Competition Policy in India
Issues for a Globalising Economy

The objectives of competition policy in India are the creation of an active competitive environment and to aid and abet the process of creating globally competitive firms with enhanced investment and technological capabilities. To achieve these objectives, the government will need to play a proactive role.

Rather than restricting themselves to issues conventionally covered by competition law, the authors consider, as part of competition policy, all those policy instruments that impinge on the promotion of competition in markets. Consequently, policies relating to trade, investment and technology development also come under the purview of competition policy insofar as they impinge on the process of competition. The formulation and implementation of an effective competition policy in the current context is a difficult task as it needs to be consistent with other policies which are transforming India into a liberal open economy.

In India, protection and controls are being replaced by a competitive and de-regulated open economic system. In the pre-reform era, various restraints to competition existed: (i) investment restraints (licensing); (ii) control over acquisition of economic power through Monopolies and Restrictive Trade Practices Act (MRTP); (iii) public sector reservation for infrastructure and other industries creating monopolies in various areas; (iv) product reservation for the small-scale sector; (v) government procurement policies favouring public and small-scale sectors; (vi) trade restrictions and high tariffs; and (vii) restrictions on foreign direct investment. All these restraints (protective measures as well as controls) have been or are being relaxed now.

One key issue in the current phase of transition is of ensuring and managing competition, to derive the most out of liberalisation. The task is all the more difficult because the nation is not starting with a clean slate as various institutional structures continue to be in place. Besides, the decontrol, deregulation and privatisation initiatives are being taken at a time when global economic environment is also undergoing a major change. The GATT-94 accord and the consequent setting up of the World Trade Organisation (WTO) have changed the rules of the game vis-a-vis world trade. The finer implications of this accord for the domestic policy-making are slowly being recognised. Additionally, in an economy like India which has yet to complete its transition to an industrial economy, simple prescriptions based on static welfare analysis would not be adequate. What kind of competition policy needs would emerge during this transition process? How should these needs be addressed? What possible approaches one can use for tackling the competition aspect in the context of bringing about economic development, trade and investment in the post WTO global economic environment? An exploration of these complex sets of issues is important.

Wider Macro-Economic Context

We recognise the objectives of competition policy to be in creating an active competitive environment, and in aiding and abetting the process of creating globally competitive firms with enhanced investment and technological capabilities.

It is argued that the government will need to play a pro-active role in achieving these objectives that has to go beyond traditional regulations.

A broad concept of competition policy is used in this study. Rather than restricting ourselves to issues conventionally covered by competition law (e.g., mergers and acquisitions, restrictive business practices, collusion, etc.), we consider all those policy instruments that impinge on the promotion of competition in markets, as part of competition policy. Consequently, apart from competition law, policies relating to trade (market access, export subsidies, exchange rate, tariff and non-tariff barriers), investment (FDI, privatisation, tax, product reservation, interest rate) and technology development (IPRs, R and D, technology licensing and alliances) also come under the purview of ‘competition policy’, insofar as they impinge on the process of competition. The underlying premise of the paper is that the formulation and implementation of an effective competition policy in the current context is a difficult task as it needs to be consistent with other policies which are transforming India into a liberal open economy.

Changing Conceptual Underpinnings

The developments in the theories of industrial organisation during 1980s and 1990s have created some scepticism about the relationship between market concentration and market power and a greater recognition of the possible efficiency enhancing role of vertical as well as horizontal agreements, mergers and acquisitions. Consequently, most competition authorities today do not per se view large horizontal mergers, practices facilitating co-ordination, exclusionary practices, etc.
as anti-competitive. Earlier, it was common in countries like the US, for rules to per se deem certain types of business practices as being anti-competitive. Today, a case-by-case analysis is the norm. In other words, the rule of reason approach is increasingly becoming more popular.

Moreover, in the application of the rule of reason approach, the competition authorities and courts have shifted away from relying primarily on market share evidence for predicting the competitive consequences of business practices. Market share, though still quite important, are increasingly treated as only one element in a detailed economic analysis of the consequences of the particular conduct at issue. A large variety of factors including trade barriers, sunk costs, technology and product life cycles, rate of growth of demand, etc., are used to analyse the potential efficiency enhancing and market power effects of a business practice. Besides, both static and dynamic implications are sought to be ascertained.

This trend towards a more detailed economic analysis of individual practices has possibly reduced the errors in determining the likely effects of business conduct. It would have also increased the skill and resource requirements of the state institutions to undertake adequate analyses of potentially anti-competitive practices. Most competition authorities in developing countries do not have these capabilities. Moreover, the information requirements of these analyses are also extremely high and the requisite data are often difficult to compile, given that reporting norms for companies are quite rudimentary and often the practices of accounting leaves much to be desired.

