

Competition Commission of India
Annual Day Lecture
by
Shri P Chidambaram,
Union Finance Minister
20th May, 2013, New Delhi

My distinguished colleague, the Minister of State for Corporate Affairs, Shri Sachin Pilot, Shri Ashok Chawla, Chairman, Competition Commission of India, Members of the Competition Commission, distinguished guests, ladies and gentlemen.

2. It is my pleasure to address this august gathering and deliver the Annual Day lecture of the Competition Commission of India. The evolution of the Indian economy is a fascinating story in itself, apart from the successes and failures of the last 22 years. Old structures have given way to new ones. Special mention needs to be made of India's regulatory framework for competition and other matters such as capital markets and financial services. It is entirely new, it marked a clean break with the past and the assumptions of the past, it has brought about a transformational change, and it has provided much-needed oversight of a liberal and open economy. Just look back at the road we have traveled in the area of competition. From the Monopolies and Restrictive Trade Practices Act, 1969, we have moved to the new architecture of the Competition Commission of India, a lean, knowledge-driven organization that befits the dynamics of a fast growing economy

Social Contract

3. As society evolves, it adopts social contracts: that is, various norms, conventions, and laws that help clarify the interaction of citizens with each other, with institutions, and between institutions. Economic regulations are the set of social contracts that help guide economic activity in ways that enhance the public good.

4. According to economic theory, the need for regulation arises because of "externalities" – for example, when an activity such as the production of goods imposes social costs that the market is unable to prevent. A producer of chemicals may cause the pollution of a stream and he does not care about it. A market, left to itself, will not force the producer to take into account his pollution. In these circumstances, government intervention is called for. Competition regulation, as I will argue shortly, is similar; actions that lessen competition in the market

place are not the concern of any single participant, but hurt the market and the public. It should, therefore, be the concern of both market participants, as a collective, as well as the government, to ensure that competition prevails.

5. The Competition Act, 2002 establishes a Commission "to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade." There can be no manner of doubt whatsoever that the goal of Parliament is to promote competition, to sustain competition in markets, to allow new entrants into the market, and to protect the interests of the consumers. This is a blow against monopolies. It is also a blow against anti-competitive and unfair practices or predatory behaviour. The Competition Commission has vast powers including powers to modify agreements, pass punitive orders and to split up enterprises. In this respect, the Competition Commission of India enjoys the same broad powers as are given to similar Commissions in other jurisdictions.

The Conceptual basis of Competition

6. Allow me to dwell a bit on the conceptual basis and foundations of competition. Innovation emerges from healthy competition, as does economic efficiency. When Adam Smith wrote about the 'invisible hand' of the market producing economic outcomes that were the most efficient, he was referring to the advantages accruing from the presence of competitive markets. On the other end of the spectrum are non-competitive markets. Non-competitive markets are characterized by a small number of producers or buyers controlling the market. In such a situation these entities can act as price-setters so as to maximize profits at the expense of other market participants. Such a situation is not only unfair but also reduces economic efficiency since it shrinks the available economic pie – too little is produced as the monopolist tries to keep his profits high by ensuring goods are scarce. He has little incentive to serve the consumer, since the consumer has little or no choice. There is scant regard for quality or timely delivery. Innovation, efficiency, and customer service suffer or are totally absent. Need I recall the days when you had a choice of a car between an Ambassador and an Ambassador and the choice of an airline between Indian Airlines and Indian Airlines?

7. Competition ensures markets are not only beneficial but they are also fair – the best producers win, not based on their connections or influence but because they build a better cycle, a better motorcycle or

a better car. In India, there is an especially important reason to ensure that markets are not only fair, they are also seen to be fair. Our history put business and profits in a poor light. The License Permit Raj had suggestions of crony capitalism, where a few got licenses based on their proximity to power. The deregulation that started in the early 1990s started the process of dismantling that route to market power. The first evidence of a competitive market is the entry of new players. In my view, the most fascinating development of the last 22 years is the number of unknown entrepreneurs who have built huge and successful businesses and taken over as leaders in their fields. That could not have happened without a competitive and level playing field. Today, the consumer in India is princess, if not queen - that she will become soon. And business is forced to cater to her interests, and is therefore seen in a better light. We have to ensure that the economy continues on the path of competitive, fair, and transparent business practices, and any aberrations that interrupt the path are set right. Hence the need for an effective Competition Commission that favours none and spares none.

8. I would like to focus on five key issues for competition policy. These are: mergers and acquisitions, natural monopolies, regulatory capture, governance biases towards Public Sector Enterprises, and predatory behaviour.

