lateral regimes/agreements inadequate cover issues related to competition and appear to be inadequately equipped to deal with 'modern' competition related issues in sectors like telecommunications, pharmaceuticals and global value chains.

## Way Forward

Much time has passed since the last discussions on multilateral framework on competition and more than 130 countries have now adopted competition law or policy. This indicates quickly maturing domestic competition regimes. However, different competition regimes have the potential to understand the scope and contours of competition law differently. Such different regulatory coverage has the potential to increase the cost for actors, based in developed, as well as emerging economies.<sup>40</sup>

Further, the markets have been changing dynamically and existing arrangements at domestic, regional and multilateral level seem insufficient to deal with impact of ‘emerging competition constraints’ in form of NTBs to trade. Also, the competition impact of regional trade agreements on non-partners, network industries, global value chains, intellectual property, state owned enterprises, and government procurement, need to be reviewed closely and addressed accordingly. Again, these issues equally affect actors in developing and emerging economies.

While understanding about competition related issues has increased, countries have still not managed to arrive at a solution of dealing with traditional competition related problems like export cartels, state immunity, and the increasingly contentious issues of state power to regulate. With developing countries increasingly housing multi-national corporations, such actions equally hurt developing and developed countries. However, countries have been making strong arguments to retain their regulatory powers and immunity with respect to actions which could be subject to competition law. There is a need for greater discussion among countries to understand the direct and indirect impacts of such actions and achieve a balance between interests of competition and countries regulatory power.

Greater cooperation and coordination between countries on competition related issues will not be possible without exchange of information, while maintaining confidentiality. Cooperation and coordination is also necessary to improve capacity and understanding of late entrants to competition regulation.

It is for these reasons, amongst others, that we are witnessing a trend on increase in number and scope of regional trade agreements. Such agreements are aimed at building greater cooperation amongst parties and include more countries than could have been envisaged previously. However, as discussed earlier, such agreements have several unintended impacts on non-parties and also potential to result in countries unwillingly submitting to pre-determined regulatory regime and standards, to their disadvantage.<sup>41</sup> As indicated above, other new bilateral trade agreements also do not adequately provide for competition related issues, and issues such as compliance and dispute resolution remain a concern.

Given the current scenario, initiating discussions on competition at a multilateral level would be beneficial to all stakeholders. However, it might not be necessary to start with the objective of having a multilateral agreement on competition. The goal must be to address the issues mentioned above and evolve an indicative ‘code’ on competition which could guide countries while operating at domestic, regional and multilateral level.

There is a need to realise that competition operates across borders and its intended and unintended effects cannot be restricted by national boundaries.<sup>42</sup> Consequently, the time is ripe to take up competition discussions at multilateral level. Similar sentiments were expressed by experts at CUTS session on the subject at WTO Public Forum, 2015.<sup>43</sup>

Annexure 4.1: Comparison of India's Select Trade Agreements <sup>44</sup>											
Type of provision	Summary of provision	Sri Lanka 1999	MERCOSUR 2004	Singapore 2005	Chile 2006	Afghanistan 2006	SAFTA 2006	Nepal 2009	South Korea 2009	Malaysia 2011	Japan 2011
Objective	To provide/ promote fair conditions of [fair] competition [for trade]	✓			✓	✓	✓		✓		
	Promote cooperation for the effective enforcement of competition laws in each Party										
Investigation of origin of goods	Power to request investigation of origin of goods imported, if such goods compete and upon suspicion that such goods and enjoy preferential tariff without complying with rules of origin		✓								
	Change of conditions of competition to be considered less favourable if such change favours services or service provider of a party over other party			✓					✓	✓	✓
Change of competition conditions for service provider											
Continued...											

*Contd...*

Type of provision	Summary of provision	Sri Lanka 1999	MERCOSUR 2004	Singapore 2005	Chile 2006	Afghanistan 2006	SAFTA 2006	Nepal 2009	South Korea 2009	Malaysia 2011	Japan 2011
Abuse of dominant position by service provider	Monopoly supplier of a service not to act in a manner inconsistent with specific commitments, and not to abuse monopoly position while competing, directing or indirectly, in a supply of service outside the scope of monopoly.  These provisions are applicable to exclusive suppliers where a party (a) authorises or establishes a small number of service suppliers; and (b) substantially prevents competition among those suppliers in its territory.			✓					✓	✓	✓
Consultation and cooperation	Entering into consultations with a view to eliminate business practices of service suppliers which			✓					✓	✓	

*Contd...*

Type of provision	Summary of provision	Sri Lanka 1999	MERCOSUR 2004	Singapore 2005	Chile 2006	Afghanistan 2006	SAFTA 2006	Nepal 2009	South Korea 2009	Malaysia 2011	Japan 2011
	<p>may restrain competition and thereby restrain trade in services</p> <p>The requested party shall <b>co-operate</b> and supply publicly available <b>non-confidential information</b> of relevance, and other information, subject to its domestic law, and other information, upon execution of confidentiality agreement between contracting parties.</p>										
	<p>The parties may enter into <b>consultations</b> regarding select matters, including the elimination, subject to their respective competition laws, of <b>anti-competitive practices</b> that affect trade or investment between the Parties.</p>										
	Cooperation in promotion of fair competition and								✓		

*Contd...*

Type of provision	Summary of provision	Sri Lanka 1999	MERCOSUR 2004	Singapore 2005	Chile 2006	Afghanistan 2006	SAFTA 2006	Nepal 2009	South Korea 2009	Malaysia 2011	Japan 2011
	strengthen cooperation and coordination on competition law enforcement. <b>Consultation between competition authorities</b> on various matters relating to competition, including capacity building, exchange of information, notification procedures and principles of comity.										
	The Parties shall, in accordance with their respective laws and regulations, endeavour to cooperate <b>in the field of controlling anticompetitive activities subject to their respective available resources.</b>										✓
Transfer of technology	A party will not impose or enforce requirement to transfer technology, production process or other proprietary knowledge,								✓		✓

*Contd...*



Type of provision	Summary of provision	Sri Lanka	MERCOSUR	Singapore	Chile	Afghanistan	SAFTA	Nepal	South Korea	Malaysia	Japan
		1999	2004	2005	2006	2006	2006	2009	2009	2011	2011
	except when the requirement is imposed by a court of justice, administrative tribunal or competition authority to remedy an alleged violation of competition laws and regulations										
Measures against anti-competitive activities	Each Party shall, in accordance with its laws and regulations, take measures which it considers appropriate against anticompetitive activities, in order to facilitate trade and investment flows between the Parties and the efficient functioning of its market.										✓
	No restriction to take measure against unfair competition							✓			

*Contd...*

Type of provision	Summary of provision	Sri Lanka 1999	MERCOSUR 2004	Singapore 2005	Chile 2006	Afghanistan 2006	SAFTA 2006	Nepal 2009	South Korea 2009	Malaysia 2011	Japan 2011
	Each Party shall provide for protection against acts of unfair competition										✓
<b>Non discrimination</b>	Each Party shall apply its competition laws and regulations in a manner which does not discriminate between persons in like circumstances on the basis of their nationality.										✓
<b>Procedural fairness</b>	Each Party shall implement administrative and judicial procedures in a fair manner to control anticompetitive activities, pursuant to its relevant laws and regulations.										✓
<b>Transparency</b>	Each Party shall promote transparency of the implementation of its competition laws and regulations and its competition policy.										✓
<i>Contd...</i>											

Type of provision	Summary of provision	Sri Lanka	MERCOSUR	Singapore	Chile	Afghanistan	SAFTA	Nepal	South Korea	Malaysia	Japan
Adoption of competition rules	The parties agree to consider adoption of trade facilitation and other measures, including rules for fair competition, to support and complement the agreement for mutual benefit.	1999	2004	2005	2006	2006	2006 ✓	2009	2009	2011	2011
Source: Asian Development Bank Asia Regional Integration Centre, FTA Comparative Toolkit											

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## Endnotes

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- 13 India-EFTA BTIA, India-Canada CEPA, India-Australia CECA, which are being negotiated by India, cover issues relating to competition, intellectual property and other issues. Kyle Robert Cote and Purna Chandra Jena, *India's FTAs and RCEP Negotiations*, Discussion Paper, CUTS International, September 2015
- 14 Supra note 6
- 15 ETFA states comprises Principality of Liechtenstein, the Kingdom of Norway, and the Swiss Confederation

- 16 Chapter 15 of the Canada Korea FTA is available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/korea-coree/toc-tdm.aspx?lang=eng>
- 17 Text of Canada Honduras FTA is available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/honduras/toc-tdm.aspx?lang=eng>
- 18 The South African Development Community Economic Partnership Agreement group comprises Botswana, Lesotho, Mozambique, Namibia, South Africa and Swaziland. Angola has an option to join the agreement in future. Interestingly, Lesotho does not have a competition regulator as yet
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## CHAPTER 5

# Regulation in Developing Countries: Growing Pains of the Indian Merger Review Regime

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Given the lack of information and institutional weaknesses found in low-income countries, private monopolies are more likely to exploit their position by influencing the regulatory environment or by evading regulation. Weak regulation of competition is likely to undermine the potential gains to be made from privatisation and deregulation.<sup>1</sup>

### Regulation in Developing Countries

An interesting take on competition law in developing countries by Amine Mansour<sup>2</sup> highlights that even enacting such a law can be difficult in a developing country as there will be a vested interest in maintaining *status quo* i.e. the undeserved profits (arising from lack of competition), which the powerful and dominant firms enjoy at the cost of the consumer and the economy. This is, especially likely in the face of the concentration of economic and political power in the same hands. The same clout can make enforcement a very difficult task for competition authorities. Therefore, on one hand, “one of the most important roles for competition law and policy from the perspective of development is tackling the concentration of economic and political power”. On the other hand, it is this very concentration that can also make competition law and policy ineffective in most developing countries.<sup>3</sup>

It is a well-known fact that the regulators in developing countries face several challenges. First is the constant threat of external influence and capture by the regulated.<sup>4</sup> Second is information asymmetries<sup>5</sup> and the third is lack of public support in the face of general ignorance of or indifference towards its mandate.<sup>6</sup> The latter is particularly true of a subject like competition whose impact on everyday lives and economic development is not easily understood by even the intelligentsia in a developing nation.

Theoretical literature on regulatory capture indicates that given the political implications of regulation, economic policy rather than being guided entirely by 'benevolent' planning (or pure *public interest*) would attempt to balance the loss of favour with powerful producers/the regulated (as a result of regulation) with loss of votes from consumers at large (who benefit from regulation). Thus, "regulation (would) typically entail less than 100 percent producer protection but also less than perfect protection of consumers against market power".<sup>7</sup> This also implies that the 'regulatory entry' or intervention is likely to be more politically feasible when there is near monopoly or near perfect competition as in the former case, the 'political gain' from grateful consumers would outweigh 'losses with producers' and in the latter case, marginal loss from angry consumers can be offset by political gains from grateful producers.<sup>8</sup>

This may also explain why action by the competition regulator in cases of abuse of dominance or anti-competitive collusion, where the benefits to the consumers as a class are patently clear, are tolerated better than the enforcement of competition law in merger cases where such benefits are not easily discernible.<sup>9</sup>

An effective antidote to regulatory capture and rent seeking lies in the rule of the law. As eloquently stated by English Philosopher John Locke this means, "*Freedom of men under government is to have a standing rule to live by, common to every one of that society, and made by the legislative power erected in it. . . and not to be subject to the inconstant, uncertain, arbitrary will of another man*". Rule of the law requires not only the static aspect of equality before the law, transparency, certainty, predictability and immunity from arbitrary actions by the state, at present, but also a dynamic aspect wherein "the state.. (is) able to honour (the various facets of) the rule of law tomorrow, even if it experiences turnover in officials".<sup>10</sup>

It has been argued by Weingast, American political scientist and economist that developing countries exhibit the characteristics of a 'natural state', which limits competition in the economy and polity in contrast to those of 'open access' state as seen in developed countries.<sup>11</sup> According to him, rent seeking by powerful entities is inherent to the mechanisms of political-economic stability in a natural state.

Even relatively mature natural states like India, though they have theoretically adopted much of the institutional wherewithal required to establish the rule of the law, still falter, especially on the dynamic aspect of rule of the law.<sup>12</sup> This is on account of the interplay of economic and political incentives in a society like ours, which is still largely 'based on personal (rather than impersonal and hence equal) relations and personal exchange', which are prone to change with shifts in power centres.<sup>13</sup> Thus in such states it is difficult both to implement and sustain institutional and

regulatory reforms'. One such area of reform would be enforcement of competition law and like every other regulator, the competition regulator is also exposed to pressures from powerful interest groups who would resist regulation and push for roll backs when they can.

## **Mergers: Review and Impact**

The recent global financial crisis of 2008 and the recession that followed created a scenario where even developed countries with more firmly established rule of the law, faced to some extent, the regulatory conflicts and political pressures typically encountered in developing nations. In this context, a United Nations Conference on Trade and Development (UNCTAD) paper has stated, “the *crisis* increased pressure on the governments to relax merger control laws and standards of enforcement, on the whole. This presented a major challenge to competition authorities who in certain jurisdictions saw their role sidelined in favour of the pursuit of other often short-term policy objectives...However, succumbing to systematic political pressure to relax competition rules and enforcement can have adverse consequences on competition both at domestic and international levels and delay global recovery”.<sup>14</sup>

The Paper notes, “mergers affect market composition and structure and impact policy areas beyond competition. For example, a large proportion of foreign direct investment (FDI) takes the form of mergers and acquisitions and is often encouraged by governments, particularly in developing countries seeking growth.... Competition Policy, which seeks to regulate and prevent mergers that might have an adverse effect on competition in the market, might clash with such policy objectives. Mergers, therefore, lie at crossroads between industrial, political or economic policy objectives...”. The long-term consequences and inadvisability of interfering with merger review based on short-term policy objectives is succinctly expressed in this Paper.<sup>15</sup>

*“Competitive markets work for the benefit of consumers and efficient firms.... Efficient undertakings benefit from good investments and make profits. During a downturn, firms contract and leave markets in order to adjust to reduced customer spending. Inefficient firms with least attractive products and/or highest costs exit the market, making room for more efficient firms to expand and new firms to enter the market when the economy picks up again. And so the cycle continues; the exit of firms, like their entry, being integral to the market mechanism. Competition law and policy prevents the artificial manipulation of this pattern through firms conspiring amongst themselves to bypass the effects of the market and obtain market power by fixing prices, excluding efficient rivals, merging with significant competitors or receiving discriminatory state subsidies or protection. The emasculation of such laws and policies due to short-term difficult economic circumstances undermines the market mechanism and leads to*

*adverse medium-to long-term consequences. Over time, prices generally increase to the disadvantage of consumers, and product quality suffers as there is reduced incentive to innovate as input costs are lowered.... Another real danger with the approach of setting aside competition policy and merger control rules in exchange for State intervention and industrial policy is that government interventions may simply not work. Regulators often get it wrong and despite good intentions it could be the case that their efforts are in vain.... the relaxation of competition policy and merger control enforcement is usually an inefficient and counterproductive means to achieve economic recovery and in fact may slow the process of economic recovery”.*<sup>16</sup>

Our long and unhappy experience with the ‘License Raj’<sup>17</sup> is often quoted by powerful entities to criticise what they perceive as over-regulation. Yet when it suits them, they are prone to use arguments favouring market distorting protections and exemptions from regulation, disguised in the garb of promotion of public policy objectives, such as promotion of FDI.<sup>18</sup> Such policy considerations, especially when these are not explicitly articulated by law, can adversely affect the transparency and predictability of regulation from a stakeholder viewpoint.<sup>19</sup>

#### **Box 5.1: The Why of Merger Review**

“Mergers consolidate the ownership and control of business assets, including physical assets like plant and intangibles like brand reputation. They can enhance corporate – and wider economic – performance by improving the efficiency with which business assets are used.... Merger policy works *ex ante*: it seeks to restrain those mergers, which, if allowed to go forward, would likely reduce competition. This contrasts with prohibitions on anti-competitive agreements and abuses of market power. Such prohibitions operate *ex post* in as much as they penalise unlawful past actions but also operate *ex ante* via their deterrent effect. Without merger control, the risk of breach of competition law prohibitions would arguably be greater. But why is merger policy required? Why not rely on the laws against such breaches rather than intervening in mergers beforehand? There are two main points.

- (1) Mergers eliminate any competition that exists between the merging parties and reduce the number of firms competing in the market. Where this reduction has a substantial effect on overall market competition, the market will be less oriented to consumer and efficiency goals, even in the absence of breaches of competition law. Acquiring business through successful competition for custom in the marketplace is one thing; acquiring business through merger is another, at least when competition is jeopardised.

- (2) The enforcement of competition law prohibitions is imperfect. Detecting and proving infringements of the prohibitions is difficult. The need to rely on those laws is reduced by maintaining competitive conditions, so that the incentive and opportunity for collusion, abuse of market dominance, and other infringements are prevented from arising, at least in so far as they result from mergers. Further, even where structural remedies are available *ex post*, there can be high economic costs of disentangling a transaction where the merged entity has subsequently been found to harm competition.<sup>20</sup>

### The Growing Pains of India's Merger Review Regime

India's merger review regime<sup>21</sup> is hardly four years old and has been praised for its efficiency and rapid progress. While only two cases have been subject to remedies following a Phase II investigation, so far<sup>22</sup> there have in fact been a number of cases, where the Competition Commission of India (CCI)<sup>23</sup> has obtained voluntary commitments or clarifications from parties to allay possible competition concerns and consequently made its order conditional on certain behaviour.

There are stringent timelines set out for CCI wherein it must decide even a complex merger within 210 days from its notification to the regulator. This includes completing gaps in notification,<sup>24</sup> which are frequently plentiful partly on account of tight deadlines for notification that India's Competition Act<sup>25</sup> enforces on filing parties<sup>26</sup> and partly because there is a tendency to give the regulator as little information as possible. The regulator is in fact made to jump through several hoops before a complete picture of the competitive significance of the transaction emerges. In the absence of requisite market related information forthcoming from parties or where the case specifics so demand information must be obtained from third parties.<sup>27</sup>

The regulator's efforts to do its job in the face of these obstacles is not helped by constant pressure by way of vested interests projecting the regulator's labours as being unnecessary or deliberately obstructive or anti-industry. Informal discussion with competition authorities of other jurisdictions has revealed that their competition lawyers have over the years played a critical role in understanding the requirements of merger filing and educating their clients in this regard.

Similar efforts on the part of lawyers in India would go a long way in improving the efficiency of merger review and would constitute an important contribution towards competition advocacy. As of now, interaction with merging parties often reveals that they are completely unaware of prescribed

filing requirements and their significance and the manner in which mergers are reviewed by a competition authority. Given the relative newness of merger review regulation in India, Indian law firms have been and must continue to focus on educating their clients and encouraging them to file combination cases correctly and efficiently.<sup>28</sup> By actively encouraging compliance, they would be assisting the CCI in its mission to build a pro-competition society and economy. While a competition authority might make valiant attempts to educate the public at large, it is managing the pressure exerted by vested interests (dominant firms and their agents) that is, particularly challenging. Advocacy by CCI and competition lawyers in India has a critical role in building a compliance culture.

It is in fact very difficult for a young competition authority struggling to progress on a steep learning curve and stymied by resource availability, to counter powerful forces who lobby privately and in the media, often attempting to disparage the competition authority's efforts to carry out its mandate. Grey areas or lack of legal clarity are often quoted as deterrence to compliance but ironically, attempts by the CCI to make the rules explicit are not always welcomed. Literature on regulation suggests that such resistance arises as the fewer the ambiguities, the lesser is the discretion available to the regulators to interpret the rules differentially on a case by case basis. Explicit regulation limits the scope for powerful entities to have their way. Paradoxically, studies on developing countries strongly recommend a clear-cut, rule based (relatively mechanistic) approach to regulation in order to cope with imperfect regulatory capacities and the threat of capture and external pressures.

In this context, it is heartening that the stakeholders have responded positively to CCI's recently introduced set of amendments to merger regulations.<sup>29</sup> These have in fact been appreciated for bringing in much needed clarity on notification requirements. There are a number of overtly industry-friendly changes to regulations by way of expanding the ambit of the authorised signatory<sup>30</sup> and reducing the scope of what constitutes a trigger for notification of a combination in terms of communication of intent about a combination to certain categories of institutions.<sup>31</sup> These were introduced taking into account views expressed by stakeholders in various fora including meetings held with competition lawyers.<sup>32</sup>

A common demand that emerged from such interactions was to make filing, requirements, more clear and thereby to reduce subsequent requests for information. The recent amendments do just that and the response has been positive. It has been generally accepted that explicit instructions on filing including unambiguous description of information requirements can help expedite merger review and avoid subsequent requests for information that the regulator is often compelled to resort to on account of vague,

hurried, careless or deliberately evasive notification of the deal<sup>33</sup>. The notification formats are made for the typical combination case. There would be outliers that do not require a similar level of detail. This problem is solved in mature jurisdictions through pre-filing consultation (PFC) on merger filing. CCI too encourages merging parties to seek advice on procedural and substantive issues relating to filing with an assurance of confidentiality.

The rationalisation of self-imposed regulatory time lines for forming a *prima facie* opinion on a merger<sup>34</sup> must be viewed against the above-mentioned constraints as also in the context of vast differences in the design of similar regulation in other jurisdictions. Indian statutory provisions compel merging parties to notify a transaction to the CCI within 30 days of specified trigger events. Perhaps this explains why in spite of the availability of a window for confidential pre-filing consultation<sup>35</sup> on how to notify, including vetting of draft notices, the same has rarely been availed by merging parties. Competition agencies in jurisdictions like the European Union (EU) iron out most of the information requirements in detailed pre-notification consultations, making it easy to adhere to statutory deadlines, as by the time the notice is filed, it has been already been vetted by the regulator in detail (a process that might run into months).

Further, for the CCI, the deadline of 210 days from the date of notification runs non-stop under the Act unlike many other jurisdictions wherein time elapsed under statutory deadlines is counted only from the day that complete information (to the satisfaction of the regulator) is received.<sup>36</sup> For complex mergers that go into detailed investigation (Phase II), the statutory time line of 210 days has always been counted without taking into account Phase I clock stops.<sup>37</sup> This is a significant difference. While the time limit was introduced in the Indian statute to allay industry's fears over regulatory delays by industry. Unfortunately, this loud and relentless ticking of the clock could also be gamed by the regulated to stonewall the regulator's attempts to obtain required information, knowing well that there is only so much time available to the regulator before it must issue its order.<sup>38</sup>

The power to invalidate a notice was always available under the Combination Regulations. The first notices to be invalidated date back to 2011-12.<sup>39</sup> Greater clarity on what needs to be notified, coupled with a clearer enunciation of the modalities of exercise of this power, should inspire better notification and act as a deterrent to the above-mentioned gaming. Needless to say, the regulator is unlikely to invalidate a notice on frivolous grounds.<sup>40</sup> Yet a good amount of negative attention was focussed on this issue. This is surprising considering that other Indian regulators, such as the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) do not allow themselves to be bound by incomplete submissions either. Further, annulment of incomplete notices is also carried out in advanced



jurisdictions like the EU, apart from penalising firms for incomplete/incorrect information in the notice.

For example, highlighting the importance of providing correct and complete information in prescribed format, in the case of DeutschBP/Erdölchemie,<sup>41</sup> the European Commission (EC) held, “The Form CO (prescribed notification format) requires the parties to submit a complete and comprehensive set of information including all aspects relevant for the assessment of the concentration” and that, “A complete Form CO with comprehensive information is of crucial importance for the Commission’s merger control procedure, *inter alia*, due to the tight legal deadlines the Commission is required to meet in these procedures, and the notifying parties must be aware of this importance. The internal provisions set up within the notifying party for the preparation of the Form CO have to reflect this high importance of a complete notification. Consequently, the party has to organise its internal procedures with the highest care to ensure that the legal duties and requirements under the Merger Regulation are communicated to all relevant units, and that all relevant information is identified and supplied in the Form CO. The fact that in the present case information was missing in three different areas revealed imperfections in the procedures applied by BP and Deutsche BP in this instance, which led to submission of an incomplete Form CO” (emphasis supplied).<sup>42</sup>

It was further observed by the European Commission (EC), “the Commission takes the view that the infringement is of considerable gravity. The notification is the basis and the starting point of the Commission’s investigation of a merger case. It determines to a large extent the approach of the Commission towards the case and the areas and focal points of its investigation. Incorrect and misleading information creates the risk that important aspects relevant for the competitive assessment of the transaction are neither investigated nor analysed by the Commission, and its final decision consequently is based on incorrect information. In assessing mergers, the Commission is subject to extremely tight deadlines. In this framework, it is essential for the Commission’s work that it can focus its investigation on the relevant issues from the very beginning of the procedure, based on comprehensive and correct information provided in the notification”.<sup>43</sup>

CCI’s experience has been that in the past, there was a tendency to take filing very casually and an expectation that the regulator should make good even huge gaps in information through post notification correspondence, even in case where the notice clearly flouts the rules. This is a terrible and unfair waste of regulatory resources, which comes at the cost of other parties whose cases might get delayed as a few cases drag on, due to careless filing. Further, as pointed out both above, both in the Indian and



the international context, complete and correct notification is critical, given that merger review is to be carried out in a time bound manner. The recent amendments as they bring clarity to notification requirements as well as grounds for invalidation, are a step in the right direction.

Apart from incomplete notices, the CCI faces many other hurdles even as it strives to process cases for early approval. There have been cases where in spite of obviously high combined market shares, notices are filed in the shorter Form I, which becomes an inadequate basis for review. Then there is the problem of deliberately widely defined relevant markets.<sup>44</sup> In cases where the market for say, groceries or retail banking is defined at national-level and consequently, basic information on market sizes and shares required for a meaningful review of the competition impact of the deal is missing. This invariably leads to requests for information, which is not always forthcoming as promptly as it should.

The industry tends to complain about CCI's information requirements. Given the newness of India's merger review regime, the CCI might not at present have the kind of in-house capacity in terms of experience and data that helps mature regimes fast track cases. For some time to come, merging parties would be the primary source of information about not only the contours of their deal, but also their business and sector. Thus in present times, speedy review requires that parties are forthcoming in providing the prescribed information needed for competition assessment.

A day might come when, given its own depth of knowledge of industry and the players involved, the CCI reduces the notification format for most mergers to a page. Until then, the industry would need to bear with the regulator and comply. Interactions with counterparts in mature regimes has revealed that they have followed a similar path. However, in spite of with their longer experience and established jurisprudence, even today, they stand firm on information requirements and can be far more intrusive than CCI has ever been.

