

The Application of Antitrust Law to State Run Enterprises (SOEs) in India

by
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1. Definition and Importance of SOE's

State Owned Enterprises (SOEs) or Public Sector Undertakings/Enterprises (PSUs) as commonly referred to in India are government majority held companies, statutory corporations set up by an act of Parliament and fully owned by government. The group includes parastatals and departmental enterprises. In India they constitute an important segment of the economy and account for about 26% of the gross domestic capital formation.

India adopted a strategy of mixed economy (public and private enterprises) after independence. Market failure a major concern at that time, dominated the thinking on the appropriate economic strategy and it was but natural under those prevailing circumstances to opt for a mixed economy model assigning a major role to SoEs. "Controlling the commanding heights" was the credo that over four decades after independence saw the expansion of SoE at all levels of economic activity. With state ownership providing the mantle of a 'tool for `social development' the expansion of SoEs gained further momentum especially at the state level.¹ Emergence and awareness of the possibility of state failures partly on account of the obfuscation of commercial and social roles of SoEs resulting in lower productivity and efficiency ushered in economic liberalization policies in 1991 with emphasis on market orientation. Economic liberalization shifted the divide between private and public in favor of a greater role for the private sector through removal of entry barriers erected through the mechanism of licensing. Markets as the mechanism for resource allocation have replaced licensing.²

* Member, Competition Commission of India. The views expressed are personal and not of the Commission. Any errors or omissions are entirely of the author.

¹ As a federal country there are SoE's of the central Government of India and SoE's of each state. The state level SoEs normally go by the nomenclature of state-level public enterprises (SLPES).

² See Geeta Gouri., "Privatization and Public Sector Enterprises In India: Analysis of an Impact of a Non-policy" *Economic and political Weekly.*, November 30, 1996., Y.Venugopal Reddy., **Privatisation**

The presence of SOEs is however still large and they continue to occupy critical sectors of the economy and play a significant role. There are as many as 244 central public sector enterprises. There are probably a few thousand at the state and municipal levels SOEs are present. But a significant difference is that now SOEs co-exist with corporate houses in most industrial activities and are open to market forces even in areas where they have a monopoly position on account of earlier entry barriers. To the extent that these enterprises engage in commercial economic activities, the issue is whether competition in the market is affected by the existence of these SOEs. References to the Commission on anti-competitive behavior of SoEs have been few and largely advisory under Section 49 of the Act.

Public sector in India refers to all government activities including administration, running utilities, financial system of the government and commercial enterprises.³ It is therefore vast and SoEs constitute a subset of the public sector. There are many economic entities which do not come under a strict definition of SoEs⁴ but are part of the public sector, involved in commercial activities and impact on competition. Distinction is drawn between departmental enterprises (DE) and non-departmental enterprises (NDE). Departmental enterprises are part of government financial system with funding coming from the general budget but under separate accounts of income and expenditure. Highways, construction of houses, educational and health services, postal services all constitute departmental enterprise. Railways is the largest departmental enterprise in this category but with a separate budget. Non-departmental enterprises are legally separated from the government and maintain a separate set of accounts as under the Company Law. These enterprises were set up either under the Companies Act or under special statutory provisions.

2. Rules

Perhaps taking a cue from the definition of public enterprise, the Indian Competition Act, 2002, defines the term "enterprise" in section 2 (h) as

Approaches, Processes and Issues, Galgotia Publications, New Delhi, 1992. The process of redivide has been mainly through delicensing, relaxing entry restriction and through equity funding of SoEs.

³ Ibid.

⁴ SoE specifically relate to majority equity holding by the Government.

“a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relating to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space”.

From the above definition it is clear that all the commercial activities of the government, excluding the sovereign one, come under the provisions of Competition Act. No antitrust exemptions are applicable to SoEs including price or purchase preferences.

There are two major features of SoEs in India that however provoke interest. Firstly, many SoEs are in capital intensive industries where even with removal of entry barriers competition tends to be limited. Secondly, in areas of ‘natural monopoly’ predominantly in utilities where reforms and market orientation has been introduced. Reforms is on unbundling the SoE utility but retained for the present in the natural monopoly component such as wires in the telecom sector or power sector with the public sector but with no entry barriers.

3. Framework for Anti-trust analysis of SoEs

A tabular format has been developed which helps to identify areas of economic activity where the presence of SOE could restrict competition. Modalities of introducing competition are suggested as also identifying the relevant sections of the Competition Act, 2002 of India that become operative.

The basic framework used in the table follows the licensing policies laid out in the Industries (Development and Regulation) Act 1948. Under this Act, industries were classified into three categories. Schedule A: reserved exclusively for SoEs; Schedule B: largely reserved for SoEs but existing private sector enterprises permitted to continue; Schedule C; largely for the private sector but SoEs were not debarred. In the case of

departmental enterprises the above schedules were not applicable as no licenses were involved. Economic liberalization policies removed boundaries of all three categories but as incumbents. As stated we look at two categories namely, ‘natural monopoly’ and ‘legally created monopoly sectors’, as issues of competition are critical therein.