Importance of Competition Authorities

The competition policies differ significantly across countries. For example, unlike the US anti-trust authorities whose enforcement priorities were horizontal restrictions, the European competition law has tended to focus more on vertical distribution relationships. This is presumably because Europe is trying to consolidate the formation of a single European market to supersede the traditional national markets. The US, on the other hand, has had a national market for most goods and services for a long time. Similarly, since many markets in Korea were already monopolistic or oligopolistic at the time of introducing the competition law, the law focuses on unreasonable or anti-competitive behaviour of dominant firms rather than on direct prohibition of monopolisation or attempts to monopolise. In the same vein, the administrative structures to implement competition policies also differ significantly across nations.

Most developing countries are in the process of enhancing the powers of their competition authorities. For example, despite the general trend of downsizing and merging of administrative agencies in Korea, the Korean Fair Trade Commission (KFTC) was elevated to a ministerial-level agency in March 1996 and its chairperson now participates in cabinet and other ministerial level meetings and contributes in the making of important policy decisions. These changes reflect the growing recognition that competition policy is extremely important in a globally integrated economy and needs to be properly integrated with other economic policies. Furthermore, the KFTC has been specifically charged with the responsibility of improving anti-competitive laws and regulations to remove factors that restrain competition in the government sector. In the revised Fair Trade Act of 1996, a provision has been included authorising the commission to present its views on the need to rectify anti-competitive provisions in the laws and regulations of other administrative agencies and ministries.

New Needs for Competition Policy

The Indian corporate sector has utilised a variety of strategies in the post-reform period to cope with the increasing competitive pressures due to internal and external liberalisation. With the maturing of the Indian oligopolies, the competition policy needs of the country are also undergoing changes. Some salient aspects of the changes in the Indian industrial sector are:

- The Indian corporate sector is vigorously restructuring itself. Restructuring is mainly geared towards consolidation in few chosen areas to correct the inefficiencies created by over-diversification in the pre-reform era.
- MNCs have actively participated in the merger and acquisition process to get market entry or to strengthen their presence. Acquisitions have been used by MNCs to quickly get access to various complementary assets.
- MNCs are better placed vis-a-vis domestic firms in the acquisition game because of their deep pockets and relatively cheaper access to capital. The intentions to invest in India by MNCs are significantly influenced by these differences in the cost of capital.
- The reliance of the Indian corporate sector on foreign technology purchase has increased. More and more technology flows are now tied with equity. Purchase of technology (especially foreign) is taking precedence over R and D; inhouse technology generation has taken a backseat. Besides, a large variety of inter-firm alliances are taking place.
- Firms are making efforts to improve manufacturing capability. This is being done through building alliances as well as through initiatives within the firm. Quality upgradation seems to be an important priority. These efforts at improving manufacturing capability may still prove to be inadequate to meet the competitive challenges. These inadequacies may also adversely affect India’s chances of efficiency seeking FDI, the need for which has been emphasised.
- Product differentiation strategy seems to be dominating over strategies of building distribution and marketing related complementary assets. Such a strategy helps Indian firms to stand up to transnationals with their strong and internationally recognised brands. Yet, because of inadequate attention to R and D manufacturing, which have significant pay off but in the long run, the long-term competitiveness of many Indian corporates is in doubt. Besides, interestingly, distribution and marketing related expenditures (and not advertising) seem to have led to higher margins and profitability in the 1990s.
- Export based growth strategies are being adopted by some of the corporate sector firms but such strategies are not widespread; export orientation increased appreciably in the early years of reform but have seen a major collapse since 1997-98. Overall, exposure to the international market is still inadequate to put the Indian firms on higher growth and learning trajectories.
- Overall, concentration levels in most industry groups have either shown no trend (increase/decrease) or have declined during the 1990s. In very few product groups a trend increase was observed during the post-reform period. However, a large number of industries remain very concentrated even in the late 1990s.
- While no significant trend was observed in the price cost margins for most of
the industries profitability rates were positively affected by product group specific concentration levels in the 1990s. The fact that a similar relationship has been observed for the 1970s and 1980s suggests stability of the links between concentration and profitability.