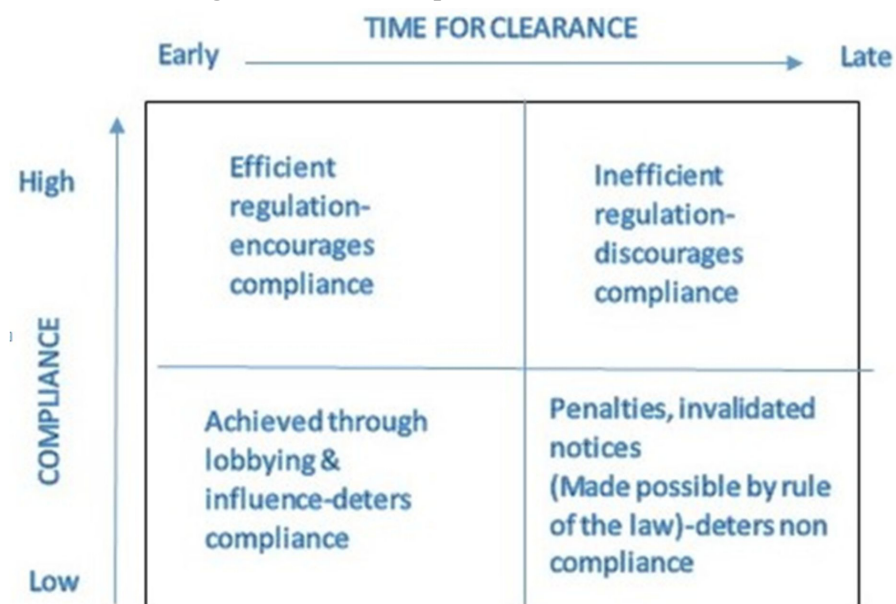
### **It Takes Two to Tango**

Finally, a much wanted notion is that strict regulation would deter investment. Suffice to say, this is not true because if that were the case, developed countries would attract the least investment. The consequences of diluting scrutiny afforded by competition law have already been discussed above. However, this initiative is about efficient regulation, not the lack of scrutiny. It is heartening to take note of reports that suggest that even as the Government is actively encouraging speedy clearances and rationalisation of rules across the board, "access of big business to upper echelons of

government has declined dramatically”.<sup>45</sup> Effective regulation is about clarity and efficiency not about leniency, lobbying and rent seeking.

Thus, coming back to where we started out, what is needed for long-term economic growth is effective and a credible regulation. This necessitates that rules are explicit rather than ambiguous and that they are applied fairly across the board and upheld by the rule of the law. This would enhance trust and encourage compliance. When fear of delays and harassment are removed, compliance is no longer a deterrent to investment. This is explained in the matrix below, which maps the combinations of low vs high compliance and possible outcomes in terms of early and late clearance and the along with the impact on future compliance.

**Figure 5.1: The Compliance Outcomes Matrix**



To digress a bit, as Indians we are often entranced by the peaceful queues we encounter in the developed world. There is hardly any fidgeting or impatience on part of the queuing public. A typical example of this admirable discipline is the calm queuing seen in crowded metro stations during rush hour. This is possible on account of the credibility of the system. The waiting public is confident that while on one hand, breaking the queue will be frowned upon universally, on the other, they will definitely be able to obtain the awaited service, when it is their turn.

The Indian queue, on the other hand, is almost invariably broken by the public and not strictly enforced by the authorities. Therefore, waiting creates a gnawing anxiety and impatience arising out of uncertainty. This is exactly replicated in our approach towards compliance to rules as a nation. We are unsure about the significance of the rules and compliance requirements and are doubtful about the efficient, equal and impartial application of the rules. We are also acutely conscious of the possibility of our own or another's ability, given the laxity of the system, to jump the queue or bend the rule. This makes us reluctant to adhere to rules or patiently await our turn. This inspires a culture of trying to get around the system and to influence it.

For the system to work, the efficiency and impartiality of the authorities/regulator, must be coupled with willingness on the part of even powerful stakeholders to comply equally (rather than expecting to be treated preferentially). This combination exists in the developed world and has proven to be more conducive to a healthy investment environment than an easygoing approach to regulation. The compliance culture of the advanced nations arises from efficient implementation of regulation coupled with strong deterrence by way of punishment for both non-compliance by the regulated and complicity on the part of regulators.

Such a system when firmly and consistently enforced in a merger review regime would also enhance trust and reduce the anxiety on the part of merging parties much like the queuing public. The regulator on its part should continue to make rules of the game clearer as it gains experience. It should also continuously build capacities to meet the valid stakeholder demand for speedy merger review. This would lead to outcomes that are positive, both for the investment environment in the country and for the consumer who is the ultimate focus of competition regulation.

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## Endnotes

- 1 Paul Cook, Paper No. 2, "Competition and its regulation: key issues," Centre on Regulation & Competition, University of Manchester, October 2001.
- 2 Amine Mansour "The Concentration of Economic and Political Power, A Priority for Competition Law and Policy in Developing Countries?" , [http://www.cuts-ccier.org/pdf/reguletter\\_Jan-Mar2015.pdf](http://www.cuts-ccier.org/pdf/reguletter_Jan-Mar2015.pdf)
- 3 *Ibid.*
- 4 "The 'capture' of a regulatory body by the firms it is supposed to discipline. This implies influencing the regulator through various means including both bribes (including post retirement employment )as well coercive inducements, such as (a) spreading negative (career damaging) rumors about the regulator or (b) through open confrontation, which may destabilise a regulator as it would impact government support to the regulator. The stronger the 'rule of the law' in a country and the less likely are such inducements to work. The ability to capture regulators through lobbying reduces incentive of regulated firms to comply with regulation and to compete in the market through productivity & efficiency rather than rent seeking, thereby imposing a social cost (from, "Regulatory capture: a review, Ernesto Dal Bo, Oxford review of economic policy, Vol.22,No.2).
- 5 Whereas the regulated firm has insider knowledge of its operating environment, the regulator lacks the same (from "Leading Issues in Competition, Regulation, and Development", edited by Paul Cook).
- 6 Advocacy and increased consumer awareness can mitigate the harmful effects of regulatory capture as consumer groups who are beneficiaries of regulation and potential voters can then act as counter power.
- 7 *Ibid.*
- 8 *Ibid.*
- 9 This is apart from the fact that the anti-competitive outcome of market power is already manifest in such cases unlike *ex ante* analysis in merger review which work on the likelihood of such an outcome. See also "The Why of Merger Review" in part II. This may also *inter alia* explain the threat of regulatory intervention in areas such as internet services in spite of the obvious benefits of healthy competition (See for e.g., Archana G Gulati, "The Net Neutrality Debate in the Indian Context, with a Pinch of Salt," at: <http://circ.in/pdf/Net-Neutrality-India-Debate.pdf>)
- 10 Barry R Weingast, "Why Developing Countries Prove So Resistant to the Rule of Law," Working Paper No. 382, Stanford Center for International Development, March 2009 at: <http://scid.stanford.edu/publicationsprofile/1933>
- 11 "The open-access state ...relies on competition, open access to organizations, and institutions [to maintain order], and is characterized by rent-erosion and long-term economic growth. " It is based on impersonal relationships and impersonal exchange. Most developed countries fall in this category.(*ibid*)
- 12 "No matter how attractive are today's institutions or rights, they are no good in the long-term if tomorrow's regime can alter them at will. This issue is

intimately tied to the issue of creating a perpetually lived state, a state whose characteristics and institutions do not depend on the identity of leaders or dominant coalition.”(ibid)

- 13 “Relationships in natural states are personal relations; specifically, relationships among members of the dominant coalition are personal: they depend on the identities of the individuals. How the natural state treats an individual – his rights, privileges, rents, and duties – depend on his individual identity, so these rights, privileges, rents, and duties typically differ across individuals.” (ibid)
- 14 “The role of competition advocacy, merger control and the effective enforcement of law in times of economic trouble,” UNCTAD note TD/RBP/CONF.7/6 dated August 26, 2010.
- 15 (Also see the Why of Merger Review (Box 1)).
- 16 *Ibid.*
- 17 The Licence Raj or Permit Raj (raj, meaning “rule” in Hindi)[1] was the elaborate system of licences, regulations and accompanying red tape that were required to set up and run businesses in India between 1947 and 1990. From [https://en.wikipedia.org/wiki/Licence\\_Raj](https://en.wikipedia.org/wiki/Licence_Raj)
- 18 These are used to override competitive review of mergers entailing foreign investment.
- 19 Unless explicitly built into the law, entertaining such considerations is likely to encourage lobbying or rent seeking.
- 20 “The Analytical Framework For Merger Control”, Final paper for ICN annual conference, Office of Fair Trading, London at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc333.pdf>
- 21 Under Sections 5 and 6 of the Competition Act, 2002 a proposed merger or acquisition (combination) meeting prescribed thresholds, must be filed with the Competition Commission of India (CCI) for review (as to whether the combination is likely to cause an appreciable adverse effect on competition (AAEC) within the relevant market in India.) For simplicity, either the terms merger/combination are being used in this paper to signify combinations.
- 22 Unlike cases where the Commission believes that there is no likelihood of an appreciable adverse effect on competition (and whose review ends in Phase I itself); in cases where the Commission is of the [prima facie] opinion that a combination is likely to cause, or has caused an appreciable adverse effect on competition within the relevant market in India, it carries out a detailed investigation into the combination (taking the case to Phase II). Till date the Commission formed a prima facie opinion that appreciable adverse effect on competition (AAEC) is likely to arise in 3 cases (Notifications with registrations numbered 164, 170 and 190). In Case No. 164, voluntary modifications were accepted by the Commission and Phase II inquiry was therefore not required. However, in the other two cases, detailed inquiries were carried out (Phase II) and structural remedies imposed on the parties to the combination. Case No. 170 related to the merger of Ranbaxy Laboratories Ltd. into Sun Pharmaceuticals Industries Ltd. On the basis of combined market share of the Parties, incremental market share as a result of the proposed combination, market share of the competitors, number of significant players in the relevant

market, etc., the Commission focused its investigation on 49 relevant markets for formulations where the proposed combination was likely to have an appreciable adverse effect on competition in the relevant market in India. In addition to these relevant markets, the Commission also investigated two pipeline products of Ranbaxy and possibility of any vertical foreclosure in the market for active pharmaceutical ingredients (APIs). On the basis of its assessment, the Commission decided that the proposed combination is likely to result in appreciable adverse effect on the competition in India in relevant markets for seven formulations; however such adverse effect can be eliminated by suitable modification. The Commission thus approved the proposed merger between Sun Pharma and Ranbaxy, with modifications, under Section 31(7) of the Act, subject to the Parties *inter alia* carrying out the divestiture of their products relating to seven relevant markets for formulations as detailed in table below. Further, the Commission also directed that the proposed merger shall not take effect before the Parties have carried out the divestiture of the products so specified as per the order of the Commission. The other case (bearing registration No. 190) relates to the cement sector and to the global acquisition of Lafarge by Holcim wherein finding AAEC concerns in the market for grey cement in the Eastern region of the country, the Commission has directed the divestitures of two plants of the parties in this market.

- 23 The Indian Competition regulator.
- 24 The initial filing of information about the combination (merger or acquisition) by the parties to the combination, in prescribed format.
- 25 Competition Act, 2002 at: <http://cci.gov.in/images/media/Advocacy/CompetitionAct2012.pdf>
- 26 Parties must file within 30 days of occurrence of defined trigger events.
- 27 This is also never easy as many a times consumers, competitors and government bodies take a long time to respond.
- 28 Supra note 21
- 29 These are available at: <http://www.cci.gov.in/May2011/Home/regulation/gjuly2015.pdf?phpMyAdmin=NMPFRahGKYeum5F74Ppstr7Rf0>
- 30 An amendment that allows any person duly authorized by the parties to sign a combination notice as against only a few key managerial personnel permitted to do so earlier.
- 31 Regulation 5(8) of the combination regulations.
- 32 The Combination Regulations came into force on June 2011.  
([http://www.cci.gov.in/sites/default/files/regulation.pdf/CCI\\_Combinations\\_Regulations\\_2011\\_11\\_05\\_2011\\_0.pdf](http://www.cci.gov.in/sites/default/files/regulation.pdf/CCI_Combinations_Regulations_2011_11_05_2011_0.pdf))

The subject matter of earlier amendments includes both introduction of exemptions as well as tightening notification requirements to prevent parties from structuring deals in a manner that evades notification. The ultimate aim is to make the rules clearer and provide certainty to merging parties. Thus, the February 2012 amendments included *inter alia* raising the bar for exemptions under Item 1 of Schedule 1 under Regulation 4 of Combination Regulations from 15 percent to 25 percent and including intra group mergers as a category of combinations that are ordinarily not notifiable under this Schedule. At the same time a regulation was introduced for attribution of value of assets and

turnover of transferor company to transferee company (in cases where assets are transferred for effecting a transaction), while reckoning assets and turnover for the purpose of meeting thresholds under Section 5 of the Act. ([http://www.cci.gov.in/sites/default/files/regulation\\_pdf/feb%202012\\_0.pdf](http://www.cci.gov.in/sites/default/files/regulation_pdf/feb%202012_0.pdf)). In the April 2013 Amendments additional exemptions under Schedule 1 were introduced to allow creeping acquisitions of up to 5% where the acquirer holds more than 25% but less than 50% shares or voting rights in a company. Further clarity was provided also in respect of intra group mergers and acquisitions. ([http://www.cci.gov.in/sites/default/files/regulation\\_pdf/april%202013\\_0.pdf](http://www.cci.gov.in/sites/default/files/regulation_pdf/april%202013_0.pdf)). In the March 2014 amendments it was provided *inter alia* that the requirement of filing a notice shall be determined w.r.t the substance of a transaction and structuring of transactions having the effect of avoiding notice shall be disregarded and further clarity on notification requirements was introduced w.r.t filing requirements. ([http://www.cci.gov.in/sites/default/files/regulation\\_pdf/march%202014\\_0.pdf](http://www.cci.gov.in/sites/default/files/regulation_pdf/march%202014_0.pdf))

- 33 Some of the comments are available at (a) <http://www.kpmg.com/IN/en/services/Tax/FlashNews/Amendments-to-Combination-Regulations-under-the-Competition-Act-2002-1.pdf> (“The amendments could provide greater clarity and transparency in the filing of applications. Specifically, the issuance of Guidance Notes to Forms could go a long way in clarifying various ambiguities, which were faced by the applicants.”) and (b) [http://thefirm.moneycontrol.com/story\\_page.php?autono=1829801](http://thefirm.moneycontrol.com/story_page.php?autono=1829801) (“While the changes will certainly lead to filings being more tedious and may delay transaction timelines, the CCI must be appreciated for bringing in more transparency and certainty to its procedures. This may actually prevent the regulator from ‘stopping-the-clock’ during its review process, which had become the norm rather than the exception”.)
- 34 From 30 calendar days to 30 working days to provide sufficient time for review under Phase I.
- 35 <http://www.cci.gov.in/May2011/Home/ConsultationPrior250511.pdf>
- 36 Competition authorities in Singapore, Canada and USA follow this rule.
- 37 Regardless of the fact that these clock stops are afforded by the regulation referred to as Combination Regulations
- 38 Please see in this regard K K Sharma, “Counter Point-II Jet-Ethihad combination approval in Combination Registration No. C-2013/12/144, *Competition Law Reports*, Manupatra, September 2015.
- 39 Out of a total about 315 notices received so far, only 10 have been invalidated for improper filing that is not in accordance with the Act and/or regulations. The reasons for invalidation include *inter alia* not meeting thresholds, all interconnected transactions not being filed, failure to provide information on markets where there are overlaps, filing in Form I instead of Form II etc.
- 40 Cases COMP/M.2345 and M.2624 *BP/Erdölchemie*.
- 41 *ibid*. In this case, the European Commission imposed a fine of •35,000 on Deutsche BP AG for negligently providing incorrect and misleading information in relation to the acquisition of German chemicals producer Erdölchemie GmbH. In its notification, the company failed to indicate several relevant elements as

regards the market for acrylonitrile (ACN), a chemical used for the production of acrylic fibres, plastics and nitrile rubber.<sup>42</sup> After BP supplied the missing information, the European Commission was able to complete its inquiry and finally cleared the transaction on April 26, 2001. In its response to the European Commission's Statement of Objections under Article 14 of the ECMR, BP had argued that "[t]he omissions are mainly a result of internal communication and co-ordination problems and are related to the participation of several individuals from different BP units and from outside BP at the preparation and the drafting of the notification"<sup>43</sup> and that "the incompleteness is not due to an organisational negligence, but to an exceptional set of unfortunate circumstances in an isolated case".

44 *Ibid.*

45 So as to project market shares as being low.

46 Tom Lasseter, Kartikay Mehrotra, "In Narendra Modi's India, billionaires and business lean their place", at: [www.livemint.com/Politics/RFfQb5jJrrDHtMtXe5yCUL/In-Modis-India-billionaires-and-businesses-learn-their-pla.html](http://www.livemint.com/Politics/RFfQb5jJrrDHtMtXe5yCUL/In-Modis-India-billionaires-and-businesses-learn-their-pla.html)



## CHAPTER 6

# Competition and Regulation in Higher Education in India

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### Introduction

In the coming years India is looking forward to a huge increase in enrollment in higher education because of several reasons. In the next decade India will experience enormous growth in its middle classes from 50 million in 2014 to about 500 million by 2025.<sup>1</sup> Given that the relationship between economic growth and growth in the tertiary enrolment ratio (the percentage of total enrollment, regardless of age, in post-secondary institutions to the population of people within five years of the age at which students normally graduate high school) is particularly strong for economies with low levels of per capita gross domestic product (GDP), one would expect a huge number of first generation learners to demand higher education in the near future.

Demographic change is another reason why there would be an increase in demand for enrollment. More than 50 percent of the Indian population is under the age of 25. By 2020, India would have one of the youngest populations in the world, with an average age of 29. Because of greater access to secondary education and improved retention rates one should expect the demand for higher education to go up with this demographic change.

Therefore, the greatest challenge before India's education planners is to expand the education system without sacrificing excellence. This can be done by increasing competition in the quality space and through entry of new providers, with such entry regulated so that low quality providers do not even temporarily enter the higher education sector. Competition in the quality space would push quality up while entry would be associated with a scaling up of private higher education.

Scaling up is also vital because higher education is also characterised by network externalities, not assumed to be present in the standard model of the competitive market.<sup>2</sup> The presence of network externalities implies the

satisfaction that a consumer of higher education gets is increasing in the total number of consumers of higher education. This means that more common is the provision of higher education the greater is the value added realised by a consumer of higher education. Thus, any increase in the number of consumers at the margin not only implies that there is a value added at the margin but it also means that there is an increase in value added for the non-marginal consumers. An increase in the number of consumers thus expands the cake of value added from higher education more than proportionately.

Competition in the quality space would imply that excellence would continue to be pursued. Thus, there would be joint generation of network externalities and excellence. However, a strong impediment to effective competition in the quality space is asymmetric information. By asymmetric information we mean that parents and prospective students do not have the same information about the quality of education being provided that education providers themselves have.

If consumers of higher education are deficient in information regarding the mentioned quality then effective competition in the quality space among higher education providers does not materialise. This is because parents/students do not have the requisite information to distinguish between high quality and low quality providers; given this fact, there is no incentive for providers to compete in the quality space. To redress the asymmetry in information, which is assumed to be absent in standard models of perfect competition, an accreditation authority which provides accurate information on the quality of education is very necessary.

The plan of this chapter on higher education is inspired by the two mentioned features of network externalities and asymmetric information and their implications. The presence of network externalities in higher education coupled with the rising demand for education fueled by economic and demographic change implies that it is imperative that regulations do not unnecessarily discourage entry by new providers in the higher education sector. Accordingly, regulations in the higher education sector will be examined for precisely this property. The asymmetric nature of information implies that effective competition in the quality space is impeded – there is a need for removing the asymmetry through an effective accrediting body. Accordingly, the accreditation authority in India in regard to its effectiveness will be examined.

But to begin with, there is need to examine the higher education network as it stands at present. This chapter will shed light on the qualitative and quantitative spread of higher education. The discussion will be largely based on the study by Centre for Civil Society (2014).<sup>3</sup>

## Spread of Higher Education in India

India has one of the largest educational systems in the world. In fact the number of students enrolled is the second highest after China. The higher educational institutions in India are of two types – degree granting and non-degree granting institutions. The number of degree granting institutions has increased from 103 in 1970-71 to 692 in 2013-14. This amounts to a six and a half fold increase at a compound average annual growth rate of 5.94 percent per annum. Out of the 692 degree granting institutions at present 117 (16.9 percent of the total number of institutions) are deemed to be universities,<sup>4</sup> 170 (24.56 percent) are private universities,<sup>5</sup> 311 (44.94 percent) are state universities,<sup>6</sup> 43 (6.2 percent) are Central Universities<sup>7</sup> and 52 (7.51 percent) are institutes of national importance. The number of non-degree granting institutions has seen a comparable growth rate of 5.6 percent between 1970-71 and 2011-12. In 2012 there were as many as 33023 colleges in India – of these 19630 were private colleges (59.4 percent of the total number of colleges); 13014 were state colleges (39.4 percent) and the rest (669 or 0.2 percent) were central colleges.

Thus, private institutions accounts for a quarter of degree granting institutions and as much as almost two-thirds of non-degree granting institutions. This fact points to a fair amount of private competition in higher education. In fact, the role of private institutions has been increasing in recent times. In 2001, enrollment in unaided private higher education institutions as a percentage of total enrolment was 32.90 percent; in 2007 that share had increased to 54.20 percent; and finally in 2012 the share reached 58.90 percent.<sup>8</sup>

A noticeable trend has also been an increase in the number of self-financed programmes in state aided institutions – colleges and universities. An example is Mumbai University where these courses have grown exponentially since their launch in 2000. The university presently has 80,000 seats in various self-financing undergraduate programmes.<sup>9</sup>

Another remarkable feature of the higher education system is the recent rapid increase in enrolment. During the 11th Five Year Plan Period (2007-12) the Gross Enrolment Rate (GER) increased from 15 to 17.9 percent. This implies that the network facilitated by higher education has expanded giving rise to a higher level of network externalities.

Rapid growth in the number of institutions through the private route is also seen in the case of engineering colleges and polytechnics. Before independence the growth of engineering colleges and polytechnics in the country had been very slow. However, two factors resulted in the growth of these institutions after independence: efforts taken during successive five

year plans and policy changes in the 80s which allowed private and voluntary organisations to set up technical institutions on self-financing basis.

In 1947, there was a total of 44 engineering colleges in the country of which 42 were 'government and aided' and only 2 were 'private unaided'. By 1980, there had been a more than threefold increase in the number of engineering colleges – the total had gone up to 157 with 142 belonging to the 'government and aided' category and 15 belonging to the 'private aided' category. Thus, between 1947 and 1980 the proportion of engineering colleges that was private had gone up from 5 to a still low 10 percent. It was only after 1980 that the picture began to change with the setting up of private engineering colleges far outstripping that of government ones. By 1990, the total number of institutions had gone up to 309 – as many as 145 (46.9 percent) were private.

In 2000 the shift was even more dramatic: out of a total of 669 institutions as many as 467 (69.8 percent) were private. By 2007 there was a veritable flood of private institutions – their number had reached 1402 (86.7 percent) as compared to only 215 government institutions. Even beyond 2007 there has been a rapid growth of engineering colleges: between 2006 and 2013 the intake in technical institutions has increased by almost 200 percent while the number of technical institutions has increased by almost 90 percent in the same period.

Next section will look at regulations in higher education and examine as to whether they discourage entry, particularly by private players

### **Regulations in Higher Education in India: An Analysis**

The discussion in this section is again based on the account of regulations in higher education contained in the study by Centre for Civil Society (2014).

The regulatory constraints in higher education are seen to be a roadblock in achievement of the GER target of 23 percent. The final chain in delivery of higher education is the classroom. In a large majority of cases this final chain of delivery is housed within an affiliated college which is bound by the affiliating university regulations. Depending on the course being taught in the classroom the regulations of the professional Council responsible for the course also come into play. Also in play are the regulations binding the affiliating university, i.e. the Central and State Government Acts responsible for setting up of the university and the regulations of the UGC.

Thus, consider a college X offering a course Y in the classroom. Let the college X be affiliated to a university Z. Then the university Z's regulations

will bind the teaching of the course. Let the professional council U be responsible for the mentioned course Y in general. Then the regulations of U will also bind the teaching of the course Y in college X. Thus, to summarise three sets of regulations will bind the teaching of the course Y in college X – the regulations of the affiliating University, those of the concerned professional Council and the regulations embedded in the Central/ State Act responsible for setting up of the university. Each set of regulations contains within it some barriers relating to entry. These barriers, if unjustified, unnecessarily block the spread of higher education.

### ***Regulations Governing the Setting Up of Private Universities***

The UGC regulations 2003 govern the setting up and regulation of private universities. They require a university to be set up through a separate act rather than an executive order. The UGC regulations also restrict the jurisdiction of a private university to the state in which it has been incorporated. Over the last two decades several states have taken up the task of setting up private universities zealously.

Critics point out that the legislative route to setting up a private university is inappropriate. The legislative route is adopted so that a university is set up only after a free and fair discussion among MLAs has ratified it. However, the efficiency of the legislative route is severely constrained by the fact that state legislatures function quite poorly: a ten year trend in Rajasthan shows that the state legislature sits on an average for 28 days in a year; 22 is the corresponding figure for Delhi. Second it is seen that bills are passed in the State legislature after little discussion. For example, in the Delhi assembly the average discussion time for the passing of a bill is a little over half an hour. Many a time a bill is introduced and passed in the assembly on the same day – thus, there is no chance for the MLAs to absorb the meaning of the legislation they are passing.

Given the existing inadequacies of the legislative route, setting up an executive facilitated scrutiny process for examining the applications for setting up of universities would be far more appropriate and less fraught with delays.

Some states have passed an Umbrella Act specifying in detail the process and requirements for establishment of a private university. In such states each time a private university is set up a separate act is passed or the establishment is ratified under the auspices of the Umbrella Act by appending to a list of universities. In states where there is no Umbrella Act such as Uttar Pradesh each private university is established through a separate act. Below are discussed some of the requirements, laid down by acts, that have to be met by the private universities:

- 1) Not-for-profit-nature: Anyone who wants to set up a private university has to do it through a non-profit entity – a society, trust or a Section 25 company.<sup>10</sup> However, while these entities are all apparently ‘not-for-profit’ many of these actually are in reality profit making. That said, the not-for-profit nature of higher education creates significant roadblocks in raising finances. Given that the equity route for raising finances is not open because of the required ‘not for profit nature’ finances have to be raised through loans from banks. However, banks treat educational institutions on par with other profit making concerns and charge interest rates that are too high.
- 2) Land norms: There is often a requirement for the establishing entity to have possession of a minimum acreage of contiguous land. For example, Uttar Pradesh had the requirement of 50 acres of contiguous land for Amity University. Generally the establishing authorities plan universities near cities where it is difficult to get contiguous land. Many of them, therefore, have to undertake land acquisition through the government route and the related process is often very lengthy. For example, a university in Haryana took nearly three and a half years to acquire land and begin construction. The discussion shows that existing land norms for establishment of a private university constitute high entry barriers and need to be revisited, especially the requirements for contiguity.
- 3) Prior experience and expertise: Rajasthan and Haryana have a requirement for prior experience and expertise in education. This clause itself restricts competition from new players. A survey of stakeholders has shown that the states are often willing to waive off this clause if the potential founders of the university seem genuine. However, given that waiver is discretionary it creates opportunities for rent seeking.
- 4) Justification for establishment: Rajasthan and Haryana have a clause that requires the founding body to justify the establishment of the private university in the Project Report that has to be submitted to the government. Such a requirement increases the potential of rent seeking.
- 5) Endowment Fund: A minimum requirement of Endowment Fund has been specified in each of acts of three studied states, Rajasthan, Haryana and Uttar Pradesh. This is maintained so that the university can be run, in the event of dissolution of the university, till the last batch of students completes its courses.