Market Structure of SoEs in India and Anti-trust law

Sector	Market Structure	Anti-trust Law –Competition Concerns
<p>Natural Monopoly --- Public Utilities: Telecom, Power, Ports (Air and Sea), Railways, gas and oil pipelines</p>	<p>Market reforms in this segment stemmed from the division of product from the carriage where carriage is the natural monopoly segment. Unbundling has facilitated greater private participation except in those segments which display natural monopoly characteristics. These are mainly networks of former public utilities where the predominant characteristic is that of sunk cost. SoE in most instances are still retained in the network segment.</p>	<p>The dominant feature of natural monopoly is the existence of sunk costs. Sunk costs can act as barriers at a point of time to entry.</p> <p>If unbundling retains the vertically integrated framework by way of agreements then the analysis of contravention of Competition Law will be with respect to Sec 3(4) ; if the natural monopoly leads to horizontal mergers then Section 3(3) become operative. And in determining Sec 3 the Commission will examine Sec 19(3) and (4).</p> <p>In this segment of economic activity, competition is <i>‘for the field’</i>. The modality for introducing competition is by way of auctioning the network for entry of new players.</p>
<p>Legally created monopolies where entry to private sector was not allowed except in instances where they already existed and were not nationalized. Mainly</p>	<p>Open to private sector with the removal of entry barriers. Large capital investment lead to monopolistic competition.</p>	<p>Given their dominant position SoEs are liable to contravene Section 4 of the Act.</p> <p>Trade liberalization and removal of trade barriers is the best mechanism for ensuring competition. The Commission role is more of a facilitator.</p>

Capital-intensive Heavy Industries e.g. steel, generation equipment, transformers etc.		
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Section 3 of the Competition Act, 2002 deals with Anti-competitive Agreements; Section 4 with Abuse of Dominant Position. Sec. 19(3) and (4) set out the parameters which will have due effect on appreciable adverse effect on competition and on whether an enterprise enjoys a dominant position.

From the above the table it is clear that the difficult area as regards anti-trust law is with regard to SoE in public utilities providing essential services. Services are non-tradeable and involve high sunk costs as in wires and bandwidth in the case of telecommunications and transmission networks in the case of the electricity segment.⁵ Networks are capital intensive and the sunk costs can be entry barriers. With well developed financial markets sunk costs are no longer associated with entry barriers. Instead user charges can emerge as entry barriers. In a public utility where social costs often override other considerations especially in the essential services category such as electricity and telephony, user charges are often kept low making investment a non-viable proposition. Briefly the telecom and electricity are examined as SOE's still retain a presence in the natural market segment.

In India reforms in the telecom sector have seen the establishment of market conditions both in the access and service segments. A separate Regulatory Authority, Telecom Regulatory Authority (TRAI) is in place. Advice was sought from the Commission by Government under Sec 49 of the Act and given as regards awarding of bandwidth to private players.⁶ The suggested mechanism was that of bidding process and the

⁵ Grid networks electrical and band waves are normally referred to as carriage and are natural monopolies.

⁶ Under sub-section 3 of section 49 of the Competition Act, CCI is responsible for and has the mandate to undertake measures for the promotion of Competition Advocacy, creating Awareness and imparting training about competition issues. The Commission has been engaged in undertaking Competition Advocacy with government ministries, regulators, state governments and other authorities. From time to time it has given its views on proposed economic laws and policies of the government and regulatory policies and practices of sector regulators, where these impact competition in the markets. Accordingly, the Commission had communicated its opinions *inter alia* on the draft Indian Post Office (Amendment) Bill, 2007, the Warehousing (Development and Regulation) Bill, 2006, the Shipping Trade Practices Bill, 2007 and the Petroleum and Natural Gas Regulatory Bill, 2005. The Commission has also given its views on

bandwidth be auctioned to the highest bidder while duly ensuring transparency in the mechanism. In this sector the initial entry of private sector was in the mobile phones segment. The different models of business associated with the telephony business have attracted a lot of attention and the benefits of competition are the common man are well accepted without a squeeze on profitability of these companies have not been squeezed.⁷ But the basic advantage was the low level of teledensity existing at the time of entry of private players which enabled charging lower user charges but with increased volumes.

The electricity or power sector is more complex in India as it is a concurrent subject and all state governments have their own state regulatory authorities. It is also a sector where reforms are relatively new as compared to the telecom sector. The stages of reforms which involve unbundling, introducing private players spans an entire spectrum from complete government monopoly to fully unbundled and private players in the competitive segments. But largely, the transmission networks at the state level are still with the SoEs and so are the distribution networks. The Electricity Act, 2003 and the establishment of regulatory authorities in each state is responsible for regulating the sector. Consumer choice is the focus of reforms and under the Electricity Act Open Access where consumers are free to choose their source of supply with non-discriminatory access to the networks is the modality.

4. Observations

In both these two utilities on account of sunk costs there are initial entry barriers on account of low user charges. The incumbent has the advantage in the first round. Expansion of networks may not see this advantage.

In the telecom sector mobile operators could maintain lower charges on account of untapped markets. As long as there is unsatisfied demand expansion with lower user costs recovery of network charges is not a constraint. In the electricity sector expansion of the

regulatory policies and practices in the fields of banking, telecommunications, and intellectual property rights such as patents and copyrights.

⁷ The Indian model as it is known has allowed for low costs and high profitability. The average revenue per customer (APRU) is among the lowest in the world. As per *Economist* issue of Sept 26-Oct.2,2009 survey of telephony markets titled 'Mobile miracles' APRU in India is \$6.50 and call charges of 0.02 per minute as compared to APRU of \$51 in USA, \$51 in Japan and \$36 in Europe.

transmission network, the prevailing unsatisfied demand for electricity will sustain new networks even at relatively higher user charges.

The problem of such costs in public utility as regards entry barriers come from user charges. High user charges may not be sustainable where consumers are concerned while low user charges depend on market. Ownership is not an issue.