The policy initiatives will need to encourage investments in R and D and in complementary assets like manufacturing, etc. It would also have to ensure rapid increases in exports. The cost of capital advantage of the MNCs is real and needs to be tackled squarely. Else, the Indian corporate sector may not be able to win the battle in spite of all the strategic initiatives mentioned earlier. At the moment, the MNCs seem to hold an unfair advantage over domestic firms in the M&A game. Despite the fact that there is no increase in concentrations in most industries, they remain high in many industry groups. While it is difficult to ascertain whether higher profitability in concentrated industries is a result of collusion or higher efficiency, given the positive link between profitability and concentration, a competition policy focus on concentrated industries is unavoidable. However, as Indian oligopolies mature with a wide range of non-price competitive strategies, the task of competition authorities to distinguish between market power and efficiency related influences will become increasingly difficult.

Institutional Gaps

Insofar as the liberalisation process initiated in 1991 increased competitive pressures, one would have expected a significant spurt in the monopolistic, restrictive and unfair trade practices cases. The dominance of non-price competitive strategies discussed above would also indicate that the incidence of such cases should have gone up. However, the evidence put together by us on the MRTP cases shows that the number of enquiries instituted per year by MRTPC have declined in the 1990s. The reasons for this decline are not entirely clear. But part of the explanation lies in the relative inactivity of DG (I&R) and MRTPC in instituting enquiries. The reasons for this relative inactivity need to be explored. Lack of resources and expertise available with these agencies may have led to delays in case disposal, a large backlog of cases decreasing ability or interest in pursuing cases of anti-competitive activities.

Services and real estate have emerged as important sectors where the incidence of RTPs and UTPs is high. They continue to be high in consumer products. Evidence relating to advertising linked MRTP cases does suggest that the role of MNCs in such cases is high. They are either involved in these cases as one of the parties or the cases relate to product groups where MNCs are important competitors. The emergence of MNCs as a potent competitive force seems to have influenced, at least to some extent, the incidence of anti-competitive activities. Our analysis suggests that apart from mergers and acquisitions, MNCs have chosen advertising as one of their key non-price strategies. This is expected as such a strategy optimises the use of large and cheap capital resources available to them and in sectors with lifestyle associated consumer goods, brands would be the most important entry barrier that MNCs could create.

While the number of inquiries instituted by the MRTPC per year have declined during the 1990s, consumers, consumer and trade associations are pursuing inquiries of such activities through the MRTPC in a more vigorous manner. It is possible, that the delays involved in MRTPC proceedings and low success rate may have resulted in more and more cases of unfair trade practices being tried in consumer courts. We recommend that the interface between MRTPC and the CP Acts should be looked at more carefully.

Competition Policy and Economic Development

Competition policy seeks to prevent restrictive business practices and market structures that significantly lessen competition. The objective of such a policy is to maintain and encourage competition in order to foster greater efficiency in resource allocation and maximise consumer welfare. These objectives are achieved through an inter-face with other economic policies affecting competition in local and national markets. The related regulatory policies include those relating to infrastructure (where natural monopolies are likely to occur), international trade, foreign direct investment, intellectual property rights, financial markets and privatisation.

The expected benefits of laws that enhance competition are many – stronger market forces, lower costs and prices and an increase in consumer welfare, pressures towards sound business discipline, culture and ethics. It is also argued, that closer interaction of business and government is needed to ensure that firms are large enough to compete effectively in international markets. Markets often fail to guide investments to industries that would generate high growth and governments must. Therefore governments have to lead the market by identifying strategically important industries, and few large firms that can act as national champions and engines of growth. Consequently, the usual competition policy may hinder domestic firms’ ability to become competitive because it makes it difficult for them to coordinate their business policies and consolidate operations through such strategies as mergers and acquisitions. Internalisation of poorly developed market. Besides, the risks, uncertainty and lower profits associated with competition could limit their ability to conduct R and D, innovate and improve product quality. The proponents of this view point to the high post-war growth rates of Japan, Korea and other east Asian economies as evidence of national competitiveness relative to that of the United Kingdom and the US.

Several inadequacies in these arguments have been identified. For example, it is suggested that firms and not nations compete and many of the interventions listed above (including export cartels) are unsustainable as other nations can also adopt similar policies. Similarly, exports play an important role for learning and growth. Besides, the links between firm size, concentration and performance are not entirely clear and inter-firm rivalry has significant dynamic benefits. The study argues that while governments cannot significantly affect international business environment, nations do matter as firms exist within nations. Domestic policies may influence international competitiveness and the nature and role of competition policy has to be contextual to the stage of economic development.

Competition Policy and Investment Policies

One of the main reasons for strengthening competition law can arguably be the inadequacies of existing laws in controlling restrictive business practices (RBP’s), imperfections in the market structure and weaknesses in the distribution system. Without a comprehensive legislation to prohibit or control RBPs, one cannot ensure fair competition and efficiency since dominant firms especially MNCs may indulge in unfair trade practices prohibited in other countries with competition legislation. Similarly, entry strategies of MNCs
into a liberalising economy with a potentially large market, could turn predatory and work to the elimination or destruction of competition from domestic firms.