- 6) Factors which determine whether a proposal is accepted or not include financial soundness, background of sponsoring body and potentiality of courses: The first factor is onerous and constitutes a substantial entry barrier whereas the last two are widely subjective and offer considerable scope for rent seeking activity, thus distorting competition among potential private providers of education.

### ***Regulations Governing the Operation of Private Universities***

The following are the requirements laid down by the acts with regard to the operation of a private university:

- 1) Accreditation: Rajasthan and Haryana specify that universities need to obtain National Board of Accreditation (NBA) or National Assessment and Accreditation Council (NAAC) accreditation within the first three years of their operation. This is a fair requirement: accreditation provides information to the public about the quality of a programme and thus removes asymmetry of information between the provider and the 'provided'; as well as facilitates fair competition.
- 2) Fee Structure: In Rajasthan, there is a committee for regulating the fees of private universities. Once the fees are stipulated they remain at that level for a period of three years. This implies that the first batch of students after the setting of the fee end up subsidising the two subsequent batches of students for whom the real fee is much lower. In Haryana, there is no need for prior approval of fee structure; however it is required that fee concessions be provided to 25 percent of the students who are mandated to be domiciles of Haryana. This requirement of a concession on the existing level of fee incentivises players to push up the existing level of fees so that adequate revenues are generated.
- 3) Prohibition on Granting Affiliation to Colleges: Private universities are not allowed to affiliate colleges, thus restricting colleges to seek affiliation from only government universities. Moreover, each government university has a territorial monopoly – thus, colleges falling in the territory of a particular government university have to be affiliated to that government university. These facts rule out competition among universities for affiliating colleges, a phenomenon that could have contributed to the betterment of quality of education facilitated by university in terms of syllabi etc.

### ***Regulations Governing the Setting Up of Private Deemed Universities***

The second way in which a body can set up a private degree granting institution is by asking for a deemed status. According to the Ministry of

Higher Education, an institution can be declared a deemed university if it has set a very high standard in a specific area of study. These institutions enjoy academic status and privileges of a university.

There are two routes to becoming a deemed university: first is the general route for institutions with 15 years of standing and second route is through an application under the *de-novo* category.

In 2000, the UGC simplified and liberalised the guidelines for granting “Deemed to be a University” status. This was done to encourage the participation of private players in the higher education sector, with its attendant benefits for competition and enrollment. The *de-novo* route was also introduced for the first time. From 2000 to 2005 as many as 26 privately sponsored institutions got the deemed status and between 2005 and 2009 there were many successful applications for the same. Currently, there are 117 institutions that are deemed to be universities.

Unlike private universities (which are under the jurisdiction of respective state governments) deemed to be universities, whether government or private, are under the direct jurisdiction of the UGC. We now study the UGC imposed entry, operational and exit norms associated with these institutions. The norms for entry and operation for these institutions are mentioned under the UGC Regulations, 2010. The following are the eligibility criteria for declaring an institution as ‘deemed to be university’ under the general category:

- The institution must have been in existence for at least 15 years.
- It must have acquired the characteristics of a university: diversity of programmes of study; proven contribution to innovation in teaching; and verifiable high quality of research output.
- The institution must also possess the highest grade of accreditation offered.

The following are the eligibility criteria for institutions aspiring to be deemed universities under the *de-novo* category:

- They must be registered with a not-for-profit society or trust
- They must possess the highest grade on the assessment certificate.
- They must be devoted to research in ‘emerging areas of knowledge’.

Note that some of the expressions such as ‘verifiable high quality of research output’ and ‘proven contribution to innovation in teaching’ are very vague. Similarly, the definition of ‘emerging areas of knowledge’ is also unclear. The subjectivity of these terms gives rise to rent seeking and lobbying opportunities which distort competition between institutions that are aspiring to attain deemed status. In order to do away with such subjectivity eligibility,



criteria should be set in quantitative terms. Below we examine some of the entry requirements in detail:

1) Land and infrastructure norms

The land requirement as prescribed by the UGC is for a single course. As the number of courses increases the land requirement can be worked out as the sum of the requirements prescribed by the concerned professional councils for the various courses. Thus, if a deemed university is to offer two courses x and y and the corresponding professional councils are A and B then the land requirement is the aggregate of the requirements prescribed by A and B.

The land requirement prescribed by the UGC is five acres of land if the campus is located in a metropolitan area, seven acres in a non-metropolitan urban area and ten acres in a non-urban area.

2) Corpus Fund

All non-government funded institutions must maintain a corpus fund in the name of the institution through government securities or other forms approved by UGC. In the case of institutions under the de-novo category the amount required of the corpus fund is Rs. 250 million. In case of institutions under the general category the amount varies from Rs. 80 million for professional courses to Rs. 40 million for others.

The fund acts as an assurance to the UGC that the management of the institution will fulfill its commitment to provide quality education and research. A violation of UGC norms or those specified by the regulatory council leads to upward revision of the fund amount.

3) There is no specification by the UGC of any date or circumstances under which the fund will be returned to the applicant. In any case the considerable endowment fund that has to be maintained by the applicant for deemed university status constitutes a substantial entry barrier and restricts competition in the deemed university space.

### ***Regulations Governing Affiliated Colleges***

We now look at the regulations imposed by an affiliating university which govern the potential entry of colleges into the university and the operation of the affiliated college. Since these regulations differ from state to state and even within a state from university to university, Centre for Civil

Society's study of three universities in Madhya Pradesh and common features of the regulation emerging therefrom have been considered.

In order for an institute to be granted affiliation to a university a detailed application has to be made from the institute to the university. The nature of the application form varies. In the case of two of the universities studied, details regarding the foundation society or trust establishing the institute are required. In the case of the third university the institute applying for affiliation has to provide details of academic, infrastructure and sports facilities. This university also insists on minimum land requirement. On receiving the application an inspection of the institute is made by each of the universities. It is ascertained whether adequate facilities are available with respect to library, laboratory, physical education, sanitation and teaching staff. There is fair amount of subjectivity in defining what 'adequate' means, though the extent of this subjectivity varies from university to university.

The institute, after receiving the affiliation from the university, functions directly under the university administration. There is very little autonomy with respect to the operations of the institution particularly fees, curriculum, examination dates, teaching hours, admission of students etc.

Several recommendations emerge from the study of university regulations binding affiliated institutions. First, these institutions must be given greater autonomy especially in regard to the curriculum. While certain core courses and their syllabi can be dictated by the university the institute should free to tailor other courses to the needs of the potential students. Second, the focus on quality assurance must shift from input based indicators to performance based indicators. Input norms such as minimum land requirement discourage entrepreneurs from starting good quality educational institutions. This not only restricts the spread of higher education but has a negative impact on average quality of education offered. Transparency of affiliating norms should be emphasised. Use of the word 'adequate' in stated requirements should be avoided as it introduces unnecessary subjectivity and causes confusion.

### ***Regulations Imposed by Professional Councils***

Colleges are also affected by regulations at the course level which are imposed by regulatory bodies such as All India Council of Technical Education (AICTE), Bar Council of India (BCI) etc.

The UGC is the main governing body in the higher education sector. It provides grants to public universities as well as tries to maintain high educational standards in these institutions. The UGC Act of 1956 specifies the administration of the universities it governs in detail: number of working

days, number of lecture hours per subject, minimum qualifications for students and teachers etc. Supplementing the UGC are 15 autonomous regulatory and statutory institutions, each responsible for the teaching of a set of courses at the college level. These councils are responsible for the recognition of courses, regulation of course syllabi and provision of grants and other awards. Each council has its own set of rules for the governed institutions. Each body has a huge overlap of its functions with the functions of the UGC as well as other regulatory bodies.

AICTE is the council responsible for the regulation of technical education in India. It plans, formulates and maintains norms and standards for technical education. It also provides quality assurance through accreditation.

*Procedure to Seek Approval from AICTE for Starting a Technical Institute*

Before applying institutions have to obtain a 'No Objection Certificate' from the affiliating university. To start with, an application form has to be filled up and submitted. The new institution must be registered as a trust under the Trust Act, society under the Societies Registration Act or a company under Section 25 of the Companies Act. Application is accepted only after the building of the institution is complete without any deficiencies.

The next step is evaluation of the application by Scrutiny Committee. Presentations of all proposals are invited by the Scrutiny Committee. Applicants who are communicated deficiencies by the Scrutiny Committee may appeal within a period of 15 days of the date of receipt of rejection. A total of 20 documents have to be submitted to the Scrutiny Committee: land deed, building plan of the institute, proof of working capital, detailed project report, copy of the syllabus etc. Next an expert committee is constituted to check availability of computers, equipment, software, internet, printers, book title, book volume, subscription of national and international journals etc.

The Regional Committee of the AICTE takes into account the reports of the Scrutiny and the Expert Committee as well as the views of concerned State Government and affiliating university. It then recommends the application for further processing. Based on its recommendation, the Executive Committee of the AICTE takes the decision of approval or rejection. The letter of approval is for two academic years.

The AICTE insists that certain norms have to be met by the applicant before approval is granted. One of them is a corpus fund of Rs. 10 million which is a substantial entry barrier. Second, the infrastructural regulations are very detailed and inflexible. Fulfilling them is only possible for an institution/individual with large monetary resources. These infrastructural requirements constitute imposing entry barriers.

## Accreditation of Higher Education Institutions

The Centre for Civil Society (2014) study continues to be the main basis of discussion in this section. The National Policy on Education in 1986 introduced the idea of quality assurance in higher education in India. Following this the National Board of Accreditation (NBA) was formed under the All India Council for Technical Education (AICTE) and the National Assessment and Accreditation Council (NAAC) under the UGC.

The UGC Regulations 2012 makes it mandatory for institutions, colleges and universities to be accredited by an accrediting agency. There are several factors which incentivise accreditation: a higher accreditation grade might result in a higher grant; failure to get accredited might result in revocation of recognition by the UGC etc.

The NAAC was established as an independent body under the UGC in 1994. It accredits central, state, private and deemed to be universities, institutions of national importance and affiliated and autonomous colleges. The process of accrediting an institution starts with the submission of a Letter of Intent by the institute which details the programmes it offers, its history and recognition by the UGC. Those seeking accreditation from the NAAC for the first time are required to submit an Institutional Eligibility for Quality Assessment Form which asks for background information on the programmes, staff, faculty, students and facilities. Once the letter of intent and the mentioned form is submitted a peer team visits the institution and an accreditation decision is made after the team's reports and grade sheets have been assessed.

Evaluation by the NAAC is based on seven criteria: curricular aspects; teaching-learning and evaluation; research, consultancy and extension; infrastructure and learning resources; student support and progression; governance, leadership and management; innovations and best practices. Each of these criteria is scored by marking sub-sections known as Key Aspects. The scores on various criteria are combined to yield a Combined Grade Point Average (CGPA) through a weighting scheme. The weighting scheme is such that in the case of autonomous and affiliated colleges *Teaching-learning and Evaluation* criterion gets a very high weight whereas in the case of universities, *Research, Consultancy and Extension* criterion gets a very high weight.

Final Accreditation Grades are A (very good), B (good), C (satisfactory) or D (unsatisfactory) with the first three grades implying that an institution has been accredited and the fourth implying that it has not been accredited.

The NBA was established by the AICTE in 1987 with the purpose of evaluating technical programmes. It became an autonomous accreditation body in January 2010. The accreditation process starts with a Self-Assessment Report (SAR) which is to be filled out by the institute asking for accreditation. The SAR covers the following criteria:

- 1) Vision, Mission and Programme Educational Objectives
- 2) Programme Outcomes
- 3) Programme Curriculum
- 4) Students' Performance
- 5) Faculty Contributions
- 6) Facilities and Technical Support
- 7) Academic Support Units and Teaching-Learning Process
- 8) Governance, Institutional Support and Financial Resources
- 9) Continuous Improvement

Once the SAR is submitted by the relevant programme of the institute, the NBA constitutes a team of one chairperson and two evaluators to evaluate the programme. Based on the SAR a pre-visit report is prepared. A three day visit is then undertaken to the institute to evaluate the strengths, weaknesses, concerns and deficiencies of the programme in regard to the listed criteria. The reports and notes of the evaluators are then considered by the NBA in compiling a final report and giving a final accreditation status.

The NBA assigns an institution with one of three possible accreditation statuses: Accredited, Provisionally Accredited or Not Accredited. If the institute gets a minimum of 750 points and a minimum of 60 percent in each of the nine criteria a status of Accredited is given for a period of 5 years; a status of Provisionally Accredited is given for a period of two years if the institute receives between 600 and 750 points; finally, a status of Not Accredited is assigned if the score is less than 600 points.

The NAAC and NBA are both characterised by inadequate coverage of higher educational institutions in regard to accreditation. For example, by 2011 only 5,780 out of a total of 35,500 institutions had been accredited by the NAAC. The NAAC accredits an average of around 400 institutions every year, a number that is entirely inadequate for full coverage of educational institutions to be attained any time in the near future. The NBA is beset by the same problem. Between 1998 and 2009 it was able to accredit only 50 percent of the applications it received.

It is not only inadequate coverage but the nature of the accreditation process which is problematic. In regard to accreditation there is too much stress on input indicators such as classroom sizes, library sizes, number of faculty rooms etc. This deters institutions providing unconventional learning

such as open and distance learning from seeking accreditation. Prospective students and their parents who look at accreditation grades in order to ascertain the quality of instruction being provided automatically bypass these unconventional institutions even though the educational outcomes of these institutions might be of a high quality. The problem of asymmetric information is at best only partially solved by the accreditation process. This hampers effective competition among institutions in the quality space.

Having examined the regulations governing potential and existing private higher educational institutions for implications for entry and competition, we now look at the implications of pending (before Parliament) education bills for the same

### **Pending Education Bills and their Implications for Entry by New Providers**

The discussion in this section is based on the study by British Council (2014). One of the most important bills that is pending is *The Foreign Educational Institutions Bill*. Its broad aim is to regulate entry and operation of foreign educational institutions and when introduced it will mark a remarkable change in an environment where foreign education providers have hitherto not been allowed. However, though it is much anticipated by foreign educational institutions, Indian commentators are skeptical that this will be passed in the near to medium term future.

A bill with higher chances of being passed in the near future is *The Universities for Research and Innovation Bill*. It would allow the establishment of universities as hubs for education, research and innovation. It would allow entry even by foreign universities and would allow freedom in faculty recruitment, including foreign. Both foreign institutions and Indian corporates are waiting for this bill to be passed.

Yet another bill on the anvil is the National Accreditation Regulatory Authority for Higher Educational Institutions Bill, 2010. This bill makes provisions for the assessment of academic quality, programme and infrastructure in higher educational institutions through a new body. This bill if passed would promote competition in the quality space.

### **Conclusions and Policy Recommendations**

Economic growth resulting in expansion of the middle class and a demographic shift towards younger age groups has resulted in demand for expansion of higher education. The presence of network externalities (benefits accruing to each person with higher education from the network of such persons) which are in proportion to the size of the network also calls for the expansion of higher education facilities.

The challenge before Indian education planners is to expand the education system without sacrificing excellence. This can be done by encouraging competition in the quality space and regulating entry such that new high quality providers are not blocked from entry into the sector.

In regard to entry a study of the recent past indicates that there has been substantial expansion of the higher education sector fueled by private entry. However, Gross Enrolment Ratio in India is still very low by international standards. This means that entry by new private players should be encouraged to the extent possible.

Our study finds that higher education providers have to meet regulations of too many bodies. For example, an affiliated college has to meet four sets of regulations – the regulations of the affiliating university, those of the professional council concerned with the course being taught, regulations embedded in the Central/State Act responsible for setting up of the affiliating university and lastly the regulations of the UGC.

Further, regulations governing the entry of potential higher education providers into the sector contain many barriers to entry. For example anyone who wants to set up a private university has to do so through a non-profit entity, has to have possession of a minimum acreage of contiguous land, has to meet a minimum requirement of endowment fund etc. Those wishing to get approval for setting up deemed universities have to again fulfil a land requirement and a hefty corpus fund requirement. In order for colleges to be affiliated to universities a minimum land requirement is again insisted on. In general while deciding on affiliation there is a focus on onerous input requirements rather than performance based indicators.

The study finds that effective competition in the quality space is not being encouraged to the extent possible. The lack of coverage of higher educational institutions by accrediting bodies such as the NAAC and NBA are roadblocks in this regard. Thus, the asymmetry of information between the education providers and the provided is not suitably remedied. Therefore, the initial conditions required for effective competition are not met. An increase in the number of accrediting bodies coupled with an apex regulator is called for.

To summarise, entry by quality higher education providers is not being encouraged due to complex, multi-layered and barrier ridden regulations in the higher education sector. The pursuit of excellence through promotion of competition in the quality space using the means of accreditation leaves much to be desired.

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## Endnotes

- 1 British Council (2014), “Understanding India: The future of higher education and opportunities for international cooperation”, Report
- 2 Network externality is defined as a change in the benefit that a consumer derives from a good when the number of other consumers of the same good changes
- 3 Centre for Civil Society (2014), “Regulatory Structure of Higher Education in India”, Research Paper
- 4 Deemed to be university status is accorded by the University Grants Commission (UGC) to an institution after careful consideration of an application. Both government and private institutions can be deemed universities. Deemed universities have greater autonomy in regard to operations, syllabus, admission and fees than State and Central universities
- 5 Private universities are set up by an act in State Legislature and are run/financed by non-government agencies. They also have to obtain recognition from the UGC. Private universities do not have the power to affiliate colleges that are run by a different trust
- 6 State universities are set up through an act in the State Legislature. A State university receives funding from the state government and sometimes from the Central Government, usually via the University Grants Commission
- 7 A Central University is usually established through an act in Parliament and is funded by the Union Government
- 8 Ernst & Young (2012), “Higher education in India: twelfth five year plan (2012-2017) and beyond”, FICCI Higher Education Summit 2012
- 9 Daily News and Analysis (June 1, 2015), “Demand for self-financed courses catching up fast.”, Newspaper Article
- 10 Section 25 company is a not-for-profit company used for promoting art, science, commerce etc.



## CHAPTER 7

# Competition and Regulation in Highways Sector in India

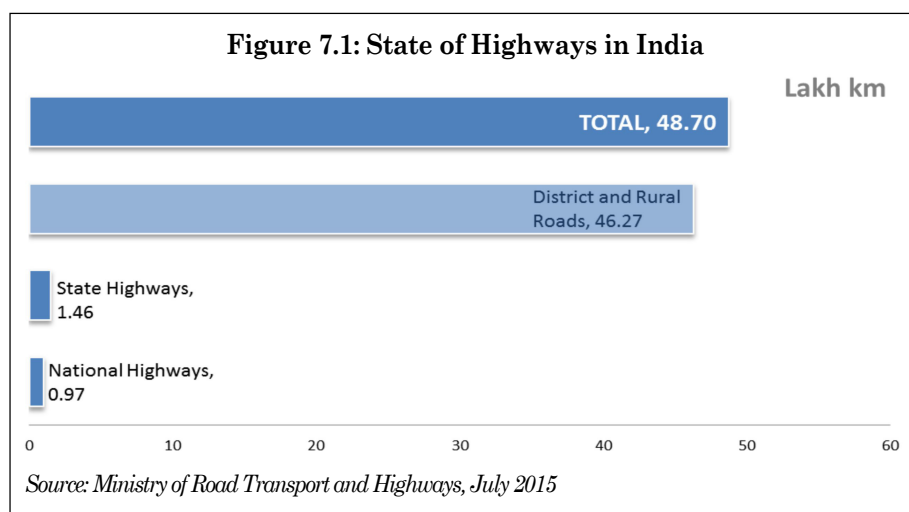
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### Introduction

Roads are definitely the most common mode of out-of-home movement and invariably the first and the last physical link between the origin and destination excursions. Contingent on capacity, roads sufficiently display the characteristics of a non-rival and non-excludable public good.

While India has benefitted from dramatic investment increases for expansion of the National Highways (the ambitious National Highway Development Project or NHDP) and the notable increase in rural road connectivity through *Pradhan Mantri Gram Sadak Yojana* (PMGSY), the overall capacity and quality of the road network still leaves much to be desired. Substantial variation in highways across their classification and through geographical boundaries is unhelpful and impacts mobility. At the same time, slackening overall pace, land issues,<sup>1</sup> blocked capital and the resultant decline in private interest is alarming. Building institutional capacity, addressing regulatory hurdles and inducing competition would do much to accelerate highway infrastructure delivery and propelling much needed economic growth.

India holds the distinction of having the second largest road network in the world presently at 4.8mn km, together with the densest (road km/sq.km) network among comparable sized economies. This network facilitates movement of more than 60 percent of all goods in the country and 85 percent of India's total passenger traffic. Roads and Highways in India have seen dramatic rise in investment over the past two decades resulting in enhanced physical connections between cities, towns and villages in the country. Various development programmes for different classes of roads have yielded a significant expansion in network size. With the notable exception of the NHDP, the major focus of this network expansion has been to improve connectivity rather than to increase network capacity.<sup>2</sup>



PMGSY scheme that specifically focusses on improving new connectivity and upgradation of rural roads has benefitted rural economy immensely. The government has recently announced another major initiative – the ‘Bharat Mala’ project, aiming at developing 5,600 km of new roads all along the border and coastal areas at an estimated cost of ₹56,000 crore. Additional 4,700 km of roads to connect religious and tourism centres and to enhance connectivity in backward areas is expected to come up at an estimated cost of ₹44,000 crore.

Besides this, world-class highways will be developed to connect 100 of the 676 district headquarters in the country. While National Highways are being developed realising the urgency in enhancing trunk capacity and rural roads in ensuring universal connectivity all of which is revered, there has been no fundamental drive for State highways and District roads. The development focus has somehow been on either end of the road spectrum; with the middle layers left mostly unattended and to that extent have constrained inclusive network capacity.

#### Box 7.1: Road Planning in India

It might be worthwhile to briefly note the history of formal road planning and development in India. The first attempt at formulating a long-term road development plan was the Nagpur Plan of 1943. It envisaged 200,000 km of road network to be delivered over a twenty-year period i.e. by 1963. It also laid the genesis for the familiar modern hierarchical division of the road network as determined by certain objective criteria. According to the Nagpur Plan, National Highways would pass through the states and places having national importance for strategic or

*Contd...*

administrative purposes. State Highways would link state capitals with other large cities in the state, and district roads would take traffic from the main roads into the interior of the district – merging these two types of roads as State highways. Finally, rural roads would connect the villages with major roads.

The classification of the road network was therefore largely defined by the settlements that a road linked. A new 20-year plan, the Bombay Plan of 1961-81 for Indian roads was subsequently adopted to bridge the development gaps of the previous plan, with rural accessibility being the central theme. The Bombay plan, for the first time, made the case for access controlled highways as well as went on to refining the State Highways classification. This was followed up by the third 20-year plan 1981-2001 proposing for the first time, ‘softer’ considerations, such as energy conservation, environmental impact and road safety as integral to road policy and infrastructure together with the ubiquitous goals of network expansion, raising capacity and improving accessibility.

In 2001, the Ministry of Road Transport and Highways formulated the Road Development Plan Vision: 2021 focussing on mobility of main roads and increasing rural access. Further, past two decades have seen some of the most ambitious road development schemes, such as NHDP, PMGSY and much of the road growth in India. Presently, India plans to build a 5,000 km road network all along the borders and coastal areas under a scheme called ‘Bharat Mala’ in the coming five years.

*Source: India Transport Report: Moving India to 2032, National Transport Development Policy Committee (2014)*

Whichever way the Indian road network developed, certain concerns imply uniformly across all through. The roads are usually capacity-constrained, slow, unsafe, pathetically maintained and patchily administered. Meanwhile, efforts to improve the situation are hampered by the delayed clearances, multiple overlapping authorities and jurisdictions, frequently changing rules of engagement with the private sector, unyielding land laws, and skill shortages.<sup>3</sup> Further, weak quality monitoring and poor data recording do not help timely operational corrections, having lesser scope for rational long range planning. Often, the roads are allowed to deteriorate to levels where their use becomes untenable proving regular maintenance to be inadequate, necessitating much expensive rehabilitation.

## **Institutional Framework**

Roads in India are categorised into three broad hierarchical systems: primary, secondary and tertiary.

### ***Primary***

- National Highways constitute the primary system. Forming just about 2 percent of the total road network they carry 40 percent of total traffic. These primary highways traverse the length and breadth of the country connecting major ports, state capitals and union territories and large industrial and tourist centres and include roads for strategic considerations. Contrary to the traditional view that a National Highway facilitates intercity travel and transport of goods, it is an integral part of the road network serving the rural areas.

### ***Secondary***

- State Highways (SH), together with Major District Roads (MDR), constitute the secondary system and provide links with higher and lower order roads in the total journey. They link with NHs, district headquarters of states and important towns, tourist centres and minor ports. These roads characterise medium mobility and accessibility, essentially serving collection and distribution. Representing about 4 percent of the total road network these highways carry 25 to 30 percent of the total road traffic.

### ***Tertiary***

- Rural roads cover other district roads and village roads forming the tertiary road network. A number of organisations are responsible for the administration of the road network at various levels of government. With the exception of PMGSY roads, Ministry of Road Transport and Highways (MoRTH) is the managing central agency for the nation's road network. Table 6.1 illustrates the broad institutional framework governing the administration, finance and execution of the various road categories.

All the State governments have Public Works Departments (PWDs), which undertake the provision of road infrastructure. Road Development Corporations (RDC)/Boards in many states have been created as an implementation arm of the PWDs to promote and administer Public Private Partnership (PPP) contracts. Although their overall mandate is limited in comparison with the regular road authorities and their corporate structure provides them the leverage of faster implementation and expeditious decision-making capability.<sup>4</sup>

<b>Table 7.1: Institutional Framework Controlling the Functioning of Roads</b>		
<b>Road Category</b>	<b>Administrative and Financial Control</b>	<b>Execution Responsibility</b>
<b>National Highways/ Expressways</b>	Centre* – Ministry of Roads Transport and Highways	National Highways Authority of India, State Public Works Departments (PWD), Border Roads Organisation
<b>State Highways, major/other district roads</b>	State government	State PWDs and subordinate agencies
<b>Panchayat, rural and urban roads</b>	State Government/ Ministry of Rural Development (PMGSY)	State/Local governments
*Certain expressways can also be under the State Government CIRC Working		

With the road network's widely distributed nature and role, it is not surprising that exceptionally large number of institutions and agencies are responsible for their design, construction, operation and maintenance at all levels of the government. Given the multitude of responsibilities and functions associated with all classes and categories of roads this is perhaps the only cogent. However, the current institutional arrangements limit inter-agency coordination. It has been found that horizontal and vertical inter-agency cooperation has been clearly lacking. Roads are not always built in accordance with the existing or planned land use to ensure inter-modal connectivity and to connect well with other parts of the network to boost overall capacity. The road agencies do need considerable capacity building for more consistent implementation of the government mandate.

### **Stakeholder Concerns**

The Road and Highway sector in India is presently experiencing significant dormancy and the stakeholders have their valid concerns. Private participation and investment in the sector has almost dried up with several new unbidden projects and existing projects being delayed, stalled or abandoned. The situation exacerbated by the economic slowdown, the prime stumbling blocks have been hasty bidding without adequate control for pre-construction activities, land issues, weak preparation of feasibility reports by the government, unrealistic cost estimates, poor traffic forecasting, lack of developers' ability to achieve financial closure cost escalation due to

delays etc. Some projects saw an escalation of as high as 30 percent on account of costlier land and raw materials.