Mergers

9. There are massive gains, both private and societal, from mergers and integration in industries: economies of scale, ease of information transmission, reduction of uncertainties, and synchronization of demand and supply are just some of the benefits of integration. At the same time, we have to ensure that mergers do not substantially reduce competition and consumer choice.

10. A good example is the telecom sector. Given the high costs and rapid pace of technological development, telecom is a market where there are obvious gains from integration. However, as has been shown by developments in the United States and Europe, consumer experience is extremely sensitive to the prevailing market structures. What is important is not just to ensure current competition between existing players, but also potential competition between existing players and new entrants and between current technologies and emerging technologies. At the same time, regulators need to keep in mind the feature this sector has of a natural monopoly, with large up-front fixed costs and low variable costs. Such industries can succumb

to ruinous competition, where no player makes enough money to be financially healthy. Regulators have to take a call on the right balance between too many players and too few.

11. The Indian telecom market has thrived with competition. Indian call rates are amongst the cheapest in the world, as Indian firms have evolved a uniquely Indian business model. Large volumes have of course helped, but those large volumes and the broad reach of communications – a cellphone in almost every hand -- would not have been possible if it were not for the low price emerging from the business model. However there are downsides. Quality has suffered. The sector is laden with debt. New players are loathe to enter and some existing ones are threatening to quit. Auction of spectrum has found no bidders in several circles. Going forward though, one can foresee the continuing need for regulation to ensure competition, innovation, and low rates and better service for the consumers. A fundamental restructuring of the players in the market may well occur. Of course, the sector has its own regulator, the TRAI, but the overarching role of CCI in competition policy cannot be ignored.

12. There are other sectors that may well need restructuring, and each sector has its own issues. For example, some banks, including some public sector banks among the 26 public sector banks that we have, may be better off merging. The need for two or three world-size banks in an economy that is poised to become one among the five largest in the world is rather obvious. At the same time, mergers may reduce competition in certain segments or geographies substantially, and may alter competition between banks and non-banks. Are our regulators well positioned to evaluate the consequences to competition in different sub-markets and across regulatory jurisdictions? Is there a role for the CCI here? Finally, we have seen bank mergers lead to too-big-to-fail entities. What constitutes a merger too far? How do the relative merits of prudential regulation and competition regulation weigh? We have not confronted these issues as yet in India, but undoubtedly will have to in the not too distant future, and will have to prepare for them.

Monopolies

13. Let me turn now to pure natural monopolies. They arise when there are gains from concentration of ownership, for instance, because of large upfront investments. Fortunately, there are fewer and fewer situations where pure natural monopolies exist. For instance, power distribution used to be thought of as a natural monopoly, but given the

advances in technology, we can allow multiple producers to distribute via the same grid – indeed, much of India is moving this way. Nevertheless, there are still a number of areas, many of them involving services to the public such as water distribution, which are natural monopolies. Given that we are increasingly turning to private firms in these areas, we do need regulation. We need separate regulators for such sectors, whose role will be to keep the private producer working for the public interest while ensuring the producer makes reasonable profits and that the public sector does not transfer undue risk on to the private sector.

Regulating the Regulators

14. At the same time, there is a danger that these sectoral regulators are liable to be captured by industry players and do not see the benefits of competition coming from new technologies, new entrants, or new sectors that erode hitherto natural monopolies. The Competition Commission can play an important role in keeping an eye open for such behaviour and ensuring that the public is well served. Regulating the sectoral regulator in these matters, while difficult and fraught with legal difficulties, is an essential role the Competition Commission may have to play.

Public Sector Enterprises

15. This brings me to public sector enterprises. In theory, public sector enterprises are not influenced by pure profits, and are an arm of the government. As such, concerns about excessive prices and anti-competitive practices may seem unwarranted. Yet, this assumes an idealistic view of public sector enterprises that is not borne out by reality. As an institution, a public sector enterprise may well care about its profits and market share as much as any private sector entity. Moreover, the deadening effect of lack of competition or the lack of incentives to innovate or produce quality goods and services is as likely to affect public sector enterprises, where survival is assured, as it does private sector enterprises. But perhaps the most important reason to bring public sector enterprises under scrutiny for anti-competitive practices is that we increasingly have an open economy, where the private sector has to compete with the public sector. A level playing field is in the best interests of the public – the consumers whose interests the Commission is mandated to protect.