Controlling monopolistic practices in developing countries via a competition policy should not merely allow multinational companies greater access to the markets of developing nations. This would result in greater monopoly globally instead of curbing monopolies. Local monopolies of developing countries may be weakened or broken up by a traditional competition law, enabling bigger multinational monopolies to takeover more of their markets. The capabilities of domestic firms and the conditions under which they compete need to be ascertained and possibly even strengthened through active policy in order to ensure the permanency of competition.

Recent work on the links between international trade and economic development has highlighted the positive role of codified and tacit knowledge flows in economic development. It is also understood now that such productivity enhancing knowledge flows (or technology transfer) to host country soil are facilitated by knowledge flows (or technology transfers) in different countries. Accordingly, the establishment of operating subsidiaries to host country soil are facilitated by knowledge flows (or technology transfers) in different countries. Consequently, the desire to be quickly off the ground that has made foreign firms with vast intangible assets or cost of capital advantage, to accommodate such local firms with significant distribution assets giving them some control through joint ventures, or otherwise. The analysis confirms, without doubt, what was obvious to many. FDI into India has been disproportionately large in capital using and infrastructure industries like power and telecom. In the power industry the only advantage of the foreign firm is its lower cost of capital.

In sectors where over and above the cost of capital advantage, intangible asset advantage also exists, the pressure on domestic firms have been too severe and many have succumbed to takeovers, or have sold out. In lifestyle associated product-markets, and in sectors where else FDI has been driven by the cost of capital differences corrected for expected exchange depreciation (Fischer-open) in the nineties. Nearly 14,000 proposals for FDI and technical collaborations, over the period 1990-91 to 1997-98 were analysed to explore determinants of investment intentions by MNCs. These were driven by the cost of capital factor. The ratio of distribution expense to all expense, which proxies for the strengths of existing (largely domestic) industry’s distribution assets, had a negative influence over the desire for majority and dominant stake by the participating ‘MNC’. Thus distribution assets are a countervailing strength to domestic business, and enable them to bargain for lower foreign ownership than what would otherwise have been possible.

The strength emanating from distribution assets is only a temporary one, and as foreign firms develop their own assets, or as local firms have to part with them ‘cheaply’, the ‘advantage’ would evaporate. It is only the desire to be quickly off the ground that has made foreign firms with vast intangible assets or cost of capital advantage, to accommodate such local firms with significant distribution assets giving them some control through joint ventures, or otherwise. The analysis confirms, without doubt, what was obvious to many. FDI into India has been disproportionately large in capital using and infrastructure industries like power and telecom. In the power industry the only advantage of the foreign firm is its lower cost of capital.

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For economies in transition, it is extremely important that they reap full advantage of the competition among multinationals. Absence of a well functioning competition policy may take away such opportunities. Besides, re-organisation of domestic capital may be as important for economic growth as the inflow of FDI. In the absence of competition law, reform of local institutions and business law in general, re-structuring of domestic investment necessary to trade liberalisation alone may not come about. Broadly, then, liberalisation of FDI-related policies enhance contestability in host country markets. However, the key issue is that reduction in regulatory barriers to FDI and domestic liberalisation should not be allowed to result in the creation of private barriers to entry and anti-competitive behaviour of firms. This possibility is real because FDI can increase concentration in national markets.

One needs to recognise, however, that attracting FDI may not mean that technology transfer will take place automatically. Moreover, while re-organisation and the associated exit of certain domestic firms from specific sectors is probably unavoidable in a liberalising scenario, it should be kept in mind that markets are not as contestable as one wants them to be and entry of firms which have been driven out through anti-competitive practices (like predatory pricing) is likely to be extremely difficult. Therefore, anti-competitive practices adopted by MNCs and the advantages they may have vis-à-vis domestic players need to be carefully monitored in transition economies. Access to capital at low costs is one such advantage.

Our study showed that many mergers and acquisitions have taken place in India to access complementary assets like marketing, and distribution networks to reduce lags in market entry. Thus ‘inefficient’ domestic producers with complementary assets may become prime targets for mergers or acquisition by MNCs as economic liberalisation takes place. But these mergers may be transient or unstable and MNCs may dump the Indian partners as soon as they feel comfortable with the economic environment. In such situations dynamic welfare effects of mergers (especially cross-border) while difficult to ascertain may not have increased.