A large number of disputes have arisen between road concessionaires and NHAI because of unsatisfactory contract or poor contract management. As per the recent (April 2015) estimates, road projects worth more than ₹25,000 crore are stuck in disputes between the developers and the highways regulator NHAI. A private developer recently secured an arbitration award of ₹217 crore for the extension of time (EOT) cost claim in Lucknow-Muzaffarpur National Highway Project. The delay was caused due to not-allotting of land in time to execute the work. More generally, the risk-balancing between government and private enterprise demands a consistent framework, which is fair, rational, and sustainable.

Many experts also attribute the slump in the sector to aggressive bidding by private players quoting high premiums (negative grants) assuming high project returns without adequate due diligence, only to later find funding these payments unfeasible. Many such entrepreneurs have been seeking lenient premium-rescheduling norms. This has been an area of concern for the government and it has been exploring execution formats to circumvent such practices. According to the Rangarajan Committee Report in 2014, projects facing economic stress are allowed to avail relief under a revenue shortfall loan clause given in the model concession agreement. The amount of deficit between the toll revenue collected by the highway developer and expenses incurred, including operation and maintenance costs and debt servicing and premium payments can be extended as a loan to companies, which have been seeking a rescheduling of premium.

The recent Union budget raised the allocations to ₹42,912 crore as compared to 28,881 crore apportioned to the sector in the previous year. The Ministry has also set an ambitious target of constructing 30 km of road per day within two years. While many such initiatives do help to boost confidence but these have to be translated on ground through robust mechanisms to have measurable outcomes. One of the most important stakeholders, the users of the road network have their own concerns broadly with the overall expectation of enhanced and affordable mobility.

The concerns of the main stakeholders in the Road and Highway Sector – the government (as planners and implementers), the private players (investment and execution partners) and the users of the network are presented in the Box 6.2:

Box 7.2: Concerns of the Main Stakeholders and Users	
Stakeholder	Concerns
<b>Government</b>	<ul style="list-style-type: none"> <li>• Deliver a compact road network that can efficiently balance capacity and connectivity and is consistent with political goals, technical requirements and financial judiciousness</li> <li>• Adequate market competition and rational bidding</li> <li>• Develop highway agencies to be efficient network managers</li> </ul>
<b>Private Player</b>	<ul style="list-style-type: none"> <li>• Encumbrance free Right of Way (RoW), adequate return on investment and equitable risk allocation</li> <li>• Access to finance</li> <li>• Improved governance and transparency</li> </ul>
<b>Service Provider / User</b>	<ul style="list-style-type: none"> <li>• Efficient (accessible, safe and affordable) highway network</li> <li>• Well maintained and congestion-free roads and highways</li> <li>• Improved governance and transparency</li> </ul>

In trying to address these concerns or to decipher what all is currently impeding highway development, it is useful to note the list of issues surrounding the sector along with possible planned interventions.

## Regulation and Competition in the Sector

A range of regulatory and administrative issues currently plague development of the Indian roads and highways sector. Some of the bigger challenges are difficulties in acquiring land, securing environmental clearances and managing private participation. A few of them are discussed below:

### *The Right of Way*

The acquisition of contiguous land for road projects has been one of the biggest challenges,<sup>5</sup> both for the government and the developers. The existing land laws in India makes it difficult and time-consuming to acquire the land required to complete the infrastructure projects. Delayed land acquisition is considered as the dominant reason for schedule slippages resulting into usual time overruns in road construction. At the same time, even small changes made in the alignment to compromise with accessible Right of Way (RoW) can have adverse implications for overall project costs as well as for road safety and the environment. Regulatory fault lines lie along the issues related to valuation and compensation; acquisition of agricultural, forested, hereditary and tribal lands and government right to eminent domain.<sup>6</sup> The recently introduced – the Right to Fair Compensation

and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 (LARR Act 2013) attempted to correct some of the defects of the antediluvian Land Acquisition Act, 1894 by working on the principles of consent, compensation, social impact assessment, resettlement and rehabilitation among others. In the process, however, it yielded a complex system, which would significantly increase the time and cost of any project,<sup>7</sup> thereby delaying the benefits to all. In attempting to ease this, the incumbent government introduced certain changes in 2014 proposing to amend the LARR Act 2013 through an ordinance. These changes,<sup>8</sup> however, appeared to be made at the cost of desirable protection and participation of land-owners and displaced farmers. Unable to pass through both the constitutional houses despite iterations, the Ordinance has been allowed to lapse in August 2015.

Either ways, it is a national loss. As the likely way forward and something that the Union government is apparently convinced on is that the states will need to take the lead and come up with their own laws in order to ensure that the land acquisition process continues. Acquisition of property is a List-III, Entry 42 subject provided for in the concurrent list. The provisions of Article 254(2) provide that a state government can bring legislation on a concurrent list subject that conflicts with the Central legislation provided the Presidential assent is given to such legislation. Possible learnings could be drawn from Tamil Nadu; it was the first and only state<sup>9</sup> to seek and receive Presidential assent to exempt three major categories from the purview of the Land Acquisition, Rehabilitation and Resettlement Act.

In particular, land acquisition done under the Tamil Nadu Highways Act, 2001; the Tamil Nadu Acquisition of Land for Industrial Purposes Act, 1997 and the Tamil Nadu Acquisition of Land for Harijan Welfare Schemes Act, 1978 is outside the purview of the consent clause and Social Impact Assessment clause. Around four-fifths of the land acquired in Tamil Nadu is acquired under the three Acts mentioned.

Whereas the option for the states to frame their own land laws on grounds of development might look plausible, there are, however, legitimate concerns around the resultant progress and development being non-uniform. Given that different states present varying level of institutional maturity and capability, the effectiveness with which they develop and implement these laws could be significantly disparate, again an unsupportive situation for highway growth.

Land acquisition to build new roads in tribal lands for providing much-needed connectivity to hitherto neglected populations, as well as for roads essential for national security and integration is especially fraught and



must be addressed by sound policy and judicious administration.<sup>10</sup> There is a need for innovative thinking to develop mechanisms, which would address both sides of the problem, such as making those parting with the land partners on the project or long-term lease based approach.

### ***Competition: Private Participation***

More than to ease capacity and financing constraints, a PPP should be viewed as an effective tool to promote competition in service delivery and improve the quality of service. The commonly cited rationale of engaging PPPs for accessing finance is still a weak argument as governments should typically be able to access finance at lower cost than any private companies. At the same time, private borrowing creates long-term economic liabilities that may be difficult to justify if private sector efficiencies do not reduce the overall financing required relative to public finance and implementation.<sup>11</sup>

Within the limited universe of road projects amenable to a PPP (Build-operate-transfer, Design-build-finance-operate-transfer, etc.) format, these partnerships have indeed benefited to accelerate infrastructure development in India and often offered better value for money while also helping at least short-term release of fiscal pressures. This implies better quality of services and assets over the long-term with improved productivity and coverage.

Another benefit of PPP is the result of the usual bundling of construction, maintenance and rehabilitation for the life of the project/concession, usually from 25 to 30 years.<sup>12</sup> However, these partnerships are susceptible to weak planning and feasibility studies, unresolved land issues/regulatory clearances and ambiguous risk allocation and conflict resolution. Road PPPs in India have unfortunately been saddled with most of these.

Once considered a model sector for demonstrating impressive growth through leveraging public private synergies (popularised as build-operate-transfer or BOT projects) till about 2010, the roads and highways sector has since slowed down to a crawl. The lack of private interest in public projects is not a sudden phenomenon but a trend that has developed over time and needs deeper assessment of what possibly went wrong. About twenty projects that were bid out by the NHAI on PPP route during 2012-14, none of the projects could generate a response.

Intuitively, this cannot be a result of one single factor but for more reasons including a cooling economy. As mentioned, the reluctance of the private sector to participate in roads and highways projects is partly due to the bottlenecks in the government's project approval process, followed by delays in obtaining the requisite permits to commence construction.

As these projects require a long gestation period, the widespread delays in acquiring land or RoW, clearances for rail over-bridges (RoBs) and rail under-bridges (RuBs), shifting of the utilities etc. further lead to both time and cost overruns.<sup>13</sup> These delays in obtaining approvals often result from a lack of coordination between various government departments leading to the projects being rendered financially unviable<sup>14</sup> for private participants. In addition, most of the competitive bidding processes effectively involve bets on future traffic flows, exposing these projects to considerable demand risk.

The upshot is that while PPP projects do have the potential of delivering benefits, the governance needs to improve significantly for PPPs in India to deliver value commensurate with their potential. Road PPPs can induce large benefits and increase in efficiency but the legal, institutional, procedural and regulatory framework and the PPP contract design and oversight are critical.<sup>15</sup> As immediate steps to boost private confidence and sector competition, certain measures are being advanced by the government, to limit private sector exposure to demand risk and to strengthen the dispute resolution mechanism.

### ***Risk Rebalancing***

#### ***Hybrid Annuity Model***

In trying to rebalance the risks in the PPP model with the government bearing a larger share, a new PPP format – Hybrid Annuity Model (HAM) is being experimented on some of the national highway projects. HAM is conceived more as a mix of EPC and BOT (Annuity) models, with government and private enterprise sharing the total project cost in the ratio of 40:60. The government funding 40 percent of the project cost during construction will reduce the upfront financial burden on concessionaire. The revenue risk as also the tolling rights will be retained by the government while the private player bears construction, operation and maintenance risks.

As compared to EPC projects, shift to HAM would certainly ease the cash flow pressure on NHAI as it needs to provide only 40 percent funding spread over the 30-36 months of construction period and remaining 60 percent over 15-20 years of the concession period. This will be in the form of semiannual payments, which can partly be recovered through tolling.<sup>16</sup> The model benefits the developers by reducing the financial closure requirement to 60 percent of the total project cost. Despite some risk dilution through the HAM format, the government's ability to ensure speedy statutory clearance and RoW would again be inevitable in ensuring success of the model as well regenerating private interest.

### *Exit policy*

In yet another convincing move to facilitate resource mobilisation, build investor confidence and to boost competition in national highway projects, the government has announced an exit policy. The Cabinet Committee on Economic Affairs (CCEA) has recently approved an exit policy permitting developers to exit highway projects two years after completion of construction to release locked-in equity as potential capital for future projects. The developers of PPP projects, where concessions were signed even before 2009 will be allowed to quit the projects completely. About 80 PPP projects would have the developers substituted while extant players can take up new projects stuck for need of capital. A prime reason for this is the lack of availability of equity in the market among the qualified bidders. The exit policy essentially balances risks between industry participants based on their core strengths and their relative risk appetite. While exit policy will increase the liquidity for the project developers, it has to be observed whether the exiting concessionaires will actually plug it into other PPP projects. Meanwhile, the criteria for the assessment of the substitution will require robust due diligence. To reiterate a point made earlier, the focus again appears to be skewed much in favour of the primary network.

Considerable funds and thinking is devoted for the primary network, which is essential but the secondary network suffers from lack of funds. Moreover, maintenance funding and its contracting arrangements are generally acknowledged to be inadequate and inefficient to maintain the quality of the roads and provide quality service to the road users. In India, for example, the poor condition of the secondary network is estimated to cause an annual loss of ₹200,000mn.<sup>17</sup> National priority schemes similar to NHDP and innovative PPP formats amenable to secondary network development need to evolve rapidly, for more uniform network and capacity enhancement.

### ***Dispute Resolution***

India's experience with road PPP illustrates the importance of managing disputes. These disputes in roads and highways tend to fall in a broad pattern. Land acquisition and clearance obligations for road sector concessions have been frequently contentious leading to litigation and lengthy delays.

In the past, many projects were stalled due to aggressive bidding from the developers. Lack of a proper arbitration mechanism in turn generated considerable stress on the banking system. Due to their funds getting blocked, the banking system at present shows limited capacity in terms of financing new projects. The NHAI although the apex government entity for the development, maintenance and management of national highways, cannot be considered to be a strictly neutral authority since it is a party to

concessions for the development of highway projects. In addition, the NHAI does not have adjudicatory powers.

The FY16 Budget proposes to introduce Public Contracts (Resolution of Disputes) Bill for speedy dispute resolution, a positive development given that around ₹200bn worth claims are pending with NHAI<sup>18</sup>. An efficient dispute resolution process can expedite unlocking significant capital stuck under arbitration claims and improve the liquidity position of developers. Under the proposed bill, the government wants to set up an independent tribunal to deal with the differences and disputes that might arise during the implementation of public contracts (including PPP contracts), refer these disputes to arbitral proceedings over which it would adjudicate and exercise supervisory control. The proposed Act lays down the process for the adjudication proceedings, hearings and enforcement of orders by the proposed Tribunal, which might be challenged by the aggrieved party only in the Supreme Court.

The proposed two-stage dispute resolution process is expected to reduce the time taken for resolution of disputes arising from PPP contracts<sup>19</sup>. Another similar legislation issued by the government to address commercial disputes is – the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Bill, 2015. The objective clearly is to facilitate enforcement of commercial and infrastructure contracts, thereby making India a predictable, easy and less expensive place to do business.

While these steps are indeed opportune and well supported by international experience, the building up of these institutions itself should not increase operational/jurisdictional complexities. Such interventions should consciously avoid duplication of tasks and clearly define the domain of different adjudicatory bodies, which have been constituted<sup>20</sup>. In particular, the Public Contracts (resolution of disputes) Bill must judiciously define public contracts and should not limit the freedom and autonomy of the parties to select their arbitrators. Necessary flexibility in public contracts where the counter party is foreign-owned and controlled needs to be allowed. The ability to resort to international commercial arbitration is imperative and interference might hinder foreign investments into India.

## **Conclusion and Recommendations**

The road and highway networks have increased in length and acquired complexity. Larger networks call for a different approach in planning, operation and management. Additionally, part of this network expansion in India's roads infrastructure is being created through infusion of private capital and efficiencies. Introducing private sector participation does not

eliminate the need for regulation; it only underscores the role of effective regulations and regulatory institutions.

It is crucial that necessary regulatory structures evolve that help define the roles of public, private and public-private together in a manner that result in unambiguous formal and informal rules of the game, more balanced sharing of risks, dispute resolution and ensure fair returns to private investment while protecting consumer interests. As an instrumentality of the state, regulation is happily no longer seen in a state vs. market dichotomy but rather as the one that reflects the changing role of the state towards market-led development.<sup>21</sup>

- There is a need for a more uniform planning and development of the road and highway network in India. With proper focus on the National Highway to boost trunk capacity and on rural roads to expand coverage, the middle layer – the secondary network (State Highway and MDRs) that interconnects both, must improve to enhance overall capacity. The currently sub-standard roads have ramifications for the entire primary network. With only minimal length expansion required for State Highways, the focus should be on consolidating the existing network – providing links to minor ports, industrial towns, connecting remaining district headquarters and strengthening bridges among others. Further, each state should formulate its own State Highway Development Project (SHDP).<sup>22</sup> Constitutionally, these roads are to be funded by the states but there is a case for enhanced central assistance to make up for the past negligence.

Certain states on their part have experimented with PPP formats for their highway development needs and rightfully utilising the central funds available from Viability Gap Funds (VGF) Scheme; Maharashtra, Madhya Pradesh, Gujarat, Rajasthan have been more successful than the others. PPP in state highways in fact started much later as compared to the national highways. This has been essentially due to the absence of a body like NHAI and a proper PPP policy at the state-level. States were also apprehensive of their institutional strength to manage PPP. Lagging states should similarly draw on these experiences to augment resources and explore possible value for money through the available ‘plug and play’ or customised private project development formats. However, such experiments will have to be first backed up with an appropriate policy, institutional framework and capacity building initiatives at the state-level.

- The infrastructure delivery should improve through better governance. Roads are not always built in accordance with the existing or planned land use, to ensure inter-modal connectivity, and to connect well with

other parts of the network and to that extent usually limit network efficiency. Coordination is required with various agencies at various levels for pre-construction activities, land acquisition, rehabilitation and resettlement, trees, environment safeguards, utilities, railway over/under bridges and canal crossings<sup>23</sup>. In particular, horizontal and vertical inter-agency cooperation that is currently lacking should become more institutionalised. In order to expedite the pace of the project, the government should facilitate all clearances at a single point. Perhaps, establishing a professional body, such as the office of Transport strategy recommended by the recently concluded National Transport Development Policy Committee (NTDPC) with the broad mandate for developing larger coordinated plan for all modes of transport can prove to be helpful in setting the optimal direction, which can then guide smaller plans.

At the same time, asset preservation beyond its creation is extremely vital. Road and Highway maintenance, which is already a huge challenge is only going to expand with the increasing footprints. India devotes far less effort than it should to maintenance relative to new construction. Rehabilitation then requires far more substantial financial resources than the preventive or routine maintenance measures.

Importantly, preventive maintenance also imposes lower indirect and opportunity costs since the citizenry and government are less likely to have to contend with catastrophic failure, or with the decommissioning of important links in the network for long periods of time.<sup>24</sup> A clear demarcation of administrative responsibility between capital works and maintenance of each class of road, dedicated funding, sophisticated data recording and reporting mechanisms and innovative contracting arrangements can prove to be helpful in preserving these national assets.

- Delivery of better planned, cost effective and efficient road network adequately addressing safety, quality and sustainability of assets would call for capacity building of the road agencies and the private sector. Most highway executing agencies lack planning or long-term vision/strategies. To the extent plans exist, they are generally broad-based and lack concrete output and outcome targets for which the implementing agencies can be held accountable. This makes it difficult to determine whether the goals, objectives and targets of the policy have been achieved. The nature of job of these agencies is transforming from being technical experts to network managers.

However, limited capacity with respect to structuring and management of private concessions, risk management etc. is increasingly evident. At the same time, with the increasing magnitude in highway investments

and sophisticated contracting models, the expectations for better governance and accountability are higher. The evolving role of the agencies requires them to establish systems for greater performance and to that extent an objective criteria to assess and improve their capacity requirements. A study ‘A Review of Highways Agencies in South Asia Region’ was undertaken by the International Bank for Reconstruction and Development/World Bank to help governments and policy-makers identify reforms required to modernise and strengthen the capacity and performance of their road agencies to deliver large investment programmes. **Box 7.3** captures the broad indicator framework for such evaluation.

Box 7.3: Capacity and Performance Indicator Framework for Road Agencies
<p><b>Mandate, Policy and Legal Framework:</b> Related to vision/mission statement of the highways agency and if a formal road policy backed by a legal and regulatory framework exists covering development, asset management and safety.</p> <p><b>Planning:</b> Indicators on planning capabilities of the highway agency – existence of long-term and short-term investment plans for both capital and maintenance works.</p> <p><b>Capacity:</b> Highway agency’s strength to deliver its mandate – budget expenditure efficiency, projects delivery, skill development strategies and human resource management.</p> <p><b>Efficiency:</b> Efficient contract administration to contain time and cost overruns during the implementation. Monitoring the ‘asset value’ of the network is one such indicator.</p> <p><b>Quality of Road Network:</b> To assess the agency’s ability to provide a safer, greener, reliable and more comfortable road network – viz. congestion intensity, network quality index and accident hazards.</p> <p><b>Private Sector Participation:</b> Capability to attract and promote private sector financing.</p> <p><b>Governance:</b> Institutionalising right to/ freedom of information, e-procurement, web site, publishing of annual reports, road user satisfaction surveys and grievance redress mechanisms.</p>
<p><i>Source: A Review of Highway Agencies in the South Asia Region by Rajesh Rohatgi et al. World Bank and DFID, 2011</i></p>



- Addressing the reasons for potential decline in private participation and to reinvigorate the inevitable public-private collaboration is crucial and fortunately an increasing priority for the Government. The positive vibes from the government like setting up of National Infrastructure Investment Fund (NIIF), 5/25 mechanism for re-financing (project loan to be refinanced every five years, but repaid over 25 years), innovative PPP formats (HAM), easier exit norms for highway project developers and a facilitating mechanism for quick environment clearances should give a much needed fillip. Though permitting the concessionaire to sell its equity and exit from the project after two years of completing the construction does reduce its incentive to build a project that would last longer and can result in low-quality assets for the public. There is, therefore, need to exercise necessary caution, monitor and eliminate potential risks to public interest.
- Setting up specialised tribunals and adjudicatory bodies have been the preferred mode of governments, present and past, to show their commitment to reforms. However, limited attention to ensure quality has resulted in costs of setting up such bodies outweighing their benefits. The experience with the constitution and operation of adjudicatory bodies shows that weaknesses creep in at three points: skills, resources and accountability.<sup>25</sup>

Whereas the Public Contract Tribunals are expected to make a decision expeditiously, no accountability mechanisms are in place to ensure compliance with such provisions. Multiple bodies expected to come under different legislations, do increase the possibility of forum shopping and jurisdictional conflicts. Consequently, the need of the hour is to clearly define and differentiate the scope of work of different adjudicatory authorities. The recently released report of Kelkar Committee on revitalising PPPs has made similar suggestions.

Fortunately for India, a significant part of the logistics network is still to be built. So the country can make up for past inadequacies and use the opportunity to shape its future road and highway infrastructure network to an increasingly desirable state that helps develop both widespread access and capacity. However, with expectation of increased role of the private sector in provision of transport infrastructure and services, under normal circumstances, the role of the state should be one of broad policy formulation and regulatory oversight. Such a role of the public sector should ensure competition in the sector, and potentially use regulation among other tools to ensure most efficient production of infrastructure.



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## Endnotes

- 1 In India, for instance, 70 to 90 percent of road projects suffer a 15 to 20 percent delay due to challenges in acquiring land – McKinsey Infrastructure Practice, Building India: Accelerating infrastructure projects, July 2009.
- 2 India Transport Report: Moving India to 2032, National Transport Development Policy Committee (2014).
- 3 *Ibid.*
- 4 A Review of Highway Agencies in the South Asia Region by Rajesh Rohatgi *et al.* World Bank and DFID, 2011.
- 5 According to IDFC, land acquisition and forest clearances are the biggest bottlenecks to timely completion of projects.
- 6 Supra note 2.
- 7 *The new, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act may have clarified some of these issues, but will also make land acquisition more expensive* – India Transport Report: Moving India to 2032, National Transport Development Policy Committee (2014).
- 8 The ordinance did away with this consent clause for affordable housing, defence, rural infrastructure, industrial corridors and infrastructure projects. The social impact assessment clause was also done away with in these cases.
- 9 Tutorial from Tamil Nadu for states to get around land acquisition by Vivek Kaul, Firstpost, September 2015.
- 10 Supra note 2.
- 11 Engel *et al.* (2007); Hellowell (2010); World Bank (2007).
- 12 Supra note 2.
- 13 Road to Recovery, cover story – Infrastructure Today, 2015.
- 14 In one such instance, GMR Infrastructure Private Limited (GMR) exited the high profile Kishangarh-Udaipur-Ahmedabad highway project in December 2012, for reasons related to delays in obtaining forest and environmental permits.
- 15 Supra note 2.
- 16 Indian Road Sector, ICRA Research Services (2015).
- 17 Supra note 4.
- 18 *Ibid.*
- 19 Supra note 2.
- 20 When nothing is resolved in court – by Pradeep S Mehta (CUTS International), Hindu Business Line, July 2015.
- 21 Supra note 2.
- 22 *Ibid.*
- 23 Supra note 4.
- 24 Supra note 2.
- 25 Supra note 20.



## CHAPTER 8

# Competition and Regulatory Issues in Banking Sector in India with a Focus on Bank Licencing

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### Introduction

Modern banking, in India, originated during the 18<sup>th</sup> century and has since, witnessed radical changes. As of 2015, India accounts for 46 domestic commercial banks (26 Public and 23 Private Sector Banks) and 43 foreign Banks, collectively known as Scheduled Commercial Banks (SCBs).<sup>1</sup>

SCBs through a network of 92,114<sup>2</sup> branches and employing approximately 1,096,984<sup>3</sup> people, throughout India, seeks to provide last mile connectivity of the banking services. Apart from SCBs, there exist Regional Rural Banks (RRBs) and Co-operative banks which also provide banking services. Despite a network of this big, banking sector falls short of catering to entire population of India and almost half of the population, till recently, remaining financially excluded.

There have been several initiatives taken by the government – Reserve Bank of India (RBI) and National Bank for Agricultural and Rural Development (NABARD) over the years to fuel financial inclusion (Annexure 7.1) but the impact have been below expectation. In 2011, *Swabhimaan* scheme was launched, which focussed on providing banking services to un-banked villages with population greater than 2000. Changing the focus from villages to household, the government has shown rigour by launching the ambitious '*Prime Minister Jan Dhan Yojana (PMJDY)*' mission. The mission aims to provide at least one bank account to each household, through which basic financial services like credit, remittance, insurance and pension may be provided. PMJDY, since its inception in August 2014,<sup>4</sup> has shown tremendous success by opening up 179 million bank accounts.<sup>5</sup>

Yet only 55 percent of the population is associated to deposit accounts and only 9 percent have availed credit thorough banks.<sup>6</sup> Approximately 145 million households remain excluded from banking services. Current average of one bank branch catering to 14,000 people<sup>7</sup> when compared to

government's mission of at least one branch per 1,000 to 1,500 households (approx. 4,000-5000 people), shows that lot remains to be achieved.

The banking sector may have public and private players now, but since inception till 1960s, the banking industry was dominated by private banks. The established banks then, catered to particular ethnic and religious communities<sup>8</sup> and thus, had limited outreach. In order to turn the operations of banks to benefit country's holistic development and public interest, the government, in 1960s, decided to nationalise a number of private banks.

## Nationalisation

Nationalisation meant that private banks were turned public and the government became the majority shareholder. Year 1969 saw 14 banks being nationalised and 6 more were nationalised in 1980.<sup>9</sup> Through nationalisation, the government's overall objective was to achieve a wider spread of bank credit, prevent its misuse, direct larger volume of credit flow to priority sectors (such as agriculture and small industries) and to make banks an effective instrument of economic development.<sup>10</sup>

### Box 8.1: Side-effects of Bank Nationalisation

Nationalisation led to increase in bank outreach, controlling private monopolies, directing funds to the needy, et al, it also it resulted in some problems creeping in due to lack of efficient planning and considerations to professionalism and accountability, such as:<sup>11</sup>

- Banks lacked professionalism, owing to politicians, bureaucrats and their relatives on the board.
- In order to promote agriculture and small industries, banks were forced to lend at unsustainable rates. The rates were even less to cover the cost of loans, which are still effectively as low as 4 percent.<sup>12</sup>
- Middlemen arose in the system, which borrowed from banks at lower rates (4 percent) and further circulated the money in market (especially to farmers) at multi-fold rates (36 percent).
- The Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) were kept very high (15 and 38.5 percent respectively in 1991), which left banks with very little money for advances.
- Primary focus on agriculture and small industries made it difficult for other businesses to avail loans which adversely impacted business expansion and saw declining exports.

