

# **COMPETITION ISSUES** *IN* **CONCESSIONS**



**PRESENTATION**

**at**

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**BY**

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# Concessions



- **When competition is inherently infeasible, as in natural monopoly, the next best option is to allocate the right to supply a specified market (called concession) through a competitive process**
- **Concessions are incomplete in economic terms – do not cover all contingencies**

# Concessions

- **Concession creates privately operated monopoly (dominant position), with related market power**
- **Design and oversight of concessions are complex due to:**
  - > **Long period involved; *and***
  - > **High risk for both the concessionaire and the Government**

# Competition Issues



- **In concessions competition issues arise at the stages of:**
  - **Concession design**
  - **Allocation process of concession;**  
*and*
  - **Oversight of working of concession**



# Concession design - 1

- Rather than rely on *ex-post* law enforcement alone, it is better to reduce *ex ante* incentives for or ability to engage in anti-competitive behaviour
- **Ex: Debarring parties from participation in bids in certain situations**
- **If an auction is to be used to award the concession, then all the dimensions over which competition will not take place must be specified or otherwise prepared for, in order to reduce the scope for renegotiation**

## Concession design - 2

- Include provisions in the rules for reassessing the design of concession if there are too few bidders
- ***Structural separation***: same enterprise operating both the essential facility and competing: e.g. A company operating port and using the port as a shipping company
- Separation of ownership and operation: e.g. Department of Posts, Old DoT etc.

## Concession design - 3

- **Costs and benefits of prohibiting a concessionaire from engaging in a complementary/vertically integrated activity to be analyzed**
- **Cumulation of concessions by concessionaire likely to create market power.**
- **Costs and benefits of prohibiting a concessionaire from holding a competing concession – (cost in terms of loss of economies of scale and scope)**

## Concession design - 4

- **Where possible, activities should be divided into different concession contracts, subject to economic size (e.g. length of the road stretch)**
- **In Mexico, Competition Authority has powers to issue opinions on competition aspects of concessions and even auctions. However, such opinions are non-binding**



# Competition Issues In Allocation Process - 1



- **The key elements in auction design are to keep the cost of bidding low, negotiate the right bidders to participate, ensure the integrity of the process, and take care that the winning bidder is someone who will pay or deliver as promised (Milgrom,2004).**
- **The more the bidders, the more competitive the auction is likely to be, in general**

# Competition Issues In Allocation Process - 2

- **Auction should aim at identifying the most efficient operator**
- **Re-negotiation can nullify the benefits of a competitive allocation mechanism**
- **The design of the auction affects signaling. Collusion may be difficult if bidders' identities are not revealed**

# Oversight of Working of Concession - 1



- **Legal entry barriers provided by the concession agreement makes anti-competitive practices all the more easy for the concessionaire.**
- **Hence the need for allowing new/parallel facilities to come up when demand goes up: Not in terms of period operated, but in terms of specified capacity being reached**
- **The incumbent, in such cases, should be restrained from predatory behaviour (pricing below cost, with a view to eliminating competition)**

# Oversight of Working of Concession - 2

- **Just because Government is a party to the concession does not exempt the concessionaire from the purview of Competition Act**
- **Only competition law enforcement can ensure that the legal monopoly created via concession enhances efficiency and increases consumer welfare**



# Re-negotiation Issues - 1

- Opportunistic renegotiation could eliminate the benefits of competitive auction
- A study by Guasch found that existence of regulatory body greatly reduces the likelihood of renegotiation
- The main outcome of the re-negotiations were - to increase tariffs (62%) – delays and decreases in investment obligations(69%) – increase in the number of cost components with an automatic pass through to tariffs(59%) and decreases in the annual fee paid by the operator to the government ( 31%).

## Re-negotiation Issues - 2

- **A small number of re-negotiations also led to tariff decreases (19%) and increase in annual fee paid to the government (17%).**
- **Remedy to reduce opportunistic behaviour is to envisage repeated contest**
- However, repeated contest may not be possible always. **Performance bonds and step in rights** can reduce incentives to renegotiate.
- **The concession contract can include obligation to continue providing services** until a new concessionaire has been chosen.
- In Columbia this obligation is imposed by a general law governing concessions (Klein 1998 )

# Experience With Concessions



- **Increased efficiency is the fundamental reason for concessioning.**
- **Experience of countries in Latin America and the Caribbean over 2 decades has shown that concessional firms made significant efficiency gains.**
- **For Railways average annual Total Factor Productivity (TFP) growth was 5.3% (freight) and 9.8% (passenger) in Argentina, higher than before concession**

# Experience With Concessions

- In Brazil the average annual TFP growth has been 8.4% for the first 2 years of concession (against 5.5% rate before the sectoral reform)
- A study by Estaches, Guasch and Trugillo (2003) for Latin America for Ports, for 1996-99, showed that the Mexican ports improved efficiency by 2.8% to 3.3% per year





**THANK YOU**