**Cost of Capital Advantage of MNCs**

FDI into India has been driven by the cost of capital differences corrected for expected exchange depreciation (Fischer-open) in the nineties. Nearly 14,000 proposals for FDI and technical collaborations, over the period 1990-91 to 1997-98 were analysed to explore determinants of investment intentions by MNCs. These ranged from pure technical collaboration (not resulting in any equity stake) to full ownership. Apart from the Fischer-open, other explanatory variables included proxies for intangible assets, other relevant industry level variables such as concentration, dummies to capture further liberalisations of 1995 and 1997, and price/earnings differentials between source countries and India at the industry level to accommodate inter-industry valuation differences. The Fischer-open comes out as one of the most significant variables in the multinomial Logit and Tobit regression exercises. Both the quantum of FDI and the level of desired control (share in equity) is positively affected by the Fischer-open. The results, therefore, unambiguously establish that the degree of ownership (and control) sought by MNCs was
Overall then, the Fischer-open is not only the most important factor explaining the desire for control but is also the most important driver of the quantum of FDI firms. This dual significance of the Fischer-open clearly acts against domestic firms, who now face ‘unfair’ competition from foreign firms. Intangible asset advantage alone would have been fair in a wide variety of industries.

If the only option for India as it liberalises is high interest rates, and differential cost of capital between domestic and foreign firms is inevitable, then the discrimination that we discussed is inevitable and hence not of much policy relevance. There is really no inevitability to either high interest rates or to the Fischer-open, and alternative macroeconomic policy and orientation could have reduced if not eliminated, the distortion against domestic firms, and local production of tradables.

Orthodox monetary targeting, which assumes constancy of the money multiplier, and views inflation as a purely monetary phenomenon, is at the root of the problem. In contrast, interest rate targeting with efforts to directly reduce wasteful fiscal expenditures, would help to even out the playing field. An initial strategic under-valuation would of course make the conduct of overall macroeconomic policy with interest rate targeting easier, since it would be easier to hold on to a low value of a rupee with an expanding trade sector.

Financial sector reforms initiated in recent years do not seem to have mitigated the cost of capital advantages which the MNCs have vis-a-vis local firms. And therefore, unless the playing field is made more even, any competition policy initiative in India is likely to be biased in favour of the multi-nationals. With this bias in favour of MNCs, consumers already in the market could still gain, but those outside would continue to be excluded from the development process.

Micro-Economic Rigidities

Policies of product reservation, industrial licensing and the MRTP Act have interacted with schism in the labour market and demand patterns to create a variety of imperfections in product markets. The evolution of the Indian oligopoly was has been constrained by macro-economic policies in a variety of ways. For the policies relating to product reservation, credit, trade and tax have constrained the natural growth of a competitive small scale sector. Absence of a VAT system has also resulted in a situation that mutually beneficial linkages between small and large firms have not developed as much as they could have. Recent changes in trade policy have made a mockery of the policy of product reservation. More than half of the products reserved for the small-scale sector has been put on the Open General Licence (OGL) list. This implies that while foreign firms can compete with small firms, domestic (large) firms cannot enter these product markets! Unless these anomalies are removed, local firms will not be able to make optimal choices with regard to investment and their product-market boundaries. If these choices are not open to domestic firms, to improve their competitiveness, competition policy alone would create large biases in favour of foreign firms.

Enhancing the competitive potential of the Indian economy necessarily means higher and synergistic growth of the small-scale sector and increasing inter-firm linkages especially the development of subcontracting. Such vendor development is necessary because large firms do not have access to the cheap skilled and unskilled manpower that small firms have access to. This arises due to the ‘schism’ in the labour market. Small firms by their very nature would find access to the complementary factors (investment in processes, technologies and equipment that make possible standard quality, shorter delivery time, etc) necessary to exploit these low cost and abundant factors difficult. As small firms grow they would come up against the constraints imposed by labour laws, and the ‘schism’ in the labour market. Thus, the only strategy that can expose India’s factor cost advantage to external market, and derive the gains of exports, and of falling costs in its own domestic market, would have to be centred around vendor development, and around policies that lead to faster growth of the small firm sector.

These would be incentivisation of credit flow to the sector, overcoming the credit market failures, removing reservation, and correcting the inverted tariffs. High growth policies, including strategic undervaluation of the currency to bring about export-led growth of the east Asian variety would be necessary.