*Source: International Journal in Management and Social Science, Vol.03 Issue-02, (February, 2015)*

Current scenario highlights the need for strengthening the financial service connectivity in the country. One possible way may be allowing more full-fledged or differential banks focussing on ensuring last mile connectivity of financial services. In past, RBI had provided licences to 14 private banks. It has also recently issued in-principle approvals for operations of differentiated banks such as payment and small finance banks. Differentiated banks are contemplated to meet credit and remittance needs of small businesses, unorganised sector, low income households, farmers and migrant work force.<sup>13</sup>

One of the reasons of low penetration of banking services in India may be attributed to poor competition in the sector. A number of studies have indicated that competition drives expansion and efficiency of services. While this may hold true, one of the key factors impeding competition are high entry barriers. Licensing is one form of entry barrier. Added with the inefficiencies of the Public Sector Banks (PSBs), which is clearly reflected from the ₹2.67tn<sup>14</sup> of Non-performing Assets (NPA) they contribute, the banking sector needs new private entities to reform it further. It is thus imperative to analyse the impact of the bank licensing regime in India including the entry regulations associated.

Thus, this chapter highlights the concerns of the commercial banking sector, prominent banking reforms over the years, issue of differential treatment of public and private banks and a special attention to new private bank licensing and introduction of differential banking institutions. To understand the competition and the licensing regime, it is necessary to delve into the regulatory architecture of Indian Banking sector and how the banking reforms over the years have influenced the current scenario.

## **Regulatory Architecture**

The RBI is responsible for regulating the banking sector in India. Established on April 01, 1935<sup>15</sup> in accordance with the provisions of the RBI Act, 1934, RBI was originally privately-owned. With its nationalisation in 1949, RBI is now fully owned by the Government of India and has 19 regional offices, most of them in state capitals and 9 sub-offices.<sup>16</sup>

### Box 8.2: RBI and its Functions

RBI has numerous functions, which are critical to the national development and financial stability. The major functions of RBI are:

- (1) formulating, implementing and monitoring the monetary policy;
- (2) regulating and supervising financial system;
- (3) managing Foreign Exchange; and
- (4) issuing currency; besides a wide range of promotional functions to support national objectives and acting as a banker to the government and all scheduled banks.

*Source: Reserve Bank of India Website (accessed September 2015)*

## Regulatory Reforms

Over the years there have been a number of committees/commissions constituted to bring reforms to the banking sector. Some of them have been briefly mentioned below:

### *Narasimham Committee I (1991)*

After the Balance of Payment (BoP) crisis in 1991,<sup>17</sup> the government had to embrace economic liberalisation. Similar reform was required for the banking sector for inclusive development of the country. An Expert Committee was thus set up, under the chairmanship of M Narasimham, for spearheading financial sector reforms in India. The Narasimham Committee recommended many changes to the financial sector of which one was opening of banking sector for private players. The rationale behind this was that private players would infuse competition which shall result in enhancing efficiency in the sector, desperately needed after nationalisation setbacks. This recommendation was accepted and subsequently in 1993, first window of licences for new private banks was opened.

### *Narasimham Committee II (1998)*

After the earlier Committee influenced reforms, the Narasimham Committee was again laden with the task to strengthen the financial sector further, in particular the financial institutions. The Committee report highlighted the desperate need of providing financial services to underserved and focussed on factors like size of banks and capital adequacy ratio among others. It observed that the new private banks, along with PSBs, had lagged behind on the financial inclusion objectives. Thus, the Committee, of the many recommendations for financial inclusion, recommended introduction of more

private banks which was instigated by RBI in 2003 by opening second window for bank licences.

### ***Financial Sector Legislative Reforms Commission (2011)***

In March 2011, the Ministry of Finance constituted the Financial Sector Legislative Reforms Commission (FSLRC),<sup>18</sup> to clean up and rewrite the financial sector laws according to current requirement of the country. FSLRC assessed that regulatory gaps, overlaps, inconsistencies and arbitrages exist in financial sector because of the presence of multiple regulators.

In March 2013, FSLRC submitted a report<sup>19</sup> to the Ministry which addressed the regulatory issues and a draft Indian Financial Code to supplant numerous existing financial laws. On regulation of banking sector, the FSLRC emphasised on the need of independence and accountability of the regulator, i.e. RBI. The code proposed a shift from sector-wise regulation to a differential framework where only RBI would be responsible for regulation of banking and payment system.

FSLRC also commented on the existing legislation on banking and how it impacts ideal competition and operations. In its eighth meeting, the Financial Stability and Development Council (FSDC) approved the implementation of the recommendations which would enhance governance, and not require legislative action at present.<sup>20</sup>

### ***PJ Nayak Committee (2014)***

In January 2014, RBI constituted a Committee under the chairmanship of former Axis Bank head P J Nayak, to review issues of governance in banks. The issues to be addressed included the assessment of the level of regulatory compliances required, operational framework of different banks, suggesting strategies for growth and risk management, regulatory guidelines on bank ownership, ownership concentration and representation in the board, et al.<sup>21</sup>

#### **Box 8.3: Recommendations of PJ Nayak Committee**

Some significant recommendations by the PJ Nayak committee were as follows:<sup>22</sup>

1. State ownership and control impacts PSB's performance. Thus, the Committee recommended keeping State only as investor and not exercising any control in PSBs.

*Contd...*

2. It recommended repealing the different banking Acts and bringing all banks under Companies Act, and a Bank Investment Company (BIC).
3. It recommended reduction in government stakes in PSBs to just less than 50 percent. This was to reduce burden of vigilance and right to information (RTI) on PSBs while keeping them state-owned.
4. The Committee recommended a special vehicle, similar to a holding company, which would have powers to make appointments of whole-time directors and directors that represent State.
5. The Committee suggested 'fit and proper' criteria for governance.
6. The Committee suggested a fixed term of five years for the chairman/managing director and three years for a whole-time director.

Source: "Governance reforms in banks: The Nayak Committee Report", *Business Today* (May 20, 2014)

### ***Indradhanush Scheme (2015)***

In 2015, the Union Government released another banking reform known as *Indradhanush*. This reform is intended to revamp the functioning of PSBs through a seven pronged agenda. It is yet to be seen how this reform turns out in improving the state of PSBs but may spur efficiency of the PSBs which have lagged behind their private counterparts and are bearing humongous amount of NPA on their books. The seven points of the agenda were on appointments of top management; setting up Bank Board Bureau, Capitalisation, De-stressing PSBs, Empowerment, establishing a framework of accountability and reforming governance.<sup>23</sup> However, P J Nayak himself has commented on *Indradhanush* to be insufficient to bring major reforms to the banking sector.<sup>24</sup>

#### **Box 8.4: Salient Features of *Indradhanush* Scheme**

The seven pronged agenda of the *Indradhanush* Scheme may be summarised as follows:

1. **Appointment:** Separates post of Chairman and Managing Director in PSBs as Managing Director and Chief Executive Officer (MD & CEO) and a non-Executive Chairman. Announcement of appointment of MD & CEOs and non-Executive Chairmen for various PSBs was also done in fits and starts.

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<ol style="list-style-type: none"> <li>2. <b>Bank Board Bureau:</b> The government shall set up Bank Board Bureau which would act as a link between government and bank and shall monitor PSBs performance.</li> <li>3. <b>Capitalisation:</b> Infusion of a total of ₹25,000 crore of capital into debt-laden PSBs in fiscal 2015-16. Over the next four years, the government plans to inject ₹70,000 crore.</li> <li>4. <b>De-stressing:</b> Fast processing of projects and clearances to avoid the PSB funding turning into NPAs.</li> <li>5. <b>Empowerment:</b> Providing flexibility to PSB on hiring.</li> <li>6. <b>Framework of accountability:</b> New indicators to measure PSB performance were announced.</li> <li>7. <b>Governance reforms:</b> No State interference in the operations of PSBs.</li> </ol>
<p><i>Source: Department of Financial Services, 2015</i></p>

There have been other committees as well such as Raghuram Rajan Committee, Malegam Committee, Tarapore Committee, Mor Committee, etc., which provided their recommendations on financial inclusion, microfinance and other financial issues in India. One of the key recommendations of some of the committees, starting from the Narasimham Committees, was the introduction of new private banks in the sector and now the introduction of differential banks, such as payment and small finance in India. Private entities are being rationally given banking licences by the RBI, which in past has provided the much needed momentum to banking services in India and may even in the future. The next section thus talks about the different licencing windows which RBI opened.

## Bank Licencing

### *Bank Licences: 1<sup>st</sup> Round (1993)*

Pre liberalisation scenario accounted for PSBs holding 91 percent of total bank branches in number and 85 percent of total banking business by quantum.<sup>25</sup> Based on the recommendations of Narasimham Committee I (1991),<sup>26</sup> the first window for new private bank licences was opened by RBI in 1993, and applications were invited. Based on the guidelines then, ten private players were granted licences to operate banks in India in 1993, which subsequently started their operations in 1994-95. Not all banks

could survive the competition, which lead to four banks merging with others, while six others are still operational.

Table 8.1: Bank Licences Granted in 1993	
Still Operational	Merged with other banks
1. Industrial Credit and Investment Corporation of India (ICICI)	7. Global Trust Bank
2. Housing Development Finance Corporation (HDFC)	8. Bank of Punjab
3. Unit Trust of India (UTI) (now Axis bank)	9. Centurion bank
4. Industrial Development Bank of India (IDBI)	10. Times Bank
5. Indus Bank	
6. Development Credit Bank (DCB)	

### ***Bank Licences: 2<sup>nd</sup> Round (2003)***

In 2001, based on Narasimham Committee II recommendations, RBI released guideline for the entry of new private banks and invited applications. Private banks had shown potential to drive productivity and efficiency in the sector and were looked upon, to drive it further. With focus on ‘customer service’ and ‘technology’, private banks had showed considerable improvements in the economic and financial parameters<sup>27</sup> since their introduction in 1993.<sup>28</sup> This led to improvement in overall efficiency of the sector. However, the collapse of Global Trust Bank made sure that RBI took a more pragmatic approach in granting licences and thus, granted licences to only two new banks in 2003 which started their operations in 2003-04 i.e. Kotak Mahindra; and Yes Bank

Box 8.5: Collapse of Global Trust Bank
Global Trust Bank (GTB) was granted license in 1993 in the first licensing window by RBI. GTB went on to become a leading private sector bank in India. Since 2001, GTB's name was associated with scams and controversies, thereby casting shadows over the credibility of the bank and its management.

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Due to the over exposure to capital markets and huge NPAs, the bank was in a financial mess. When GTB tried to cover up its monumental NPAs through under provisioning, RBI appointed an independent team to review the finances of the bank. The review revealed various financial discrepancies kept covered by the bank.

RBI imposed a three month moratorium on GTB on the ground of “wrong financial disclosures” and within two days the bank was merged with Oriental Bank of Commerce (OBC), a public sector bank. With the merger becoming effective, GTB’s identity came to an end and it became a part of OBC.

*Source: The Rise and Fall of Global Trust Bank, Case Study by ICMR, 2005*

### **Bank Licences: 3<sup>rd</sup> Round (2013)**

In 2011, the then finance minister, Pranab Mukherjee, announced the issuing of new private bank licences to improve the access to banking services in India. Subsequently, RBI, in 2013, released guidelines for new bank licences.<sup>29</sup> The new guidelines, surprisingly, allowed large business houses to apply for banking licences for which RBI, in earlier cases, was reluctant. However, no business houses were given banking licences. The licencing attracted 26 applicants of which only two were granted in-principle approval in 2014. These were:

- 1) IDFC Limited and; 2) Bandhan Financial Services Private Limited

#### **Box 8.6: Licencing Guidelines of 2013**

The key points of the licencing guidelines were:

- Allowed Indian resident owned entities, public sector entities, existing NBFCs as well as large industrial houses to apply.
- A “Fit and proper” criteria to ensure credibility and integrity of applicants. 10 years of operation experience and financial soundness mandated.
- Even if the applicant met the eligibility criteria, RBI could still decide against granting license.
- The new banks could only be set up through a Non-Operating Financial Holding Company (NOFHC), established by the promoters to hold their investments in banks. NOFHC was to be registered as NBFC and no individual, belonging to promoter

*Contd...*

group, could hold more than 10 percent of total voting equity in it.

- Initial minimum paid up capital requirement was set as ₹5bn of which NOFHC could hold a minimum of 40 percent of paid-up capital. This capital was to be locked-in for a period of five years from the commencement of banking operations.
- If NOFHC's shareholding was more than 40 percent, it is to be brought down to 40 percent within 3 years of commencement of business. Further to be brought down to 20 percent and 15 percent within 10 and 12 years respectively.
- Banks were to maintain a minimum capital adequacy ratio (CAR) of 13 percent of the risk weighted assets (RWA) for a minimum time of three years commencement of operations. The banks would also need to go public within three years of commencement of operations.
- The foreign shareholding was capped at 49 percent and could not exceed for the initial 5 years from the date of licensing. Post five years, the foreign share may follow norms of the existing policy (74 percent).
- The banks could not invest or provide credit to promoters or any member of NOFHC. The banks would also not be allowed to invest in capital instruments of other financial entities under NOFHC.
- A single entity or a group (apart than NOFHC) cannot have a shareholding of more than 10 percent of the paid-up voting equity capital of the bank.
- The bank shall need to open 25 percent of its branches in unbanked rural centres.

*Source: New Banking License in India, Action Financial Service (pvt.) Ltd*

The awarding of licence to a microfinance company (Bandhan) and an infrastructure finance company (IDFC) showed the primary intention of RBI to promote banks which focus on serving the financially excluded strata of society along with implementing a sustainable business model to keep the progress going. Bandhan and IDFC have started their banking operations in August and October 2015 respectively.

### ***Comparison of Old and New Private Bank Licencing Guidelines by RBI***

The perquisites for the entry of private players, for the banking industry, have been changing over the years. Table 8.2 highlights the major differences between the last set of guidelines (2001) and the latest guidelines (2013).

<b>Table 8.2: Comparison of 2001 and 2013 New Private Bank Licencing Guidelines</b>		
<b>Key Features</b>	<b>2001 Guidelines</b>	<b>2013 Guidelines</b>
<b>Eligible Promoters</b>	<ul style="list-style-type: none"> <li>The new bank should not be promoted by a large industrial house</li> </ul>	<ul style="list-style-type: none"> <li>No restriction on large industrial or business houses</li> <li>Bank may only be set up through a NOFHC</li> </ul>
<b>Minimum Equity Capital</b>	Initial: ₹2bn Target: ₹3bn within three years	Initial: ₹5bn
<b>Criteria for selection</b>	<b>Preference</b> to promoters with expertise of financing priority areas and financing of rural and agro based industries	“Fit and Proper” Criteria, sound credentials and a 10-year track record of running business successfully
<b>Foreign Shareholding</b>	Maximum Foreign shareholding: 40 percent	Maximum Foreign shareholding: 49 percent (for initial 5 years, from the date of licensing); and then 74 percent
<b>Promoter's contribution in Paid-up capital</b>	<ul style="list-style-type: none"> <li>Minimum Promoter's contribution: 40 percent of the paid-up capital</li> <li>Capital locked-in period: five years from the date of licencing</li> <li>Dilution of capital in excess of 40 percent: after 1 year of the bank's operations.</li> </ul>	<ul style="list-style-type: none"> <li>NOFHC to hold a minimum of 40 percent of paid-up capital</li> <li>Capital locked-in period: five years from commencement of banking operations</li> <li>Dilution of NOFHC shareholding in excess of 40 percent: within three years of commencement of business. To be brought down to 20 percent and 15 percent within 10 and 12 years respectively</li> </ul>
<b>Minimum CAR</b>	10 percent	13 percent
<b>PSL<sup>30</sup> Targets</b>	25 percent of its branches in rural and semi-urban areas	25 percent of its branches in unbanked rural areas
<b>Listing the Bank</b>	No mandatory listing quoted (Option to go public to raise capital)	Within 3 years of commencement of operations.
<i>Source: RBI Circulars</i>		

The new guidelines were more precise as compared to the older one; however, the eligibility criterion for entry of new private banks has now become more stringent and demanding. Higher CAR and minimum capital requirement, strict dilution of promoter's contribution to paid-up capital, limit on foreign shareholding et al, set the bar higher for the entry of new players than ever before. In both rounds, a number of entities applied for banking licences, however a handful of entities were granted licences.

The regulator, also, did not specify the reasons for granting bank licences to some and rejection of other apparently eligible entities. There appears to be no sound rationale for rejection of applications of entities which have qualified the eligible criteria, without providing reasoned decision and opportunity of hearing. Also, there is no redressal mechanism to which rejected entities could approach. No fear of potential entrants results in reduced competition.

Looking at the weak performance of PSBs,<sup>31</sup> there is a desperate need of allowing more private banks in the arena or privatising the existing PSBs and raising the entry barriers restricts the new entries. However, RBI has also tried to bridge the gap in financial inclusion by introducing differential banking.

## **Differential Banking Licences: Payment Banks and Small Banks**

### ***Payment Banks***

RBI constituted a committee headed by Dr. Nachiket Mor in 2013 to recommend innovative solutions to accelerate financial inclusion in sustainable and cost effective way. One key recommendation in its report, in 2014, was to introduce specialised banks (Payment Banks) to cater to the lower income groups and small businesses. The report also provided high level criteria to assess 'Fit and Proper' status of the Payment bank licence aspirants.

RBI, in November 2014, released guidelines on eligibility and licencing of Payment Banks. RBI received 41 applications<sup>32</sup> which included some big business houses as well. In August 2015, RBI granted in-principle approval to 11 applicants to set up payment banks. These are listed in Table 8.3:

**Table 8.3: Payment Bank Applicants Getting in-Principle Approval by RBI**

1. Aditya Birla Nuvo Limited
2. Airtel M Commerce Services Limited
3. Cholamandalam Distribution Services Limited
4. Department of Posts
5. Fino PayTech Limited
6. National Securities Depository Limited
7. Reliance Industries Limited
8. Dilip Shantilal Shanghvi
9. Vijay Shekhar Sharma
10. Tech Mahindra Limited
11. Vodafone m-pesa Limited

Payment banks can accept deposits (not exceeding ₹1 lakh), issue ATM/ Pre-Paid Instruments/Debit Cards, offer remittance services and can provide internet banking services to consumers. They can also act as business correspondents to other banks but they cannot provide credit services. Thus, a Payment Bank can not undertake lending activities, issue credit cards, accept NRI deposits or become a ‘virtual’ bank or branchless bank.<sup>33</sup>

**Box 8.7: Snapshot of Payment Bank Guidelines**

**Promoter Eligibility:**

- NBFCs, Telcos, Corporate BCs, PPI Issuers, super-market chains, companies, real sector co-operatives and public sector entities, individuals, professionals
- Partnering with a SCB/ Sound track record running businesses for five years
- Conform to ‘fit and proper’ and any other criteria prescribed by the RBI
- Minimum capital contribution: ₹400mn
- Restriction on aggregate shareholding of FDI, NRIs and FIIs

*Contd...*

**Credentials:**

- Promoter groups should have sound credentials and integrity
- Source of promoters' equity should be transparent and verifiable
- The Board should have a majority of independent Directors ·  
Compliance with corporate governance guidelines including 'fit and proper' criteria for Directors

**Business Model:**

- Business model should compliant with allowed scope of activities provided in the guidelines
- Focus to address financial inclusion
- Adoption of technology to lower the operational costs and extend reach
- Best-in class customer service proposition

**Post Licence Requirements:**

- Bank should be fully networked and technology driven
- Should have well established customer grievance cell
- Maintain leverage ratio less than 33.33
- CAR: 15 percent
- Maintain CRR and SLR requirements
- If net worth reaches ₹5bn, listing and diversification of ownership is mandatory within three years

*Source: RBI Guidelines for Licensing of Payments Bank: Opportunities and Challenges, Deloitte, December 2014*

**Small Banks**

In 2013, RBI published a policy discussion paper 'Banking Structure in India – The way forward'. The discussion paper highlighted the merit in considering access to bank credit and services through expansion of Small Banks in unbanked and under-banked regions of India. Subsequently in November 2014, RBI published the guidelines for Small Finance Bank and invited applications. RBI received 72 applications<sup>34</sup> and granted in-principle approval to 10 applicants in September, 2015, which were:



**Table 8.4: Small Bank Applicants Getting in-Principle Approval by RBI**

1. Au Financiers (India) Limited
2. Capital Local Area Bank Limited
3. Disha Microfin Private Limited
4. Equitas Holdings P Limited
5. ESAF Microfinance and Investments Private Limited
6. Janalakshmi Financial Services Private Limited
7. RGVN (North East) Microfinance Limited
8. Suryoday Micro Finance Private Limited
9. Ujjivan Financial Services Private Limited
10. Utkarsh Micro Finance Private Limited

The objectives of setting up of Small Finance Bank will be for furthering financial inclusion by: (i) provision of savings vehicles primarily underserved sections of the population; and (ii) supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology-low cost operations.

A Small Finance Bank can offer basic banking services (acceptance of deposits and lending to underserved sections including small business units, small and marginal farmers, micro and small industries and unorganised sector entities), non-risk sharing simple financial services activities not requiring any fund commitment, such as distribution of MFs, insurance products, pension products, etc. and the Small Finance Bank can also become a Category II Authorised Dealer in foreign exchange business.

**Box 8.8: Snapshot of Small Bank Guidelines**

**Promoter Eligibility:**

- 10 years of experience in banking and finance. Successful track record of running business for five years
- NBFCs, Micro Finance Institutions (MFIs), Local Area Banks (LABs) permitted
- Conform to 'fit and proper' and any other criteria prescribed by RBI

*Contd...*

- Minimum capital contribution: ₹400mn
- Restriction on aggregate shareholding of FDI, NRIs and FIIs

**Credentials:**

- Promoter groups should have sound credentials and integrity
- Source of promoters' equity should be transparent and verifiable
- The Board should have a majority of independent Directors
- Compliance with corporate governance guidelines including 'fit and proper' criteria for Directors

**Business Model:**

- Realistic and financially viable business model
- Focus to address financial inclusion
- Adoption of technology to lower the operational costs and extend reach

**Post License Requirements:**

- Need to have at least 25 percent of branches in unbanked rural areas
- 75 percent of adjusted net bank credit to priority sector
- 50 percent of loan portfolio should constitute loans and advances of upto ₹25 lakh ticket size
- CAR: 15 percent
- Bank should be fully networked and technology driven
- Shareholding by promoters in excess of 40 percent shall be brought down to 40 percent within five years of commencement
- Promoter's stake should be brought down to 30 percent within a period of 10 years, and to 26 percent within 12 years from the date of commencement
- If net worth reaches ₹5bn, listing is mandatory within three years of reaching that net worth

*Source: RBI Guidelines for Licensing of Small Bank: Opportunities and Challenges, Deloitte, December 2014*

### ***Outlook on Payment Bank and Small Bank Guidelines***

RBI, like always has stressed on financial institutions to adopt technology and innovative business models to bring the cost of providing services down and increasing outreach of financial services. However, certain clauses in the guidelines may prove restrictive to this purpose.

1. To start from, the guidelines provide the objective of payment banks to further financial inclusion. Payment banks, as envisaged by the Guidelines, enable access to formal savings and payment services

but not credit. Access to credit is an essential feature of financial inclusion, and without it inclusion cannot be complete.

2. 5 years (payment banks) and 10 years (small banks) have been set as minimum experience required, to prevent the entry of unscrupulous entities from getting licences. However, in this world of startups, the key may be held by innovative and technologically sound yet inexperienced entities. Restricting such entries may stifle innovations in business models.
3. Further, the “fit and proper” criterion sets the entry barriers too high for aspirants. The mandatory dilution of ownership by the promoters within 3 years may also repel the potential applicants from applying for licences as it may go against their interests.
4. The Guidelines provide that payment banks will be required to invest balance funds in government securities/treasury bills with maturity up to one year that are recognised by RBI as eligible securities for maintenance of statutory liquidity ratio. Payment banks must be allowed to deploy funds in corporate bonds of reputed companies (short term AAA rated corporate bonds), in addition to government securities. This would help them to earn reasonable interest, thus making the business model viable. The Nachiket Mor committee made recommendations on similar lines.
5. Lastly, RBI doesn’t provide the rationale behind the number of licences granted for payments banks (11) and small banks (10). While there is a need to introduce more financial institutions, RBI not keeping the decision process transparent is questionable.

## **Public vs. Private Sector Banks**

It has always been claimed that the public and private banks are treated differentially and thus there exists no level playing ground for all banks combined. This may be attributed to constant change in government’s stance over bank ownership (nationalising and then allowing new private entrants) or the operational factors as different banks governed by different Banking Acts in the country.

## **Sector Entry**

Over the years, the approach of the government on entry of new banking institutions has changed dramatically. From nationalising private banks to allowing new private banks to the sector, the changes have been numerous. Considering the changes, the banking scenario, over the years, may be divided into three phases for independent India:

### 1947-1959

All the banks, operational then, were private. The only notable public bank during this phase was SBI, which became public through government buying major shareholding in 1955, on recommendation of RBI. During this time, the private banks catered to specific sections of the society which left a large population unbanked and underserved. While there was requirement for banks to enhance their outreach for holistic growth of the country, the government was left with limited resources (public sector banks), to drive it.

### 1960-1990

This phase saw all major private banks being nationalised in national interest. During this phase, Indian Banks were working in a regulated system. Interest rates were regulated by RBI, credit was controlled, and SLR and CRR requirements were high, which adversely affected efficiency and financial stability. Even though there was rapid growth of deposits, profitability of banks was low. Due to constant wearing down of capital, there were questions on the survival of the Indian Banking System.

**Figure 8.1: Confused State of Government on Bank Ownership**



### 1991-present

Post the BoP crisis of 1991, Narasimhan Committee I recommended opening of sector for new private players to infuse competition and efficiency. Thus, in 1993, 2003 and 2013, three different windows were opened for new private banks to step in. The new private banks delivered the much needed competition in the industry and PSBs have been continuously losing their market shares to them.<sup>35</sup> Still, the entry barriers over the years have been raised considerably by RBI. The first window saw collapse of 4 out of 10.

However the FSLRC, in its resolution says, *“Failure of financial firms is an integral part of the regenerative processes of the market economies: weak firms should*

*fail and thus free up labour and capital that would then be utilised by better firms. However, it is important to ensure smooth functioning of the economy, and avoid disruptive firm failure.”<sup>36</sup>* Despite the evident requirement of new private entities in banking, RBI has been constantly raising the entry barriers. Thus, limiting the private players in the sector or restricting their entry, may be deemed questionable.

#### **Box 8.9: PSBs Losing Out to Private Banks**

The following statistics provide evidences on how PSBs are losing market to their private counterparts:

- 2.8 percent is the share in current account deposits that PSBs lost in four years, says a Morgan Stanley report
- 4.9 percent is the share in current account deposits that private banks have gained
- At a rate of 1-1.5 percent every year, PSBs are expected to lose market share
- 6.1 percent is market share that private banks have gained in four years
- 120 basis points of loan market share is what PSBs have lost to private banks, according to Jefferies

*Source Business Standard, “Private banks wrest market share from PSBs”. July 2015*

### **Operational Factors**

Apart from the change in government strategies for the banking industry, there exist several issues regarding the operations of the banks in India. These might be attributed to regulatory arbitrages, ownerships and the operational frameworks. These issues hinder fair competition between the public and private banks which is adverse to consumer interests. While the PSBs enjoy certain leverages and benefits as compared to their private counterparts, they also bear extra burden levied upon them by the government.