16. Public sector firms often are handicapped by government regulations on recruitment, pay, procurement and pricing that limit

their business independence and flexibility. They are also open to government directives. While these directives are rare and usually in the larger public interest, they can detract from firm efficiency and profitability. Sometimes, to presumably compensate for these handicaps, PSUs are given special privileges – they are favoured in government contracts, for instance.

17. Favours PSUs by the government can be anti-competitive, and create an un-level playing field. In the medium term, we have to remove the constraints on public sector firms that limit their ability to compete, even as we take away special privileges and make the playing field as level as possible. There are difficulties in doing that. For instance, the public may believe, or even expect, that public sector banks have the implicit protection of the government, and are thus safer. An important role of the Competition Commission in the years to come will be to guide us on how the interaction between the Government and public sector firms should play out to create the most competitive environment that we can.

18. Jawaharlal Nehru's vision of realising the nation's aspirations by mobilizing capital and labour through large state-owned enterprises did lay a strong foundation for India's economic growth. Many of the public sector enterprises that exist today have served the nation well. Now, however, there is the mandate of a new competition policy and we need to take a call on tradeoffs between the equity and rapid industrialization brought about by public sector enterprises and growing concerns about quality, price and efficiency. Are there ways to push the envelope on efficiency without compromising equity? Should the few remaining public sector monopolies be broken up into competing public sector entities? How do we create a role for the private sector in areas that are still perceived to be natural monopolies and hence reserved for the public sector? And what about public sector entities that cannot compete, and have been kept alive through regular contributions from the exchequer? Are such regular infusions distorting the competitive arena?

19. An often neglected area of competition policy is public procurement. In the case of agriculture the minimum support price (MSP) and open-ended procurement have served our farmers well. But can we procure in a better way? Currently, as a result of how the MSP and procurement policy are set, the government is the largest and in many ways the only bulk buyer of cereals. But, in the process, it is crowding out private sector procurement. The discovery of market prices for cereals is affected by government policy. What role should

competition policy play in bringing private players into procurement and in improving the benefits to both the farmer and the consumer? The role of competition policy in improving procurement is a question we need to debate.

Predatory Behaviour

20. Let me turn to a final issue before concluding. A key issue for any Competition Authority is to prevent predatory behaviour, behaviour which has the appearance of providing a better deal for consumers, but has the intent of forcing out weaker players and establishing a more monopolistic industry. In the long run, the consumer suffers as the industry becomes more concentrated. Predatory behaviour takes many forms, including the introduction of new regulations that favour incumbents over potential new entrants. Sometimes predatory behaviour is so hard to distinguish from pro-consumer behaviour. For example, when an airline cuts fares, is it because it wants to give the consumer a better deal or because it wants to drive a competitor out? Should the regulator prohibit price cutting, thus encouraging a cartel, or should it allow it in the interest of the consumer, possibly encouraging a future monopoly?

21. These are difficult questions that require careful research based on the Indian experience and economic thought and experience elsewhere. The Competition Commission must develop a body of work that allows it to address these issues. Research and deep investigation, drawing on the Indian reality and the experiences of other countries, must become integral aspects of the CCI.

A Caution

22. Let me end with a note of caution, a caveat, and a note of optimism. First the caution: Competition regulation must not become another bureaucracy, stifling growth. I have suggested a number of areas where CCI could play a role, but by no means am I suggesting it needs to take all these issues on board. The CCI must continue to be a lean organization, picking the issues it can weigh on carefully, and making a difference when it does. Its rulings must be transparent and afford clarity rather than obscurity. And it should avoid the perils of overreach as well as regulatory capture. As I have tried to emphasize in this speech, the Competition Commission will play an important part in defining the role of the government as a regulator of competition and as a participant in the competitive process. Increasingly, the government's role as regulator will, and should, become more

important than its role as a competitor. The Competition Commission will be a part of this transformation.

A Caveat

23. Second, the caveat. Competition is about improving choice. And sometimes choice can be improved in more subtle ways than regulation. For instance, direct benefit transfers will allow the poor of this country much more choice on who they get their benefits from -- the bank or the post office, and if it is a bank, which bank and from which banking correspondent. That will truly empower the poor and force providers to compete for their custom. I cannot think of a bigger blow for competition, choice, and empowerment.

My Optimism

24. Finally, the optimism. The Indian economy is entering a new phase of strong growth supported by transparent and effective institutions. In the short time that the Competition Commission has been in existence, I think it has already contributed significantly towards our goal of strong, sustainable and inclusive growth. I am optimistic that it will continue to do so in the years to come and I wish the Competition Commission the very best in its endeavours.

25. Thank you for your kindness and patience.