Public Sector: Need for Strategic Disinvestment and Managerial Autonomy

Many of the PSUs were created in India for strategic purposes. Unfortunately, they were protected from competition in a variety of ways. Absence of competitive pressures and the soft budget constraint meant that there were no pressures on these firms to be efficient. Most of the enterprises benefiting from the control and policy environment in this regard knew for certain that they would not be challenged in the domestic market. Thus, there was little incentive to work hard for the same. For the purchasing PSUs, this kind of procurement was a binding constraint. Had the policy worked through incentives and opportunities rather than constraints, and had it made market access less than certain, then there would have been significant pressures for efficiency, improvements and technological change. Thus, the great force of the market that shapes and drives firms even when present was not allowed to act. Even today, when privatisation is in the offering, most administrative ministries, at best, only dimly sense the need for competition in its most basic sense of firms being exposed to the market.

Recent amendments have brought PSUs within the purview of the MRTP Act. Given the budget deficits and impending privatisation, they no more enjoy the availability of capital at low costs. Besides, in the absence of managerial autonomy, the PSUs are not able to respond to the increasing competitive pressures from imports and other private domestic and foreign firms. The PSUs also carry a heavy baggage of rules and regulations which other firms do not have to carry. These constraints have to be relaxed if one expects PSUs to compete in the new environment. If this is not done, a competition policy may create a bias against the public sector. Thus, while it is important to see that public sector monopolies are not replaced by private sector monopolies, it is also necessary to create conditions wherein the PSUs, privatised or otherwise, are able to compete on ‘equal’ terms.

To ensure that the competitive potential of the economy is unleashed to the fullest, to serve both the domestic, and the export markets, the task of privatisation should include the creation for competition in the post-privatised environment; since in that situation, even theoretically, the assumption that private monopolies would work to the common good cannot be made. Events thus far would lead one to believe that issue of competition has played a very small role, if at all, in the privatisation initiatives.

Disinvestment offers opportunities for creating competition, and strengthening
the hand of potentially Indian MNCs and hence of competition and development of the industry in the long-run. But every situation is likely to be different, demanding, therefore, different solutions. The philosophy and approach of privatisation and disinvestment, at least with regard to critical PSUs is, therefore, all the more urgent.

Relaxing the constraints on the public sector through various privatisation and disinvestment initiatives is the need of the hour, not only to ensure the large potential for competition in these firms in the home market, but also globally. Indeed, their liberation, would be necessary and vital in the industrialisation of the country itself. It would also be unfair to Indian business and to its managers to keep the current restrictions on, when they are under threat of being taken over or, their markets invaded by foreign firms. A disinvestment strategy for success would have to go beyond the current ad hocism, to integrally address, among other concerns, the issues of competition, and appropriate industry structure to ensure competition. This can only come with a fair, transparent, and publicly accepted and supported disinvestment mechanism. Major state failure, and deep-rooted corruption means that disinvestment as a process would have to be itself distanced from government.

Trade Policy as a Competition Policy Tool

It has been suggested that trade liberalisation reduces the need for competition policy as anti-competitive practices are less feasible in an open economy, even when markets are concentrated. This is so because domestic monopolies or oligopolies lose their ability to exercise market power due to the threat of potential competition, irrespective of the share of imports in the domestic market. This view gets empirical support from studies that find differing degrees of convergence between domestic and international prices with the removal of trade barriers and a negative relationship between price and cost or profit margins and imports. However, some recent empirical studies suggest that effects of trade liberalisation may be less significant than previously thought, raising questions about the true effect of trade liberalisation on competition.

The trade policy-competition policy interface has acquired added significance in the context of the recent discussions in the WTO forums. Liberalised trade policy can not substitute for competition law; the two complement one another in promoting trade, market access, global economic efficiency and consumer welfare. Therefore, enacting a law on competition policy is necessary, even where trade has been significantly liberalised. However, the timing or the sequencing of competition laws and other liberalisation initiatives is not very simple and needs to be thought through, in the context of the conditions prevailing in an economy. The basic challenge facing governments in transition economies is to figure out an optimal way of stitching the trade and competition policy together. The report shows that unless the accompanying macroeconomic policies, and especially the exchange rate strategy is correct, trade liberalisation has the potential of to create a skewed playing field that disfavours domestic production.

Use of ‘trade disputes’ to ‘correct’ behind the border anti-competitive practices has made the situation murky. Recent cases at the WTO highlight issues that are relevant for countries enacting or modifying their competition policies:

- Given the complexities, the skill, data and resource requirements for dealing with such trade disputes through the WTO mechanism can be enormous, especially for a developing country. The coordination between departments dealing with WTO issues and competition authorities would become imminent. If a country opts for bilateral negotiations, political considerations may dominate such tasks, leading to practices like VERs and VIEs.
- Virtually all policy instruments (e.g., those relating to distribution, public sector, small-scale industries, advertising), irrespective of when they were initiated, can be brought into the purview of WTO dispute settlement procedures through a so-called ‘trade dispute’.
- Such disputes not only question the freedom of the state to institute national policies but also raise doubts about what firms can or cannot do to organise their activities.