Thus, it is essential that the government ownership should not lead to differential treatment of private and public banks. PSBs should run professionally and compete with private sector counterparts even when they are owned by government.

### ***Regulatory Arbitrages***

1. The PSBs are endowed with implicit government guarantee which ensures their insolvency. Thus consumers perceive PSBs safer as compared to private banks.<sup>37</sup>
2. State Bank of India (SBI) Act (1955) and SBI (Subsidiary Banks) Act 1959, governs the working of SBI and its associates. The Private Banks are governed by the Banking Regulation Act (1949). The Nationalised Public Sector Banks are governed by The Banking Acquisition (1970), Banking Acquisition (1980) and partially the Banking Regulation (BR) Act (1949). The different acts governing different banks, creates an unduly regulatory regime for banking players, examples of which are listed below:<sup>38</sup>
  - a. Voting rights of a shareholder in a private bank is capped at 10 percent, but voting rights of a shareholder of a PSB is restricted to one percent.
  - b. Provisions on restructuring, suspension of business and winding up is also different under different Acts. RBI has powers to intervene when the managing director of a bank, governed under the BR Act, is not a fit and proper person. In case of nationalised banks, RBI does not have such wide powers.
  - c. On winding up, RBI may apply to the Central Government for imposing a moratorium for banks governed under BR Act.
  - d. For nationalised banks the power to order a dissolution or a merger/amalgamation vests solely with the Central Government.
3. Riskier PSBs, with high *ex-ante* systemic risk and low Tier 1 capital, have in the past received greater capital support from the government.<sup>39</sup>
4. The Statutory Deposits for government run programmes are parked only at PSBs.<sup>40</sup>
5. There is added burden on PSBs for executing the government schemes/social initiatives, for which even the Governor of RBI stated that the PSBs are not compensated sufficiently.<sup>41</sup>
6. PSBs cannot appoint Chief Executive and other directors to the Board themselves.<sup>42</sup>
7. Remuneration differences and low decision making independence at PSBs.

There exist imbalances in treatment of public and private banks as per existing regulation. The FSLRC and Nayak Committee have recommended key points to eliminate these differences which are however yet to be incorporated by the government/RBI.

## Conclusions and Recommendations

The introduction of financial services through the likes of new private, payment and small banks is expected to enhance competition in the sector. The likely impact of the competition might be seen on the deposit and credit rates, and some players might go on adopting unsustainable rates. It might also result in innovations on products and ways of catering consumers which might bring down the operational costs. Considering the technology upgradations and innovations, to keep up with the competition, would have financial implications on every player and may result in lowering of margins.

This might also be a peephole for un-ethical and other unfair practices between players, for which the regulator, Competition Commission of India (CCI) as well as consumers would need to stay vigilant. However, to increase the consumer footprint, the new players as well as the old ones, would need to venture into rural setups to hold their market positions. This is likely to impel the financial inclusion drive of India. The other impacts would be the development of a good rural banking network as well as some issues that could crop up regarding corporate governance of new conglomerate-owned banks<sup>43</sup> in case of payment and small banks as no business houses were given new private bank licences.

### Box 8.10: Overlapping of Banking Regulations with Competition

RBI once wrote to the Corporate Affairs Ministry for exclusion of the Banking Sector from the Competition Act. The request, however, was declined. There are a number of functions RBI performs which overlap with the operations of the CCI. RBI, through Banking Regulation Act 1949, is the sanctioning authority for banking company's mergers and acquisition. Similarly, there are other regulatory provisions exercised by RBI which overlap with the CCI. Whilst there could be other channels that can be used by the central bank to influence outcomes of the banking sector (e.g., bailouts or directives on mergers), there are generally some specific issues that are covered by specific statutory and administrative regulatory provisions, which include the following:

- Restrictions on new entry;
- Restrictions on pricing (interest rate controls and other controls on prices or fees);
- Line-of-business restrictions and regulations on ownership linkages among financial institutions;

*Contd...*

- Restrictions on the portfolio of assets that banks can hold (such as requirements to hold certain types of securities or requirements and/or not to hold other securities, including requirements not to hold the control of non-financial companies);
- Capital-adequacy requirements, normally enforced through forced or encouraged mergers;
- Requirements to direct credit to favoured sectors or enterprises (in the form of either formal rules or informal government pressure), resulting in some needy firms failing to access credit;
- Special rules concerning mergers (not always subject to a competition standard) or dying banks (e.g., liquidation, winding up, insolvency, composition or analogous proceedings in the banking sector);
- Other rules affecting cooperation within the banking sector (e.g., with respect to payment systems).

*Source: ICN, 2005*

However, this would see an increase in pressure on the PSBs for their debt management. The reductions of margins, fresh competition, market aggression, et al shall result in lesser budget left to offset their NPAs. However, the banks may also strategise their debt management through increased efficiency and cost cutting measures, but is highly unlikely to happen given the past experiences. This may result in government infusing more money in PSBs. Even though the Government and RBI have taken many initiatives to make the industry more efficient, there are more reforms needed to ensure this. Some of these are as follows:

### ***Eliminating Regulatory Arbitrages between Private and Public Sector Banks***

Different banks in India are governed by different banking legislations. The presences of multiple legislations, creates a non-uniform regulatory scenario for the market players which deeply stifles competition. Ensured insolvency and the benefits enjoyed by SBI and its associates and PSBs must be withdrawn and there should be a standard legislation for all banks in India, irrespective of their ownership type. Tools such as Regulatory Impact Assessment (RIA)<sup>44</sup> and Competition Impact Assessment (CIA)<sup>45</sup> may help in evaluating the effects of the proposed and existing regulations to formulate the most optimal design.



### ***Ensuring Competitive Neutrality***

Other than the regulatory issues, there are several other factors that limit competition in the sector. The PSBs are laden with the responsibilities of government initiatives, which become burdensome in terms of time and costs incurred. The government should thus adequately compensate PSBs for these added responsibilities.

Usually, for all government initiatives, significant funds are parked in PSBs only, which provide them additional money to invest or to provide consumers on credit.<sup>46</sup> Private banks never receive such deposits which dampen the competition in the sector. Moreover the performance meltdown at PSBs may also be associated with the performance of employees. Like all other public sector organisations, the employees at PSBs have very less incentives to perform well as compared to those in private banks. The salaries for PSB employees are not even comparable to ones at private banks. Thus, there is a need to ensure effective remuneration which shall keep the employees at PSBs competitive to the private employees which shall promote performance.

### ***Ensuring Level Playing Ground for Banks and Non-banks***

With the existing banks struggling for a level playing field due to presence of different legislation governing different banks, the entry of differential banking institutions might make the situation even more complicated. This may be in terms of the regulations on the differential banks versus the existing full-fledged banks. Just like the regulatory arbitrages exist in case of public versus private banks, to which both entities claim imbalances in regulation, any such regulatory imbalances between differential banking entities shall defeat the purpose of their introduction.

The banks (existing and upcoming) may face competition from the differential banks which shall strive hard to expand their consumer base. This would involve fierce fights for existing consumer bases and well as expanding the outreach through modern and more innovative technologies. And this competitive regime may only be ensured by providing a level playing field for all players irrespective of the type of bank they belong. This needs establishment of a regulatory strategy which is not non-discriminatory between banks and non-banks.

### ***Transparency on Licencing by RBI***

RBI has come up with in-principle approval to 11 applicants for payment bank licences; 10 for small banks and 2 for new private banks. The rationale behind the number of in-principle approvals has not been provided neither has been the reason for rejection of applications despite meeting the entry requirements. With RBI not providing details about the licensing process

highlights the non-transparency. Though, RBI statements suggest the licences to be provided “on the tap” to show licences would be providing on rolling basis, but it does not provide reason for their actions.

Moreover, RBI deciding on the payment banks to be governed by BR Act rather than the Payment and Settlement Systems Act, 2007, has also not been made clear. Though RBI claims that an external evaluation committee had chosen the 11 successful applicants based on their own procedure and analysis, the evaluation criteria too has been kept opaque.<sup>47</sup> There is a need to make the entire process more transparent which shall make RBI more accountable for its actions and decisions.

### ***Provisions of Statutory Appeals on RBI Decisions***

The new bank licensing guidelines make it clear that even if an application checks all boxes of the eligibility criteria, RBI would have the final say on providing the license. This highlights the extent of authority that RBI enjoys in the sector. RBI is not answerable to anybody for its decisions. For all the applications rejected for new banks, payment banks or any other licences, the applicants can never seek an explanation from the regulator. The non-existence of statutory or regulatory rights makes the scenario even worse for the applicants fearing the closure of doors permanently on them.

Considering the control RBI has on banking, it would be rather unwise for the applicants to go against the regulator and better to hope things becoming favourable on the next opportunity. This sense of fear<sup>48</sup> among applicants is not desirable for a sector which needs new players to achieve the much needed financial inclusion. Thus, it is proposed that there should be a provision for statutory appeals on RBI’s decisions. Not only it would bring transparency but this will also imbibe the much needed accountability of RBI on banking reforms.

Annexure 8.1: Measures taken by Government, RBI and NABARD		
Customer Service Centres Credit Counselling Centres <i>Adhaar</i> Scheme The National Agricultural Insurance Scheme No-frill Account Know Your Customer Project on Processor Cards Micro Finance Development Fund Farmers' Club Programme Rural Volunteers as Book Writers	Role of NGOs, SHGs and MFIs BF and BC models Micro Pension Model Nationwide Electronic Financial Inclusion System Project Financial Literacy National Rural Financial Inclusion Plan Financial Inclusion Fund Support to Cooperative Banks and Regional Rural Banks (RRBs) for setting up of Financial Literacy Centres	Financial Inclusion Technology Fund Separate Plan for Urban Financial Inclusion and Electronic Benefit Transfer Scheme Financial Literacy through Audio Visual medium - Doordarshan SHG-Post Office Linkage Project on "e-Grama" General Credit Card
Source: RBI, Economic Survey, Govt. of India, etc.		

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## CHAPTER 9

# Competition and Regulation in Broadcasting

### Introduction

The Broadcasting Sector consists of Television including analog and digital cable TV services, Direct-To-Home (DTH) satellite TV services, Internet Protocol Television (IPTV) services, Head-end In The Sky (HITS) and Over-The-Air (OTA) terrestrial TV services and Radio services. Table 9.1 gives timelines of various events in this sector.<sup>1</sup>

Table 9.1: Sequence of Events in the Broadcasting Sector	
Year	Event
1982	First Indian National Satellite (INSAT) launched
1983	Doordarshan started cable TV services
1991	International Satellite TV launched
1992	Cable TV programmes launched by Zee TV and Star TV
1995	Cable TV Networks Regulation Act announced
1997	Prasar Bharati was constituted ; All India Radio (AIR) and Doordarshan were brought under it
2000	First phase FM (Frequency Modulation) broadcasting; licenses given by auction
2001	DTH guidelines announced by the Government of India
2003	First notification of Conditional Access System (CAS) in Chennai
January 2004	Broadcasting regulation brought under Telecom Regulatory Authority of India (TRAI)
July 2005	Phase II of FM broadcasting guidelines announced; auction held
November 2009	Department of Telecommunications released HITS guidelines

*Contd...*

June 2012	Phase I Cable digitisation: Digitisation and implementation of CAS in metros
March 12, 2013	Government allows leasing of foreign transponder capacity by Indian DTH providers
March 31, 2013	Phase II of Cable TV digitisation in 38mn plus cities
August/ September 2015	Phase III of FM broadcasting guidelines announced; auction being held
December 2015	Phase III of nation-wide cable TV digitisation in urban areas
December 2016	Phase IV of nation-wide cable TV digitisation in all areas
March 2015	TRAI issued Consultation Paper on Over-The-Top (OTT) services

In the following sections, market structure, competition, and regulatory issues in each of these sectors will be discussed in detail.

### ***Television Broadcasting***

It was in September 1959, when the multinational company – Philips – donated some closed circuit Television sets after an exhibition in Delhi that the Indian government decided to experiment with the new technology.<sup>2</sup> Since then and through the 1970s and 1980s, augmented by developments in satellite technology that the Indian government endeavoured Television as a development communication tool through the public broadcaster – Doordarshan. Until 1990, most Indian viewers did not have a choice but to watch one national and one regional Doordarshan channel. The first competition for Doordarshan came in the form of illegal distribution of television signal by cable and foreign television channels in late 1980s and early 1990s.<sup>3</sup>

In 1989, some entrepreneurs in Bombay (now Mumbai) launched a local cable TV network that connected homes/apartments in a neighbourhood. Movies played from Video Cassette Recorders (VCRs) were broadcast in these networks, so that the residents could see these movies without borrowing VCRs. According to a survey cited by Rahim (1994),<sup>4</sup> there were more than 330,000 households in four metros i. e. Bombay, Delhi, Calcutta and Madras (now Chennai) having cable connections with a total audience of 1.6mn. Legally, there was no prohibition on receiving a TV signal in India. Therefore, other television channels and networks owned by Indians or foreigners also started transmitting their programmes into the country using satellite technology without violating any Indian law or regulation. However, there is legal uncertainty over its distribution. The Indian Telegraph Act 1885 governed the laying of cables on public property and it required the cable operator to apply for a licence to do so (Rahim, 1994).<sup>5</sup>



However, this regulatory arbitrage, augmented the proliferation of Cable TV, fueled by the entry of international satellite television during 1991 with the coverage of the Gulf War by Cable News Network (CNN). The spread of Cable TV received a boost during 1992 with the launch of Cable TV programme networks from Zee Telefilms and STAR group by producing India specific contents.

The necessity of procuring licence for operating cable networks was first mentioned on May 10, 1993 by the Rajasthan High Court in the case of *Shiv Cable TV System v. State of Rajasthan*.<sup>6</sup> The petitioners were cable-operators who had installed TV Equipment including large Dish Antenna, to receive signals from ASIASAT (Star TV, BBC, ZEE TV, PRIMA, SPORTS, ATN etc.) and were further transmitting these signals as well as the pre-recorded cassettes through cable system to the subscribers of their local Cable TV networks. In this case, the District Magistrate ordered a ban on cable networks as they were being operated without licence.

This explained that the cable networks usually comprise two elements<sup>7</sup>:

1. A dish antenna to receive programmes transmitted by the satellites and
2. A cable network to physically distribute these programmes to the subscribers.

The Court said that since a cable operator's dish antenna was capable of receiving transient images of fixed and moving objects from satellites, the dish antenna constituted a wireless telegraph apparatus under the Wireless Telegraphy Act. It held that unless covered by an exemption, the dish antenna required a wireless license for its operation. The Court also held that the lines and cables in a cable network were covered by the definition of a 'telegraph line' under the Telegraph Act, and the cable operators had to obtain statutory licenses for their dish antennas to download programmes from satellites and to transmit these downloaded programmes through their networks to the customers.<sup>8</sup>

Subsequently, the order of the district magistrate was challenged in the Rajasthan High Court. The High Court set aside the impugned orders of the district administration as they were made without jurisdiction. It held that under the Telegraph Act and the Wireless Telegraphy Act, only the Director General of Posts and Telegraphs, a central government official was competent to take the actions in question. The High Court noted that the government had not framed any rules or guidelines to regulate cable networks. Noting that an outright prohibition on cable networks was difficult because they had already grown deep roots in several areas, the high court called on the government to establish a licensing system to regulate the

cable networks This highlighted the need for having a framework for the regulation of cable networks in India, which led to the enactment of the Cable Television Networks (Regulation) Act, 1995.

The regulation of the Cable Television Network under the Act is ensured through a two-step process. In order to keep a track of cable operators, it has ordered a compulsory registration for cable operators. It also lays down provisions to regulate the contents to be broadcasted by the cable operators. The Cable TV as in most of the countries assumed a 'regional natural monopoly' status due to the cost and difficulty in laying cables to connect homes and that there were no viable alternatives to see a large number of channels. Augmented by the broadcast nature of the network, the viewers have to be satisfied with the programmes and channels provided by the Cable TV operator with no recourse to alternatives.

The DTH guidelines were released in 2001 as a competition and substitute for Cable TV. The Cable TV digitisation progressed in parallel with nationwide completion expected to be completed by end of 2015. Though guidelines were issued for HITS way back in 2007, it has not grown till present.

### ***Radio Broadcasting***

In India, radio coverage is available in Amplitude Modulation or AM (both Short Wave and Medium Wave), and Frequency Modulation (FM) modes. In terms of coverage, AM broadcast covers almost 99 percent of Indian population and 100 percent of the area, while the FM coverage is about 37 percent of the territory of India.<sup>9</sup>

As an initial step towards consolidating efforts in public service broadcasting, the Government of India created *Prasar Bharati*, a statutory autonomous body established under the *Prasar Bharati* Act. The Board of *Prasar Bharati* came into existence in November 1997. *Prasar Bharati* is the public service broadcaster of the country. The objective of public service broadcasting is to be achieved through All India Radio (for public radio) and Doordarshan (for public television), which were earlier working as independent media units under the Ministry of Information and Broadcasting.

Table 8.2 gives the market sizes of the various media industry segments.<sup>10</sup> It is quite evident that TV continues to contribute about 50 percent of the industry's revenue.

<b>Table 9.2: Revenue of Indian Media and Entertainment Industry</b>								
<b>Overall Industry Size (Billion ₹)</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>Growth in 2014 over 2013</b>
<b>TV</b>	241.0	257.0	297.0	329.0	370.1	417.2	474.9	13.8%
<b>Print</b>	172.0	175.2	192.9	208.8	224.1	243.1	263.4	8.3%
<b>Films</b>	104.4	89.3	83.3	92.9	112.4	125.3	126.4	0.9%
<b>Radio</b>	8.4	8.3	10.0	11.5	12.7	14.6	17.2	17.6%
<b>Music</b>	7.4	7.8	8.6	9.0	10.6	9.6	9.8	2.3%
<b>Outdoor</b>	16.1	13.7	16.5	17.8	18.2	19.3	22.0	14.0%
<b>Animation and VFX</b>	17.5	20.1	23.7	31.0	35.3	39.7	44.9	13.1%
<b>Gaming</b>	7.0	8.0	10.0	13.0	15.3	19.2	23.5	22.4%
<b>Digital Advertising</b>	6.0	8.0	10.0	15.4	21.7	30.1	43.5	44.5%
<b>Total</b>	580	587	652	728	821	918	1,026	11.7%

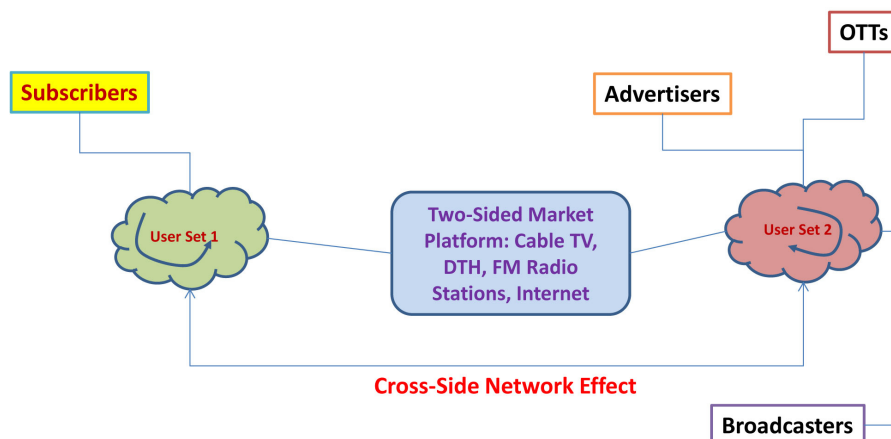
## Two-Sided Market Theory as Applicable to Broadcasting

Two-Sided Markets (2SM) and associated platforms form the basis of operation of broadcast networks. In a typical Two-Sided Market Platforms (2SMPs), there are two sets of users who complement each other's usage thereby increasing the network effect for enhanced value for both.<sup>11</sup> The theory of 2SMP and associated platforms is not new. It has been in existence since the time Visa and MasterCard were discovered and even prior to that. The platform enables these two heterogeneous sets of users to come together to conduct commercial transactions.

### *Cross-side Network Effects*

Success of 2SMP depends on the number of users on each side and the usage across them, which is often referred to as *cross-side network effect*<sup>12</sup>. Hence, in a 2SMP, the cross-side network effect typically complements the same side network effects – direct or indirect or both. These effects are captured in the case of a typical e-commerce market place as follows. Figure 8.1 illustrates a typical 2SMP and its associated characteristics.

**Figure 9.1: Overview of a Two-Sided Market Platform (2-SMP)**



In a typical broadcasting network (both TV and Radio), the platform (i.e. Cable TV, DTH, FM Radio) provides the required link between the broadcasters and the listeners/viewers. The cross-side network effect complements the same side networks in a 2SMP as shown in the Figure 8.1.

### ***Pricing in 2SMP***

Pricing is one of the important strategies in a 2SMP. Usually, one set of users are subsidised while the other set pays a premium depending on the price elasticity of the demand. In a two-sided market with positive cross-side network effects, the platform provider, even if it is a monopolist has an incentive to reduce platform profit. This is because in order to compete effectively on one side of the market, a platform needs to compete well on the other side. This creates a downward pressure on the prices offered to both sides as compared to the case where no cross-side effects exist.<sup>13</sup>

In TV broadcasting, subscribers belong to the subsidy side while broadcasters are on the money side. Broadcasters in turn embed advertisements in their channels and associated programmes to earn revenue. The FM Radio broadcasting platforms are much similar to Internet search engines (viz. Google) where listeners do not pay due to the inherent impossibilities of monetisation of broadcast content while advertisers on the money side pay to the FM broadcaster.

Table 8.3 illustrates how advertising revenue contributes to the different sectors.<sup>14</sup> Though Print (i.e. newspapers and magazines) advertisement revenue is slightly ahead of TV and TV advertisement revenue is expected

to overcome Print advertisement revenue in the years to come. It is to be noted that digital advertising has developed and will continue to develop in the coming years.

<b>Table 9.3: Advertising Revenue in India's Media and Entertainment Industry</b>							
<b>Advertising revenue (Billion ₹)</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>TV</b>	82	88	103	116	124.8	135.9	154.9
<b>Print</b>	108	110.4	126	139.4	149.6	162.6	176.4
<b>Radio</b>	8.4	8.3	10	11.5	12.7	14.6	17.2
<b>DTH</b>	16.1	13.7	16.5	17.8	18.2	19.3	22
<b>Digital Advertising</b>	6	8	10	15.4	21.7	30.1	43.5

### ***Waterbed Effect***

A significant feature of the two-sided market is that one group of users choose to use only one platform, i.e. they 'single-home.' The other group, may 'multi-home'. TV broadcasting involves the 'last mile' delivery of content either over Cable or DTH and this enjoys the natural monopoly status much like erstwhile fixed line services, hence, the subscribers often single-home.

However, availability of Internet video allows multi-homing to some extent. Broadcasters multi-home with many cable TV operators and DTH providers. Thus platforms have monopoly power over providing access to their single-homing users for the multi-homing side. This leads to the possibility of high prices being charged to the multi-homing side. By contrast, platforms have to compete for single-homing users and their high profits from the multi-homing side are to a large extent passed on to the single-homing side in the form of low prices or even zero prices. This is known as the waterbed effect and has been demonstrated in analytical models like Economides and Tag (2012).<sup>15</sup>

In broadcasting, the subscribers or viewers normally single home and they are captive users on one side of the platform. The advertisers can potentially multi-home through alternative channels of distribution (viz. radio, cable TV, DTH, print, digital, Internet). Hence, the reason for broadcast platform providers to extract rent from advertisers and pass on the subsidy to single homing subscribers.

However, in FM Radio, both listeners as well as advertisers multi-home with different FM stations, though only advertisers are priced by the platform provider.

### ***Competition***

The prospect of increasing returns to scale in network industries, especially in 2SMP can lead to winner-take-all battles, and hence, if not monopoly, but a relatively less number of platform providers. This is the case with Cable TV much like in fixed telephone services. Normally, it is found that only one or two cable operators provide services in a mutually agreed service region. In DTH and FM Radio, there is an added constraint of spectrum that limits the number of operators. Hence, in both Television and Radio, there is an inherent oligopoly market in existence. Thus there is a need for regulatory oversight into cartels and collusions. If broadcasters have a stake in the platform (viz. DTH), then regulatory oversight is needed on bundling of channels and predatory pricing of bundled channels to prevent abuses of vertical integration.

### **Cable Television**

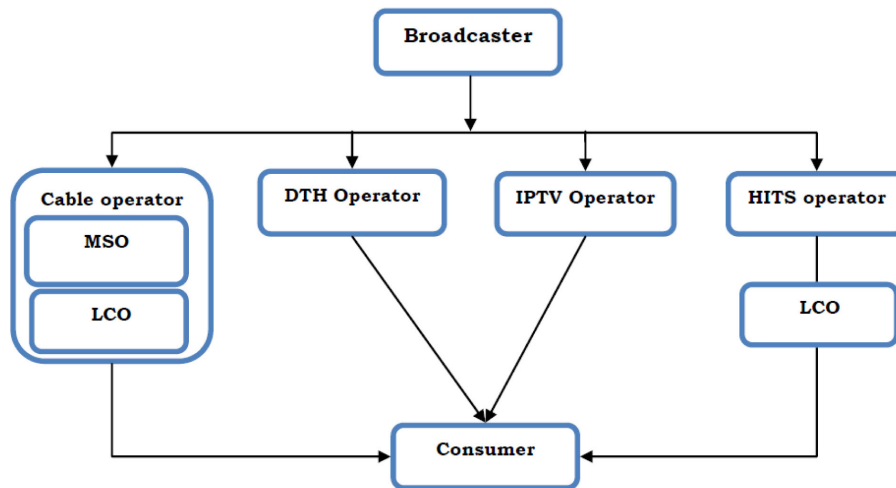
India, with 168mn TV households is the world's second largest Television market after China with a TV penetration of 61 percent. Out of this, 40mn households have DTH, while the rest are Cable TV subscribers. Though initiated by the government in June 2012 for mandatory digitisation of Cable TV, there are about 70mn analog subscribers in the country with the rest of 50mn connected to digital Cable TV.<sup>16</sup>

### ***Market Structure***

In India, Cable TV has adopted a franchisee model with the Local Cable Operator (LCO) being the main contact for the subscribers. The LCO lays down the last mile connection, thus connecting each household to the Cable TV network. The LCOs receive the programme broadcast through the Geo Stationary Satellites by installing dish antennas at the cable head-end. With increasing number of broadcasters, number of such antennas have also increased and most of the LCOs were not able to install the required number of antennas to provide comprehensive content to the subscribers.

Hence, a set of aggregators referred to as Multi Service Operators (MSOs) emerged. The MSOs aggregate the content obtained from the broadcasters and sometimes multiplex the local video channels including movies and songs, and then feed the signal to the LCOs. MSOs are often owned by relatively large business houses, which are interested in broadcasting business. Examples include Sun Cable and Hinduja's InCable. The distribution chain of Cable TV industry is shown in Figure 9.2.

**Figure 9.2: Distribution Chain of TV Broadcasting (TRAI, 2014)**



The number of Cable TV subscribers is more than the number of landline phone subscribers in the country, indicating a phenomenal growth mainly due to lesser regulation and the franchise model of the LCOs. As per the Ministry of Information and Broadcasting, there are 30,000 registered cable and satellite operators in the country, broadcasting over 339 cable and satellite TV channels in national and regional languages.<sup>17</sup>

Taking into account the number of unregistered Cable TV operators, the average size of each LCO network is estimated at 2,000 subscribers in the major metros, about 200-300 in smaller towns and 50-100 in rural areas.<sup>18</sup>

The Cable TV market has been traditionally considered as a ‘natural monopoly’ market much the same way as the fixed wire line telephony market. Since the coaxial cable laid by the LCO provides the last mile access to the subscriber, the characteristics of the network in terms of sunk cost and substitutability are much alike the wire line network.

Though there are no restrictions on the number of Cable TV licenses handed out in any geographical area as compared to that in mobile cellular licence, there is only one LCO in operation in most geographical regions of the country. This is due to the ‘regional natural monopoly’ characteristic of Cable TV as discussed in the previous section.

The LCO installs and maintains the local cable network and provides connectivity to subscribers’ homes. Since the average number of households connected to the Cable TV network is much larger in India, compared to

rest of the world, there are often devices, such as 'one-way amplifiers' installed in the Cable TV to boost the signal strength to desired levels.

The distribution chain as illustrated in Figure 8.1 has inherent weaknesses. Since the broadcasters and MSOs are not directly connected to the subscribers, there is information asymmetry between them and the LCO who is directly in contact with the subscribers. This information asymmetry was exploited to a certain extent and the LCO could potentially hide the exact number of households connected, thus saving the revenue to be shared with the broadcasters and MSOs. The MSOs in turn could disconnect signals to the LCO without any prior notice and seek undue enhanced commitment for subscriber base and higher payments. This led to blackouts and poor transmission quality of Cable TV.

The Cable TV service operates in a post-paid pricing model compared to DTH that operates in a pre-paid mode. Hence, the onus of collecting subscriber fees was directly on the LCOs and it was a very difficult task. Defaults were rampant, leading to operational losses for the LCOs. Moreover, the LCOs are required to pay entertainment tax and service tax, which are linked to the number of subscribers. Without the implementation of proper billing systems, there is a tendency for LCOs to evade taxes by under-declaring their subscriber base.<sup>19</sup>

Realising these problems, Conditional Access System (CAS) was proposed to be implemented in 2003. The CAS introduced addressability in the Cable TV network along with providing signals in digital format. The CAS ensures that only duly authorised subscribers are able to view a particular programming package. A CAS system consists of an integrated receiver decoder also called as the Set Top Box (STB) at subscriber's premise. This is an electronic device, which contains the necessary hardware, software, and interfaces to select, receive and unscramble video programmes. Since signals are scrambled in CAS, only the viewers with a valid signed contract with CAS service providers are authorised to unscramble and view the chosen programmes. Moreover, when the viewer chooses a pay channel or a programme, the information related to subscriber details, method of payment, and services purchased is stored and updated in the database. Apart from selecting pay channels, a CAS might be used for availing other services, such as Video on Demand.

In India, the LCOs are unorganised with little financial strength to implement CAS and the associated digitisation. Hence, the MSOs changed their role from B2B service provider to B2C, implementing CAS in the notified areas. The STB, the associated authorisation and billing for channels shifted from LCO to MSO, thus creating transparency down the distribution chain. However, the problem of revenue sharing between the LCO to other



entities shifted to revenue share from the MSOs. Hence, there is an inherent conflict between LCOs and MSOs. The ownership of subscribers shifted from the hands of LCO to MSOs.

The Ministry of Information and Broadcasting (MIB) extended CAS to cover the whole country in phases as given below. Though digital CAS was largely complete in phase I and II cities, roll-outs in phase III and IV in smaller towns proved to be challenging due to the following reasons:

1. The conflict between the relatively more powerful LCOs and MSOs in these regions and
2. The expected low Average Revenue Per User (ARPU) due to lower disposable income levels; the lower ARPU levels not only reduce the profits of the MSOs but also result in MSOs not able to subsidise STBs. This results in recurring effect reducing the adoption of CAS.

The subscriber base of TV broadcasting industry is given in the Table 9.4:<sup>20</sup>

<b>Table 9.4: Subscriber Base (in Millions) of Television Broadcasting Industry</b>					
<b>Cable/Year</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>Analog Cable</b>	65	74	69	68	70
<b>Digital Cable</b>	5	6	19	25	29
<b>DTH</b>	28	31	34	37	40
<b>Other digital</b>	8	8	9	9	10

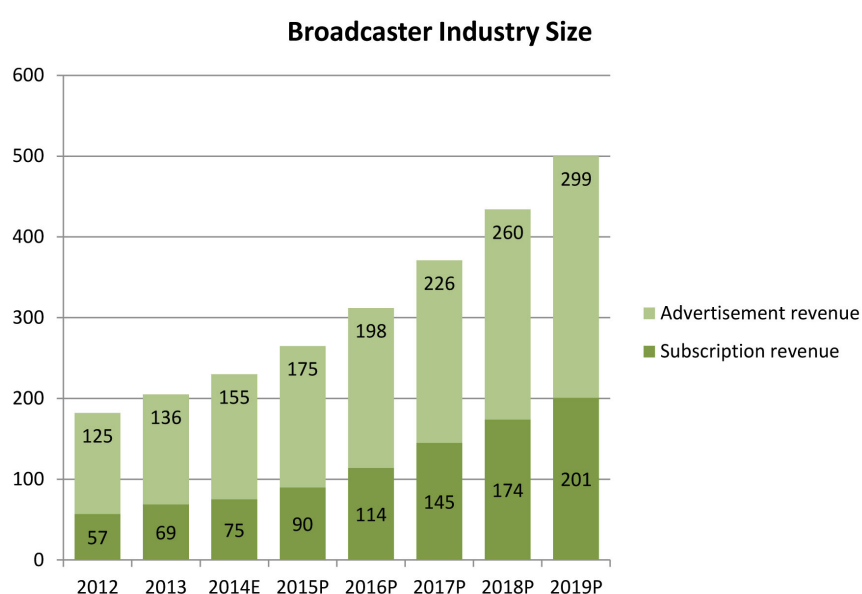
### **Pricing**

Pricing in Cable TV platforms consists of two aspects: (1) User subscription fee and (2) content carriage fee. It is to be noted that usually subscribers single-home while broadcasters who provide content multi-home. Hence, as per the waterbed effect, the platform providers should consider broadcasters as the money side and subsidise the subscribers. While the conversion from analog to digital saw an increase in subscriber Average Revenue Per User (ARPU) by about 50-60 percent, it will continue to be very low in the range of ₹120-160 in Phase III and Phase IV areas.

However, this subscription revenue needs to be passed on by MSO to LCO and the broadcasters. While the LCOs continue to be last mile haul for the MSOs operationally, the revenue collection shift from LCO to MCO puts them at loggerhead in terms of revenue sharing. On the other hand, the content carriage revenue is less controversial and is expected to increase by 10-15 percent in the years to come to more channels being carried.

As is well known, the broadcasters' major share of revenue comes from the advertisements and not from subscriptions. The broadcaster industry size currently at ₹230bn is expected to grow up to ₹500bn by 2019.<sup>21</sup> The break-up of advertisement and subscription revenue for the industry from all Distribution Platform Providers (viz. Cable TV and DTH)<sup>22</sup> is given in Figure 9.3: As digitalisation continues into phase III and IV areas, the subscription revenue is expected to continue to slide and need to be compensated by the advertisement revenue.

**Figure 9.3: Revenue Split of the TV Broadcasting Industry**



### ***Bundling***

In both Cable TV and DTH, the ‘channel aggregators’ aggregate contents from one or more broadcasters and feed to the Distribution Platform Operators (DPOs, viz. Cable TV/DTH operators). Since the channel aggregators are mostly joint ventures with large broadcasters, they combine their might and bundle channels from select broadcasters to sell as packages to distribution platform owners.

To avoid possible monopolies and their resultant abuse in channel aggregation, TRAI notified changes to the regulatory framework restricting the power of channel aggregators. As per the notification, “only broadcasters can now enter into contracts and interconnection agreements with DPOs. Further, in case a broadcaster, in discharging its regulatory obligations, is using the services of an agent, such authorised agent can only act in the name of and on behalf of the broadcaste”.

The notification added, “the broadcaster shall ensure that its authorised agent, while providing channels/bouquets to the DPOs, does not alter the bouquets as offered in the RIO (reference interconnect offers, or contracts) of the broadcaster”. This basically reduces the role of channel aggregators and disable them from bundling channels from multiple broadcasters. Bundling is one of the characteristics of an oligopoly market, such as broadcasting. Hence, the notification is trying to prevent possible cartelisation between channel aggregators and broadcasters. Since the power of channel aggregators is reduced in this form, the DPOs at present can possibly bargain more carriage fee as per the interconnect order and use it subsidise its subscribers.

However, this has an unexpected effect on smaller broadcasters who tie-in their channels with that of merger broadcasters through channel aggregators. In the absence of bundling, smaller broadcasters will have difficulty in getting DPOs to carry their channels. They will also likely to be trouble due to possible increase in carriage fees for their channels.

### **Direct-To-Home Satellite Television**

DTH Television services refer to direct transmission of TV programmes from satellites to consumer-installed dish antennas. The DTH services commonly use very high frequencies in the Ku band (viz. 12-14 GHz) for transmission. Signals in this high frequency band are very focussed and hence require smaller dishes of about 18-24 inches that could be easily deployed on roof tops. Transmitting in the Ku band and receiving programmes directly by users using dish antennas were prohibited in India until 2000. DTH is a substitute for Cable TV as it bypasses the local cable network to deliver TV programmes directly to the subscribers. The Government of India announced the guidelines for DTH in 2001.

#### ***Market Structure***

The initial adoption rate both by the service providers and subscribers was very low, with only a couple of DTH operators providing service. It was only with the entry of new DTH operators in 2006 that the subscriber growth started rising. The current 40mn DTH subscribers distributed amongst the government owned Doordarshan Prasar Bharati and six private operators is expected to become more than double and reach 76mn by 2019-23.

Most of the DTH operators are using the new MPEG4 standard, which is a method of defining compression of audio and visual digital data. DVD quality picture and crystal clear sound quality make DTH services an option preferred to Cable TV. Due to increased adoption, cost of digital STB

and roof top antennas for DTH services have appreciably come down. The operators normally bundle the STB and antenna with their services, and hence, provide them at a subsidised upfront fee.

### ***Spectrum and Transponder Capacity***

As in mobile cellular service, adequacy and availability of Ku band spectrum is quite essential for the growth of DTH market. One of the major hurdles that the DTH service providers face is the inadequacy of Ku band transponder space in the INSAT satellites. Table 9.5 illustrates the major INSAT satellites that carry Ku band transponders for DTH services.

<b>Table 9.5: INSAT Satellites for DTH Services</b>		
<b>INSAT Satellite</b>	<b>Transponders</b>	<b>Year of Launch</b>
3A	18-C; 6-Ku	2003
4A	12-C; 12-Ku	December 2005
4B	12-C; 12-Ku	March 2007
4CR	12-Ku	September 2007
4G (GSAT 8)	18 –Ku	May 2011
GSAT 10	18-C; 12 Ku	September 2012
GSAT 11	32 Ka × Ku; 6 Ku × Ka	2016

INSAT 4A satellites that host many of the DTH channels are progressing towards end, and hence, the corresponding channels need to be shifted to other satellite transponders. A shortage of Ku-band transponder capacity is looming large on the horizon for DTH service providers. With increasing number of TV channels and many standard definition channels getting converted into high definition ones, DTH players have to juggle with capacity allocations for their regional and national channels to retain their subscriber base.

As of now, there are over 800 satellite channels registered with the Government of India. At present, DTH players have anywhere between 12 and 15 transponders each. While the best of compression technology can squeeze in 25 channels to a transponder, service providers who use MPEG 2 (compression format) can get far lesser. Hence, DTH operators have a capacity to transmit hardly 350 channels. This prevents DTH players from carrying many regional channels, although these channels are important for their subscriber base, particularly in rural markets.

By now, DTH players need at least an additional 10 transponders each to accommodate the demand for new channels. The Department of

Telecommunications (DoT) policy document states that while operations from Indian soil might be allowed to use both Indian and foreign satellites, proposals envisaging use of Indian satellites will be accorded preferential treatment.<sup>24</sup>

The need for satellite space will only increase in future as the number of TV channels is expected to double in three to four years. It is estimated that the DTH industry will need more than 220 transponders in 2017 to address the growth of DTH subscribers, the proliferation of television channels and the provisioning of High Density (HD) content. Under the government's SATCOM policy, the DTH operators are not permitted to directly buy or lease foreign transponders. These can only be procured by the Indian Space Research Organisation (ISRO) on demand projection and sublet to India-based users. Over 75 percent of the 820-odd private channels are beaming into Indian homes through leases on foreign satellites. While ISRO tightly regulates this lease, it provides only 25 percent of industry requirements on its own INSAT/GSAT communication satellites.

It is also expected that more of INSAT and GSAT satellites with Ku band transponders will be put in to orbit to meet the growing demand. The 12<sup>th</sup> Plan working group on Space noted that the space agency needs to pursue rigorously to secure spectrum for another 100 Ku-band and 50 C-band/extended C-band transponders. ISRO reckons that its 2017 tally should touch 400 transponders, including 102 in the C-band and 158 in Ku bands. But that would still fall below the last Plan target of 500 transponders, as well as the broadcasters' projected needs.

### ***Channel Provisioning***

It is to be noted that both CAS and DTH are addressable systems and the users pay for channels they subscribe. However, it is to be noted that in CAS notified areas, the LCO has to offer 'basic service' that consists of about 30 Free-to-Air channels and the subscribers should be able to access these basic service offerings without the need for set-top boxes. However, in case of DTH, all programmes are viewable only by authorised subscribers through the set-top box. Even the Free-to-Air programmes of the national broadcaster Doordarshan can be viewed by DTH subscribers only through set-top box. While it is mandatory for CAS operators to provide channels to subscribers on *a-la-carte* basis, it is not so in case of DTH services.<sup>25</sup>

DTH guidelines stipulate, "the Licensee shall provide access to various content providers/channels on a non-discriminatory basis". The non-discriminatory clause does not include 'must carry' conditions. Over the past few years, the number of broadcast channels has increased tremendously. Apart from ground based channels, there are more than 270

satellite channels registered under uplinking/downlinking guidelines of the Ministry of Information and Broadcasting and close to hundred channels are awaiting permission. Since the transponder space for carrying channels is limited, it is not possible to include 'must carry' clause on the DTH operators to include all available channels in their offerings.

Hence, it is clarified in TRAI's recommendations including 'non-discriminatory' conditions that refer to transparent, predictable, fair, equal and unbiased treatment.<sup>26</sup> This essentially means that the DTH operator should select the channels for carriage on its platform in a fair and equitable manner, which would enable various content providers to constructively negotiate.

The factors that would have a bearing are price and the broad terms offered by the broadcasters. Any decision based on the above mentioned considerations are further subject to the technical limitation on the number of channels that a DTH platform can carry. Wherever the broadcasters and DTH providers are vertically integrated, then regulatory intervention is required to prevent 'tying' of channels. TRAI in its recommendations on new DTH license has clarified that it shall not reserve more than 15 percent of this capacity for its vertically integrated broadcaster(s). The rest of the capacity is to be offered to the other broadcasters on a non-discriminatory basis.<sup>27</sup>

### ***Interoperability***

DTH license agreement stipulates, "The Open Architecture (non-proprietary) Set Top Box, which will ensure technical compatibility and effective interoperability among different DTH service providers, shall have such specifications as laid down by the Government from time to time". The requirement of technical interoperability essentially protects the interest of the subscribers by enabling them to shift from one DTH service provider to another without having to buy new hardware. The regulation also requires the DTH service providers to give an option to their subscribers for obtaining the DTH hardware on hire purchase or rent basis. Thus the DTH subscribers have an option to change their service provider through commercial interoperability as provided by the quality of service regulation.

However, provisioning of interoperable set-top boxes has not been successful in India. The main reason for this is unavailability of Conditional Access Modules (CAM) of different DTH service providers. The BIS specifications for DTH set top boxes require each set top box to have a Common Interface (CI) slot for the purposes of technical interoperability. Technical interoperability is achieved by plugging in the CAM of new DTH operator in the CI slot of STB provided by the existing DTH operator. For example,

a subscriber of DTH operator 'A' who wishes to switch over to DTH operator 'B' has to procure a CAM from 'B' and plug the CAM into the CI slot of the STB supplied by 'A'.

This enables the subscriber to start receiving the services of 'B' using the existing STB and dish antenna (although the dish antenna has to be re-aligned towards the satellite being used by 'B'). The CAMs presently cost almost as much as a new set top box. Therefore, technical interoperability has not been very successful. However, the new entrants are expected to make available the CAM and with the increasing DTH subscriber base, the demand for CAM is expected to increase resulting in a price decline. These two factors should promote interoperability of STB amongst DTH operators. It is also ideal that the STBs be interoperable not only amongst DTH operators but also across CAS and IPTV providers.

The other issue is regarding MPEG 2 and MPEG 4 digital compression formats used by the DTH operators. The newer MPEG 4 format delivers DCD-quality video at lower data rates and smaller file sizes. While the older operators still use MPEG-2 format, the new entrants have migrated their transmission to MPEG-4 format, thus using superior compression technology to save as much as 25 percent of transponder bandwidth.

This change in formats implies that the subscribers who currently subscribe to MPEG-2 cannot migrate to DTH operators who use MPEG-4 though the converse is possible. The solution to this problem as outlined in TRAI (January 30, 2008)<sup>28</sup> is that the DTH operators should migrate within the stipulated time of notification of the adoption of any new standard by the Bureau of Indian Standards (BIS). Hence, the existing MPEG-2 STBs shall be changed to MPEG-4 by the DTH operators within the time frame. However, they can continue to broadcast their content in MPEG-2 until such time they shift over to the new standard.

The non-interoperability of STBs can act as 'subscriber lock-in' and prevent subscribers from switching and multi-homing. Hence, the need for DPO to subsidise the single-homing side of subscribers using the multi homing money side of broadcasters as per waterbed effects.

### ***Regulatory and Policy Issues***

The future of satellite communication, especially for DTH operators, is to provide television channels bundled with broadband using high frequency spot beams in the Ka band (18-27 GHz). Ka band based Satellite Broadband is being provided at Gigabits/sec speed in the Americas, Europe and Russia.<sup>29</sup> In India, this frequency has not yet been allocated and not even mentioned in NFAP 2011 with regard to DTH services. It is high time that the

satellite communication policy is revised to open up this band, which is extremely useful for the provisioning of HD TV as well as broadband connectivity, especially in remote parts of the country.

## **Radio Broadcasting**

In emerging economies like India, radio is still the most popular and affordable means for mass communication, entertainment, and education. The terminal devices are affordable and portable. Even low end mobile phones have FM tuners. Though the radio dipped in popularity after the diffusion of television, it has regained much lost ground due to the government's initiatives in allowing private parties to enter this segment.

In India, radio coverage is available in Amplitude Modulation (both Short Wave and Medium Wave), and Frequency Modulation modes. In terms of coverage, AM broadcast covers almost 99 percent of Indian population and 100 percent of the area, and FM covers about 40 percent of the population and 25 percent of the geographical area of the country.<sup>30</sup>

It is to be noted that in case of FM radio, the geographical jurisdiction of the operators is relatively small, such as cities. One reason for city based licensing and allocation of spectrum is the localised nature of radio content. Another important factor is that radio stations, much like Television broadcasting is a two-sided market platform. On one side are the listeners who do not pay due to the broadcast nature. The content is owned and managed by the platform provider unlike DTH and Cable TV operators. However, the advertisers on the other side of the platform consist of the money side. Advertisement is the only monetisation model for radio services. Both listeners and advertisers can multi-home on various radio stations in a chosen geography. Hence, the waterbed effect is not present due to less adherence of both sides of users.

## **Market Structure**

The policy objective of the Government for Radio in the 9<sup>th</sup> Five year plan was to improve the variety of content and technical quality of radio. On the technology front, the focus shifted from amplitude modulated transmissions to frequency modulated transmission as the latter has a much better operation in the presence of noise. In line with the policy of liberalisation and reforms followed by the Government since 1991, the Government during the 9<sup>th</sup> Five year plan allowed Indian companies to setup private FM Radio stations. Until then the government entity All India Radio was the sole radio broadcaster in the country. In May 2000, the government started the first phase and identified 108 frequencies in the FM spectrum (87-108 MHz) for auction across 40 cities of the country.



In February 2004, TRAI was asked by the Ministry of Information and Broadcasting to give guidelines for Phase II of private FM radio licensing. In August 2004, TRAI submitted its recommendations. Based on these recommendations and the Radio Policy Committee report, the Phase II policy was announced in July 2005, placing bid for 337 channels encompassing 91 cities. After scrutiny, 245 channels spanning 87 cities were given licenses for FM broadcasting. The licenses were valid for 10 years.

The grounds for further expansion of private FM radio broadcasting by bringing in the Phase-III Policy was to meet the huge unmet demand that exists for FM radio in many cities, which still remains uncovered by private FM radio broadcasting. Only state capitals and a limited number of cities with a population of three lakh and above were taken up for bidding during the first two phases of FM radio broadcasting. Border areas, particularly in Jammu and Kashmir, North-east states and island territories, are largely missing from the FM map. Even those places that were put up for auction could not find takers due to poor viability.

In the first stage of Phase III auction that was held in September 2015, about 91 FM channels were picked up in 51 cities, including two in Jammu. Only one additional channel was made available in Delhi and Bangalore and picked up at high prices. With additional channels, these cities are expected to face more competition.

### ***FM Radio Spectrum Allocation***

Radio and television broadcasting and mobile services have one thing common – the use of spectrum for transfer of information. However, there are significant differences in the manner in which they use spectrum for information transfer. Radio and TV are traditionally one-way broadcasts with one transmitter transmitting over a large area – often the entire city; while mobile services are two-way communications with transceivers in each micro cell site as explained earlier. The management of interference in radio and TV transmissions is less complex because of its one-way broadcast nature, as opposed to mobile services where two-way transmission between handsets and base stations often involving tricky interference management.

Cell reuse is non-existent in terrestrial radio and TV broadcasting as they operate at lower frequencies, which have better propagation characteristics to cover entire cities with just one transmitter. However, both these services require allocation of spectrum and its effective management. In relation to the pricing of spectrum for broadcasting and mobile services, it is relevant that the use of community radio and TV has often been thought of as a

public good, and hence, subjected to lower taxation compared to commercial mobile services, which are even treated as a 'premium' service in some developing countries.

Spectrum for FM Radio in India always used a market-based auction mechanism. The robust Simultaneous Ascending Auction (SAA) method that is used for spectrum auctioning for mobile services is being used for FM Radio since Phase II. The service area was restricted to cities defined in the following categories.

<b>Table 9.6: Categorisation of Cities for FM Broadcasting Services<sup>31</sup></b>	
<b>Category of Cities</b>	<b>Population criteria for classification of Cities</b>
A+	Metros
A	Population > 20 lakh
B	Population > 10 lakh and up to 20 lakh
C	Population > 3 lakh and up to 10 lakh
D	Population > 1 lakh and up to 3 lakh
<i>Source: TRAI, 2008</i>	

The spectrum auction for Phase III First batch was initiated in August 2015. As the curtain fell over the spectrum auction for FM Radio Phase III, Stage I, after 33 days of intense bidding, Government raked in about 1,157 crore against the aggregate reserve price of about 460 crore as the Non-refundable One Time Entry Fee (NOTEF). About 91 channels were picked up in 51 cities in the first batch of Phase III FM Radio auction. This will likely result in coverage of most cities with a population of one lakh and above with private FM radio channels.

### ***Regulatory and Policy Issues***

As in mobile services, higher spectrum price in Phase II was cited as one of the reasons for loss of profitability of FM Radio stations, especially in regions in category 3 and 4. Hence, the objective of Phase III FM radio augmentation is to increase coverage in smaller towns and rural areas of the country. There is also a need for promoting private FM radio in border areas to draw people to listen to Indian radio channels and to check cross-border propaganda. Similar initiatives are required for island territories. Even in the Phase III auction, only two channels were awarded in Jammu.

The high prices paid by the bidders in the first stage of Phase III auction, will force them to be operational first only in large cities to earn much needed advertisement revenue. The annual license fee is set to be 4 percent

of the revenue in all areas except some selected North-eastern states, which will pose additional burden to the FM operators. Given the public good nature of FM Radio but provided by private firms, the government shall look in to revising the annual fee to 1 percent (as applicable in case of 4G mobile spectrum) just to cover administrative cost and not actually milking the FM operators.<sup>32</sup>

### **Head-end in the Sky (HITS)**

HITS is one of the delivery platforms to distribute the digital TV content through a head-end in the Geo Stationary Satellites directly to LCO. The TRAI, after the consultation process allowed the third hybrid model whereby the HITS operator can work both as a conventional MSO (except that the head-end is in the sky) as well as passive infrastructure provider to other MSOs/cable operators who wish to use the facility for uplinking/downlinking their own aggregated content.

While the HITS is similar to DTH in the delivery of channels through the satellite, it is meant to supplement the Cable TV network and not act as a substitute as in the case of DTH. It is clearly stated in the recommendations and later in DoT guidelines that the HITS operator should provide signals directly from the satellite only to the registered MSOs/cable operators.<sup>33</sup> However, the operator will not be barred from providing signals, through their own cable network, if any, to consumers also after first downlinking the signals to the terrestrial station. The HITS operator under no circumstances should provide signals directly from his satellite to the consumer much like DTH providers.

The function of HITS is very similar to MSOs except that the head-end is terrestrial in case of MSOs while it is in the sky in HITS. Both carry and distribute broadcast television signals by first uplinking from an earth station to a satellite in the sky for downlinking later. One of the important advantages of HITS model is that the encrypted signals can be delivered through the HITS platform over C or extended C-bands as the LCO can receive them using a larger antenna. This also avoids rain fading and poor quality signals during monsoon, which is usually experienced with high frequency signals used in DTH.

There is no 'must carry' provision for the HITS operator, except for the carriage of some channels of national importance of the public service provider Doordarshan as in the case of DTH operations. However, broadcasters 'must provide' their channels for any distribution platform, such as DTH, HITS or cable network. TRAI in its recommendations<sup>34</sup> noted that in the absence of such a provision, it would be difficult for the

distribution platform to source content and as a result, that platform operator will not catch on in the absence of such popular content.

### ***Regulatory and Policy Issues***

Though allowed long time back, the HITS never became a serious option. However, it is noted in KPMG (2015)<sup>35</sup> that HITS could play a major role in the last phase of digitisation across Phase III and IV areas. In these regions, LCOs are often very small and do not have finances to set up their own head-ends for multiplexing channels, which is solved by HITS. The encryption, notifications and billing are taken care of by the HITS operator, and hence, the LCOs can concentrate only on customer acquisition and services. Unlike DTH, HITS allows LCOs to introduce local language channels to suit their customer needs and provides more monetisation opportunities, both from subscription as well as advertisement. Hence, HITS need to be promoted as a viable option for covering Phase III and IV areas in the cable digitisation roadmap.

### **Over-The-Top Broadcasting**

Entertainment is a big part of day-to-day lives of many people in India, especially in suburban and rural areas. FM Radio, Cable TV, and DTH provide services in this domain. Due to convergence, it is possible for all operators to provide advanced communication services including Internet access.