The Kodak-Fuji case and the general case of the Japanese keiretsu raise larger conceptual and policy questions. These questions relate to the problems that inter-country differences in economic organisation pose for international trade, competition and market access. And on the need to resolve them. Our analysis suggests that the Indian perspective on this issue should be that trade policy is concerned with access to markets; its aim is to remove artificial barriers to markets. Competition policy is concerned with firm behaviour in markets; it sets the rules under which firms compete with one another in markets. The structure of the markets is endogenous, especially in intermediate products: which markets are open and how they operate depends on where firms locate their own boundaries and how they choose to contract across those boundaries. Firms do not just operate in markets; their contractual choices help to shape the design of markets. Economic organisation varies across countries. Neither ‘firms’ nor ‘markets’, particularly intermediate product markets, are necessarily the same in each country. Following this, policy induced closed markets need to be distinguished from ‘restrictions on market access emanating from internalisation of markets’ (or conversion of ‘spot markets’ into ‘markets for long-term contracts’) by firms. Such a distinction will help put trade disputes discussed above in a proper perspective.

The appropriateness of this perspective for India also emanates from our finding that complementary assets relating to marketing and distribution provide some advantage to domestic firms vis-a-vis MNCs. In a situation when the market conditions (arising out of macro policy) favour the MNCs more (as noted above), inclusion of inter-enterprise linkages in trade disputes will render a double blow to the domestic players, and hence to competition in the long run.

Competition policy does not lend itself very easily to incremental changes and certain policies that are pursued by governments may be perceived to be in the national interest. It is not surprising, therefore, that the US does not wish to pursue anti-trust objectives or other competition oriented policies through the WTO, despite the fact that business practices are better covered by competition law than by trade law. Long established US anti-trust rules, including extra-territorial provisions, would be diluted in the process of multi-lateral negotiations. Similarly, government-condoned private business practices that create trade barriers by restricting parallel importation might come under closer scrutiny.

Overall, therefore, despite the recognition that anti-dumping interventions and government support for parallel importing prohibitions are a source of contingent protection from trade and price competition, there are several political obstacles to reduce the scope of these provisions. The US has used these provisions exten-
sively. Besides, it has recently won a major case where the WTO panel has held that the provisions of the US Trade Act of 1974, which is designed to take unilateral action against the country’s trade partners do not in any way violate the commitments taken by it under the WTO. In other words unilateral action by the US under section 301 (and super/special 301) is WTO-legal.

In this situation, it is very unlikely that the US would like to bring competition policy under the ambit of WTO deliberations.

In such a scenario it does not make sense for countries like India to agree to multilateral disciplines on competition policy unless it is agreed that prohibition on antidumping and unilateral sanctions would follow the adoption of common competition policies. Till such time, it makes sense for India to retain Article 14 of the MRTP Act in its competition law, as it seems to complement the anti-dumping provisions available in the WTO framework. We recommend a significant coordination between the commerce ministry and the competition authorities. Unfortunately, one does not see any effort in this direction.

**Sequencing of Trade Liberalisation and Competition Policy**

The issue of sequencing is similar to the non-level playing field argument vis-a-vis MNCs discussed earlier. Just as a policy of liberal FDI to enhance competitive pressures need to worry about unfair advantages that MNCs may have vis-a-vis domestic firms, the use of trade liberalisation as a competition policy tool also needs to take into consideration, constraints on domestic firms that make the playing field uneven. In a situation where the domestic firms have to deal with policy induced constraints to tackle import competition, a very strict competition policy may further accentuate these disadvantages.

The inverted tariff structure creates uneven (import based) competitive pressures across industry groups. If competition policy instruments are evenly employed to deal with anti-competitive practices across industry groups, the ‘negative protection’ faced by final goods producers will become even more significant. An industry specific implementation of competition policy instrument, which is increasingly the norm in most countries, will mitigate some of these problems but will increase the information, resource and skill intensity of competition law implementation.

The competition policy-makers and those involved in its implementation will need to be sensitive to the links between M&A activity and trade liberalisation and to the ’non-level field playing field’ created by inappropriate sequencing of domestic and external liberalisation and by the inverted tariff structure.