The traditional broadcasting industry value chain is very long. On one hand, we have Cable TV broadcasting systems that have:

Broadcasters → Multi System Operators → Local Cable Operators → Subscribers.

On the other hand, there is:

Broadcasters → DTH providers → Subscribers.

There is also one more model that was attempted by the telcos:

Broadcasters → Internet Protocol Television (IP TV) providers → Consumers.

However, the technology of IP TV was so complex and available on only select devices, such as PCs, Laptops or Smart TVs connected to the Internet based on subscription that it failed miserably, especially in India. As is true with any closed walled-garden system, the intermediaries – the MSOs, DTH providers and IP TV providers, in the above cases control the subscriptions, and hence, the revenue share of the broadcasters.<sup>36</sup>

With the availability of pluggable devices, such as *Google's Chromecast* there is a disruptive opportunity for the broadcasters to have online OTT service. By providing broadcast content as free OTT service much like messaging

applications, and enabling easy viewing on large dumb TV through a Cast application, subscribers can look forward to days when they *do not have to subscribe* for any TV broadcasting service! There are already signs of this phenomenon.

The UK based broadcaster *Mediaset* garnered about 100,000 subscribers within the first week of launching its OTT service in Italy. In India, there are online streaming services, such as *BoxTV* and *NexGTV* that have been started offering shows, movies and TV programmes. These firms are expected to build apps for Google's Chromecast that enable much easy viewing of the content on Television sets. Since advertising contributes to bulk of the broadcasting services revenue, the OTT service can be made absolutely free, with broadcasters and OTT providers cross-subsidising through innovative advertisement based monetisation models.

### **Market Structure**

As per Tracxn, the firm that tracks start-ups, the entertainment distribution industry is about US\$735mn wherein OTTs have started evolving<sup>37</sup> Start-ups, such as Apalya, Dhingana, Lukup Media, TVFPlay, MultimediaBus, and ErosNow have not only attracted venture capital funding but have been expanding in providing services.

<b>Table 9.7: Select List of Indian Start-ups in Providing Entertainment OTT Services<sup>38</sup></b>	
<b>Name</b>	<b>Services Provided</b>
<b>Apalya Technologies</b>	Mobile video distribution platform
<b>TVFPlay</b>	Digital OTT content distribution platform
<b>Eros Now</b>	OTT content distribution platform operated by Eros International Media
<b>FilmiFilmy</b>	Digital platform that aggregates video songs from YouTube and distributes over-the-top (OTT) to the end consumers
<b>ZingReel</b>	Online movie streaming platform
<b>Zenga Media</b>	Platform for live streaming of TV channels and also OTT distribution of entertainment content
<b>Hotstar</b>	Digital entertainment content streaming platform by Star India
<b>Ditto TV</b>	Launched by ZEE New Media, delivers live TV channels and video-on-demand content as OTT service

Table 9.7 indicates the new age start-ups in India in the Entertainment OTT space and their service offerings:

As can be seen, some of the OTT firms are owned or funded by the broadcasters, such as Zee or Star, so that they can reach the end users without intermediation by the cable or satellite networks. These developments are in tune with happenings elsewhere as well.

### ***Internet Radio***

Generally, the FM radio stations participate in government held auctions for spectrum for radio waves and pay huge sums to get the required quantity of spectrum for providing radio services. Since FM is city/town specific, the radio stations have to get frequencies in each city/town they want to operate.

However, Internet radio stations, such as TuneIn Radio, onlineradios.in and gaana.com offer streaming of a wide array of radio stations worldwide to subscribers as OTT services. They also provide flexibility to listen to the channels of choice without any geographical constraints, such as region specific language channels. Though advertisement models in Internet Radios is still evolving, it is a low cost service to roll out compared to the complex spectrum/antenna set up required for running FM radio stations. There are platform providers, such as TuneIn that manage subscriptions and advertisements while individual radio stations can be set up easily using widely available streaming servers, such as VirtualDJ and plugged in to the platforms. Realising this trend, radio firms, such as Radio Mirchi have started offering their programmes over Internet radio as well.

What is unique about Internet radio is that while it offers access to stations available globally, it can also cater to specific requirements of local communities including organisations. Even firms can set up their own Internet radio stations and nurture Tech and Entertainment DJs! This is almost akin to the amateur radio, also called as Ham radio that became so popular in US and other countries in early 20<sup>th</sup> century, thanks to local enthusiasts. While the amateurs had to grapple with interference and license restrictions on spectrum use, Internet radio surmounts all these with ease. Internet radio is amateur radio reborn.<sup>39</sup>

### ***Net Neutrality and Internet Broadcasting***

The rivalry and associated debate on Telcos vs. OTT firms has been simmering in different parts of the world for quite some time now. The Telcos who controlled the 'last mile access' and were powerful until the beginning of this decade have been relegated to the background by the hyper ambitious, innovative, exponentially growing, less regulated OTT

firms, thanks to the 'hour glass' Internet. With applications and content being provided over the ubiquitous Internet Protocol, the role of the Telcos has been tuned down to mere bandwidth provisioning and hence the turf war. Presently, the Telcos face threat from OTTs.<sup>40</sup>

In its simplest form, Net neutrality means that a Service Provider (viz. telco or ISP) has to treat all data bits in the same manner irrespective of their source, destination and the application that generated it. There are three parties on the Net: SPs, content providers/OTTs and users. The SPs connect the OTTs to users. Hence, they can potentially charge either the OTTs or the users for content transported through their network/platform. Since most of the users single-home (though multi-SIM handsets allow users to multi-home), they are in the subsidy side and the multi-homing content providers/OTTs are on the money side. The OTTs, can potentially charge their subscribers or subsidise them through advertisement revenues.

The Internet broadcasting services provided by the OTTs are often bandwidth hungry, which can cause undue delay to other services, such as messaging and Internet Telephony. Hence, the bottleneck access provider (viz. Telco or ISP) can potentially throttle or differentially price these services compared to other services. This goes against the tenets of Net Neutrality.

In India after the release of consultation paper by TRAI, there has been overwhelming response to treat all Internet traffic to be the same. On the contrary, the opponents of pure Net Neutrality indicate that Indian ISP and broadband market is very different from that of the other countries. India is 'mobile only Internet' market where most of the content is consumed through the wireless mobile networks. The mobile network is severely constrained in terms of spectrum and associated capacities.<sup>41</sup> Hence, the need to tone down Net Neutrality policy and rules to suit the Indian context. While the results are awaited, innovations in the OTT space continue.

## **Conclusions and Policy Recommendations**

The Cable digitisation, entry of DTH as a competing and substitutable platform for Cable TV, launch of Phase III auctioning of spectrum for FM Radio and the entry of OTT broadcasting have revolutionised Indian broadcasting sector. In this chapter, a two-sided market analysis of this important industry has been provided. As is indicated, the broadcasting industry is embracing digitisation in various forms, at production, distribution and consumption. Internet is going to be an important channel of broadcasting and poses threats to conventional methods of distribution through Cable TV, DTH and FM Radio.

It remains to be seen whether the two will coexist or either one will dominate. However, competition in the broadcasting industry is set to intensify in the years to come.

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## CHAPTER 10

# Epilogue

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Global Monitoring Report (GMR) 2013, a report by IMF-World Bank,<sup>1</sup> mentions “Urbanisation helps pull people out of poverty and advances progress towards the Millennium Development Goals (MDGs), but, if not managed well, can also lead to burgeoning growth of slums, pollution, and crime”. It is true that large cities are richer and have far better access to basic public services; smaller towns, secondary cities, and areas on the perimeter of urban centres are less rich; and rural areas are the poorest. Urbanisation is not a silver bullet for poverty but the existing scenario shows that the urban-rural divide sets up the differentiation between the availability of basic services and infrastructural development. However, if not managed efficiently, the outcomes may be far worse than an underdeveloped world.

Like all developing nations, India too is striving hard to develop but the present need is to improve holistically on all spheres. Infrastructure forms the backbone of a country and thus the related issues need to be addressed first. This is the reason the theme for this report was selected as infrastructure considering the physical, social, financial and technological infrastructure requirements. The report covers one sector in each of the four infrastructure categories covered, such as Highways (physical), Higher Education (social), Banking (financial) and Broadcasting (technological). A brief of these follows next.

Highways serve as the arterial network for the nation and thus need efficient planning on its construction, operations and management. The existing regulatory framework, which mandates for various clearances for construction of roads, needs to improve and also requires better coordination between the associated governmental agencies. Since these projects are associated with critical timelines, it becomes more important to streamline the clearance process to save on time-costs.

Another factor that needs due consideration is the maintenance of the highways, which sometimes goes amiss. Thus, it is essential to have time frame clauses for the regulatory agencies to respond to clearance applications

for highway projects as well as binding for the highway constructors for the maintenance of the highways.

Education acts as brain of a country. Not only does it raise knowledge levels of public but also gives them acumen to take the country forward. The country is in dire need of improving on the entire education system, especially for higher education. Owing to regulatory failure has resulted in setting of sub-optimal education standards and absence of competition in the higher education sector. The regulators, some also act as accrediting organisations, should ensure to providing accurate information for all educational institutions, so as to avoid information asymmetry. This shall not only fuel competition but shall enable the prospective students to opt for the right institutes and in process creating employable workforce. There also seems overlapping in function of regulators for a sector which dampens the efficiency of their working. Lack of quality checks of institutions and high entry barriers are pervasive to quality of competition in the sector as well.

Banking is indeed the stomach of a country. It feeds the much needed finances for the priority sectors identified for the development of a country. In India, banking sector is quite robust but there still lingers scope of improvements. In order to meet our target of financial inclusion, further reforms are required, both in terms of regulations and competition. With additional and new differential banks coming up (Payment and Small Banks), it is expected to dive the inclusion drive further, but there are some niggles left unaddressed. The regulatory arbitrages still exist between full-fledged banks based on their ownership, the implicit guarantee of government on insolvency for PSBs, and the possible regulatory discrimination between differential banks which might impact competition. Moreover, there seems a lack of transparency and accountability in RBI's decisions, especially considering the licencing process, which needs consideration.

Broadcasting may be referred to as the nerves system of a country, which when used optimally may act as voice to nation. The advantages that this technology presents to country's development are immense. The chapter portrays some regulatory interventions required, such as allocation of frequency bands for DTH services to provide integrated broadband services as well. This shall help in enhancing digital outreach, even to the remote areas where installation of optic fibre or tower based internet shall take time.

Also, for the radio services, in particular for FM, the high spectrum prices are proving detrimental to the profitability of FM radio stations and the issue thus needs reviewing by regulator and government. FM, television, *et al*, act as best sources of news, entertainment, public messages and

advertisement, and thus, the outreach should be expanded and not curtailed because of overbearing resource pricing and overregulation in the sector.

### **Common Challenges across Sectors**

Of the sectors addressed in this edition, there are some common challenges pertaining to regulatory and competition regime in India. It would be interesting to address these, even though one solution may not fit all. Few of these are listed below:

#### ***a. Restricting entry or high entry barriers imposed by regulator for the sector***

A number of sectors in India witness a monopoly of PSUs, especially public utilities such as roads, highways, canals, railways, etc. Lack of free and genuine competition in these sectors has resulted in poor services and in most cases, piling of debt on government due to losses. The examples may be derived from PSBs, Aviation, *et al.* For some sectors such as banking, telecommunications, broadcasting, higher education *et al.*, the entry barriers are set pretty high which not only restricts entry of new players to the sector but also smothers competition.

Despite major government initiatives, such as Digital India and Financial Inclusion, restricting new entrants restricts the outreach, innovative and low cost mechanisms of providing service through ICT and of course efficiency. Every sector should ideally have free competition and the market forces should enable self-regulation but for a number of sectors, the regulator imposed entry/exit barriers and stringent regulations have had detrimental effect to the sector in terms of affordability, availability and viability.

#### ***b. Non-transparent decision making by Regulators and their lack of accountability***

Ideally, the regulator should work in a glass office. Since the regulator is a representative of not just the public but also the entities operating in the sector, it is necessary for the regulator to be answerable to stakeholders for its actions. It should be kept in mind that the manufacturer/service providers are also consumers and thus should also be looked this way. It is important that regulators remain transparent on their decision making and disclose the rationale behind their decisions. Hence, accountability is a factor, which the regulator should give utmost importance.

One way to disclose rationale behind their decisions is by adopting tool like RIA, which identifies issues in existing as well as prospective regulations. Identifying the problem it engages in an in-depth analysis of the regulations

and proposes alternatives to existing clauses. The embedded cost-benefit analysis helps in identifying the most appropriate alternative, in process enhancing the quality and applicability of regulations.

Considering the case of banking, where RBI has granted bank licences for last 2-3 decades, the licencing framework seems opaque. RBI has not been providing reasoning on its decisions, be it the eligibility criteria for banks or the quantum of licenses granted for banks, payment banks and small banks. Similarly, in case of broadcasting and telecommunications, spectrum is a basic raw material for their services. TRAI has not provided the rationale of setting high reserve auction prices for spectrum. The cost implications of high resource prices are eventually passed on to the consumers resulting in affordability and accessibility issues for some. Hence, the regulator should release the rationale for their decisions in public domain, so as to remain transparent on its action and also being accountable to their decisions.

### ***c. Provision of statutory appeals on regulator's decisions***

Regulators, for the smooth operation of their respective sectors, come out with regulations and guidelines which are in interest of consumer as well as to keep the sector organised. However, almost no sectors have a provision of statutory appeals against the regulatory decisions. Moreover, the sector players are wary about going against the regulator as, in long run, it may prove damaging to their existence. Though, the Regulatory Reform Bill (includes an institutional framework for regulatory commissions, their role and functions, accountability to the legislature and interface with the markets and the people) has a provision for such appeals, it would come into existence only if the Bill is passed by the Parliament.

For each sector, there should be a statutory body, which hears resentments and appeals against the regulator by any stakeholders, a practice which is absent in the current scenario. Considering the example of banking, where the decisions of RBI are not only opaque but there is no provision of appealing against regulators decisions. For new bank licences, even though the entities may meet the eligibility criteria, the RBI may still decide against granting licensing without providing reasons for the same to the applicants. The applicants/sector-players should have a right to question the regulator on the decisions made which shall be benefitting to the entire sector in aggregate.

### ***d. Presence of multiple regulators and overlapping of roles leading to conflicts***

There exist many sectors having more than one regulator. Financial sector has regulators such as SEBI, RBI, IRDA etc. Higher Education sector has

AICTE, UGC, NAAC and so on. There have been evidences which have highlighted overlapping in the functions of regulators in one sector or even inter-sector. Even CCI has many overlapping functions with regulators of various sectors, which has created conflicts. These overlapping result in contradictory scenario on whose decision should prevail and create conflicts between cohesive working of regulatory bodies. It is utmost important for the regulatory bodies to work in tandem but the only way to ensure this is by clearly demarcating the roles of different regulators and eliminating the overlaps. Primacy can be given either to sectoral regulatory or competition law, depending upon the circumstances. Another approach could be a concurrent one, the UK being an example, where both competition law and industry or sectoral regulatory law possess equal jurisdiction, through consultative approach.

***e. Fiscal dependence of regulatory bodies over government and political influence in their operations***

The regulatory bodies are expected to make decisions which are beneficial for the sector and stakeholders. This may require decision making which, in some cases, might go against government agenda. Thus, it is important that the government keeps its distance from the operations and decision making of regulator. For banking, many committees have recommended the government to keep distance from the operations of PSBs. Similarly most of the regulators seems working closely, than prescribed, with the respective ministries. One example that can be thought of is TRAI and DoT.

However, in the current scenario, the regulatory bodies are dependent on ministries, especially on financials and appointments. This dependence may also have bearing on decisions made by regulators, which might not be in line with sector's growth and the decisions might also be politically motivated. Thus, it is important for regulators to maintain an arm's length with the government and removing or minimising the dependence on ministries in terms of appointments and finances.

***f. Further strengthening of the governance of state-owned/public-sector entities, simplify regulations, remove regulatory arbitrages and reduce administrative burdens on firms***

For any government initiative, the PSUs are expected to implement and take it forward by the government. Considering the example of PSBs, which are usually under obligation to carry out the financial inclusion related programmes in India, which is not the same with their private counterparts. Such obligations put additional burden on PSUs, both in terms of finances and man-hours, which are also not adequately compensated by the government (as also quoted by RBI Governor Raghuram Rajan).

This creates an imbalanced competition scenario between the PSUs and private entities and game for the PSUs to lose eventually.

The PSUs are already struggling with sub-optimal performances as compared to their private counterparts, for which the government is yet to find an optimum solution. The additional burden wrecks the remaining performance and efficiency to push the PSUs into further slump. This has seen many PSUs succumbing to added responsibilities and running in losses, forcing the government to step in and bail them out (e.g. Air India, PSBs, *et al.*) or complete shutdown as in case of HMT and others. The bailing out involves infusion of huge capital in PSUs, which does not do more than stalling the shutdown.

### **International Infrastructure Agendas**

The global agendas have been talking aloud for the infrastructure requirements of the developing and least developed countries (LDCs). Sustainable infrastructure and technology predominantly forms the part of SDGs with United Nations claiming *technology is the beating heart of economic transformation and good infrastructure protects the environment while providing the leverage people need to lift themselves out of poverty.*<sup>2</sup>

The Addis Ababa Action Agenda<sup>3</sup> highlighted an infrastructure gap of US\$1tn to US\$1.5tn every year, which is estimated for basic infrastructure investment in developing countries. To address this financing gap, Member States of United Nations (UN) agreed on launching a global infrastructure forum, which shall build on and better coordinate existing infrastructure initiatives.

The OECD Development Assistance Committee (DAC) measures the resource flow to developing countries which is referred to as Official Development Assistance (ODA). ODA, despite years of decline, remains a crucial source for financing basic health, infrastructure and energy needs<sup>4</sup> in developing countries. However, ODA has always been claimed insufficient by the developing nations and at the other end, being inefficiently used by the developed ones, which has eventually led to its descend.

Despite the on-going discussions on climate-change, development has remained a priority for the developing nations and LDCs. Bill Gates in a recent event said “*the idea of a clean energy generation doesn’t require the poorer countries slow down their development*”, which cannot narrates a clearer picture. Thus, it is important for countries focussed on development to try embedding clean energy and sustainable technologies in their activities to the maximum extent possible. Meanwhile, the developed nations should undertake the responsibility of adopting and promoting the clean development mechanism



(CDM) forward while also pledging support to the developing nations and LDCs in terms of technology transfer and finance.

## **Unfinished Agenda**

This, infrastructure focussed edition of ICRR has tried to address the issues in each of the infrastructure categories covered. While this is understood that one sector in each of the infrastructure category is not an ideal representation, the obvious constraints have disallowed us to address all sectors and thus, many of the sectors could not form a part of this report. However, it shall be our best try to address as many as possible in the forthcoming issues.

However, considering the present scenario, there are some burning issues across India, which have regulatory and competition implications. These have been briefly discussed below:

### ***1. Draft Regulatory Reform Bill***

The Centre, in July 2015, came out with a new draft for the Regulatory Reform Bill which seeks to ensure orderly development of infrastructure services, enable competition and protect consumer interest in securing access to affordable and quality infrastructure. The bill is based on three principles of separation of power, democratic accountability, and the federal principle.

Accordingly, the rule-making and enforcement functions have been separated from judicial functions, which have been vested in appellate tribunals. The Draft Bill includes an overarching institutional framework for regulatory commissions and appellate tribunals, their role and functions, legislative, financial and judicial accountability and their interface with the market and the people.

For the infrastructure sectors having different regulators, the paper pointed out that these regulators lack consistent and a coherent approach probably because of the regulatory framework in various infrastructure sectors evolved at different points of time. For financial independence of regulators, the Bill proposes budget for the regulator to be presented by the concerned Ministry for seeking Parliamentary approval for grants from the Consolidated Fund of India.

The Draft Bill also proposes that the overall functioning of the regulator should be subjected to the scrutiny by the Parliament to ensure accountability of regulators. In addition to political accountability through legislatures, the Bill also proposes that regulators must be made legally accountable.

Any person or entity aggrieved by a decision or any consumer association with an interest in the decision may file an appeal before the Appellate Authority.

The Draft Bill proposes that the functions should be standardised across regulators to ensure that opportunities for interventions are made available at every stage of the regulatory process. It ensures avenues for participation by stakeholders and allows all stakeholders, including consumer groups and citizens to interact with these institutions in a predictable and consistent fashion.

The Bill should also ensure that the Selection Committee should not comprise more than half members from government background. This is because the selection committees loaded with existing or retired civil servants do not look at non-official applicants favourably and thus ends up in a regulatory capture promoting sinecures/parking lots for retirees. It is also suggested that the ultimate selection be done by the subject parliamentary standing committees rather than the government to promote healthy selections process. Though the draft tries to address financial dependence of the regulator, it is further suggested that the regulatory commissions get their budgets directly from the Ministry of Finance on the recommendations of the Parliament rather than line ministries to maintain an arm's length distance.

## ***2. Implementation of National Competition Policy***

National Competition Policy (NCP) was drafted in 2011 by the Ministry of Corporate Affairs but has still not been enacted. The NCP is envisaged to ensure equitable application of competition principles to all economic agents in the economy. It works on the principle that social welfare is best served by promoting competition. The idea of NCP was originally mooted by CUTS in 2005 report "Towards a Functional Competition Policy for India" and was discussed further in ICRR 2007 and 2011. However, despite so many years gone by and the policy has not yet been enacted.

Effective competition is the instrument for attaining economic growth through enhanced innovation, efficiency and productivity as well as ensuring social gains by overall poverty reduction and greater consumer welfare. This is why, in his book, the Power of Productivity, author William Lewis argues that if countries eliminated the policies that distort competition, they could grow rapidly. Competition is distorted by factors, such as anticompetitive practices of enterprises as well as policies and regulations adopted and implemented by the government that have anticompetitive outcomes. It is thus imperative to push for this important policy framework to be adopted which has shown tremendous benefits abroad.

Australia adopted a competition policy in 1995 and is seen as the main catalyst to 5.5 percent economic growth since then. The NCP may also be a solution to a number of issues faced in India. However, it should not go unnoticed that the Australian competition policy was preceded by an extensive review of all federal and provincial laws from the competition perspective, and all laws and measures that had provisions violating the spirit of competition were repealed or amended.

To do so, there is a requirement to do an extensive Regulatory and Competition Impact Analysis (RIA and CIA), before bringing the draft NCP in practice. These tools shall eliminate the overlaps of functions with other legislations and laws, and may pave way for effective competition, the benefits for which are well known. Often NCP is confused with Competition Act, 2002 but it is essential to know that NCP is acknowledged and used as an instrument for boosting competition, is designed to punish and prevent anticompetitive practices, which aim to curb competition and its price-reducing and quality enhancing impacts.

The economic liberalisation for India came in 1991 and thus India has been rather young in promoting outside and private participation in the country. However, to sustain it optimally, competitive neutrality must be ensured. Moreover, there are a number of sector such as banking, manufacturing, *et al.* which have government entities operating and the current regime seems to favour the government incumbents.

Competition, thus, needs to be nurtured as it cannot be achieved automatically in India. A policy for the same shall ensure a balance and a fair playing ground for all, irrespective of ownership or any other factor. The market would have the power to decide on the winners and losers. So, the NCP may play a pivotal role in reforming India and spurring India's growth.

### ***3. Adoption of Regulatory Impact Assessment***

Regulatory instruments such as policies, legislations, rules, and regulations etc. (regulations) have widespread impacts, which affect multiple stakeholders in different ways. Regulations tend to change behaviour of stakeholders, and thus impose additional costs. Consequently, only such regulations must be adopted which can achieve intended objectives with least possible distortions. Moreover, sub-optimal regulations have the potential to impose superfluous costs on stakeholders, raise complexity and uncertainty associated with obligations, which must be avoided. Therefore, it is important to understand impacts of proposed and existing regulations to formulate most optimal design.

One of the systematic approaches to critically assess the impacts of proposed and existing regulations is RIA. It is an important element of an evidence-based approach to policy making, as it essentially comprises stakeholder engagement in policy making and review. Impacts of regulatory options are compared with 'as is' scenario on the basis of scientifically developed tools such as cost-benefits analysis, cost-effective analysis etc. and thus best possible regulatory intervention is selected.

Implementation of RIA improves overall regulatory quality, by factoring all the relevant expectations of stakeholders. Rigorous and transparent assessment of costs and benefits also increases the acceptability of regulation among stakeholders. As a result, there is greater clarity and predictability in regulatory process. This is evident from experience of other jurisdictions from adoption of RIA.

The One-in, Two-out Policy of UK, which mandates removal of £2 of costs for imposition of £1 of costs via state-led intervention, has resulted in net reduction of £836mn in costs to business between 2010 and 2013. Taking a cue from other jurisdictions, RIA has been recommended for India by several expert committees. These include the erstwhile Planning Commission's Working Group on Business Regulatory Framework, Financial Sector Legislative Reforms Commission, Damodaran Committee Report and the Tax Administration Reform Commission.

## **In Lieu of Conclusion**

In conclusion, we have the following suggestions:

1. The NCP should be enacted at the earliest but making sure it goes through RIA and CIA before implementation to remove any prospective bottlenecks;
2. For the various high-level committees commissioned by the government, though the committees come out with possible solutions, the recommendations are rarely implemented. The committees should thus be advised on the possibilities of their recommendations going through;
3. Capacity building of regulators is highly required, both in terms of manpower and technical know-how;
4. Financial independence of regulators from the ministries is desirable to improve efficient working of regulators and enhancing consumer as well as sector entities welfare;
5. Eliminating the regulatory arbitrages between public-private entities and implied preference of the government for the state-owned entities, is must in order to promote free competition overall. It shall propel consumer welfare;

6. RIA and CIA should be extensively undertaken across the sectors in order to avoid overlaps and conflicts between the governmental organisations and regulators; which is creating a conflicting situation rather than facilitating growth;
7. In case of conflicts, there should be a resolution body comprising of the chairmen of the appellate tribunals on competition and overlaps of functions of regulatory bodies; and
8. The PSUs should have powers to introduce lateral entries, in order to bolster their management and to move towards efficiency in order to compete with their private counterparts.

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## Endnotes

- 1 World Bank. Global Monitoring Report 2013: Rural-Urban Dynamics and the Millennium Development Goals. Washington, DC: World Bank. DOI: 10.1596/978-0-8213-9806-7. License: Creative Commons Attribution CC BY 3.0 available at: <http://pubdocs.worldbank.org/pubdocs/publicdoc/2015/9/961951442415876455/GMR-2013-Full-Report.pdf>
- 2 UN Global Compact Briefing Series: Issue Paper 9 “Post-2015 Agenda and Related Sustainable Development Goals Issue Focus: Sustainable Infrastructure and Technology and the Role of Business”
- 3 A DESA Briefing Note On The Addis Ababa Action Agenda, “A DESA Briefing Note On The Addis Ababa Action Agenda”, available at: <http://www.un.org/esa/ffd/wp-content/uploads/sites/2/2015/07/DESA-Briefing-Note-Addis-Action-Agenda.pdf>
- 4 As Developing Countries Strive to Enhance Economic Performance, Developed Partners Should Honour or Surpass Aid Pledges, Addis Conference Hears, available at: <http://www.un.org/press/en/2015/dev3187.doc.htm>