**Strategic Exchange Rate Policy**

Trade liberalisation in India, in the context of countries like China, Taiwan, South Korea, Malaysia and Thailand pursuing export led growth with policies that favour exportable and importable goods production via inter alia strategically undervalued currencies, has resulted in severe competition from these countries. The only way the domestic industry can be given a chance to respond to their challenge, which at the same time is not protectionist, is to precisely follow these countries in strategically undervaluing the rupee. This means more than just a depreciating currency.

Merely ensuring effective protection rates (EPRs) to be small but greater than one, would only ensure that the resource cost of domestic firms accessing the Indian market is not large. It does not create the environment for domestic firms to improve their productivity and increase their share of the global market, which is known to have been a mutually reinforcing process historically. An environment conducive to such behaviour would mean that India itself pursues an export-led growth strategy that creates huge incentives for export sales in relation to domestic sales. A ‘fair’ and equilibrium pricing of the rupee as we do today inevitably exposes Indian industry to ‘unfair’ east Asian competition in general and Chinese competition in particular. Lack of recognition of the role of macro-economic and exchange rate policy in determining a country’s competitiveness is because of the excessive focus of traditional competition policy on the industry and industry structure and the hiatus between the pure and the monetary trade theories. For poor countries with well-diversified economies, the exchange rate and macro policies are effective instruments for raising their shares in the world market. Consequently, these policies need to be explicitly considered while assessing the joint effects of trade liberalisation and competition policy initiatives.

**Inter-Firm Alliances**

The ‘two-way’ inter-firm linkages are an important mechanism for accessing knowledge bases abroad for developing country firms. However, some studies have shown that among the third world countries only firms from some newly industrialising economies, especially South Korea and Taiwan, have any significant participation in technology/R and D cooperation arrangements. Given India’s capabilities in the software sector (and to some extent in bio-technology and pharmaceuticals), inter-firm technology alliances can be a useful means of developing technological capabilities in the country. In fact, there is some evidence to suggest that such linkages have contributed to the capability building efforts of the Indian firms in the telecom software. Therefore, the Indian competition policy perspective on such alliances will need to explicitly factor in these learning possibilities.

The report argues that the policy makers should not implicitly assume that arms-length contracts between unaffiliated firms located at various points of the technology supply chain (R and D to customer) will be adequate to commercialise technology successfully. A wide variety of organisational choices are available to access complementary assets and create an interactive, dynamically efficient system of learning and knowledge flows. Horizontal and vertical technology partnering is one such organisational mechanism. A per se rejection of certain types of organisational linkages may, therefore, be inappropriate. This is specially the case when industrial organisation is in a policy induced state of flux and where rapid technological changes are putting enormous pressure on conventional models of industrial organisation. It is obvious that a rule of reason approach will be more appropriate to deal with technology cartels. The following suggestions provide useful pointers for policy-makers in India not only for R and D alliances but for competition policy in general.

- The competition law should clarify that the rule of reason approach to be used for R and D alliances will explicitly take into account the appropriability regime, the pace of technological change, the diversity of the sources of new technology, the need to access complementary assets and technologies and the need to have cooperation for feedback across the technology supply chain.
- Agreements covering technology development, standards etc among firms having moderate market share (20-25 per cent) should be explicitly exempt from anti-trust liability. The market share can even be higher in case of those
Learning in the short term, it has also created opportunities for enhanced market power. Specific product markets should become relevant only when commercialisation is included within the scope of the cooperative agreement. Even while analysing product market issues, extent of appropriability should be explicitly considered. The geographic market should be presumed to be world wide, with the burden upon the challenger to demonstrate otherwise.

The competition law should not bias the selection of inter-firm organisational forms; integration by contract on alliance should be treated as favourably as full mergers.

The law should explicitly include joint commercialisation efforts to exploit innovation as a part of R and D cooperation arrangements.

An administrative procedure should be created to evaluate cooperative arrangements among firms with higher (than 20-25 per cent) market shares for their dynamic efficiency gains and anti-competitive nature. Such administrative procedure should not be clearance oriented. Processes could be such as to result in sufficient incentives for regulatory bodies to detect and prove cases of abusive cooperative arrangements. Pro-competitive and efficient arrangements can be certified to pre-empt anti-trust litigation in future.

The social returns from innovation are usually higher than private returns and, therefore, it is very important for economic growth to ensure that the natural under-provisioning that results in the pure market situation is overcome preferably through means other than state directives. Inter-firm alliances can be an important conduit for technological capability building in firms of developing countries. Hence, if anti-trust policy is going to err, it ought to do so by facilitating innovation through inter-firm cooperation, rather than inhibiting it. However, the application of rule of reason approach to such strategic alliances will become increasingly difficult as conventional oligopolistic structures can be (and are being) substituted by strategic inter-firm partnering to gain and retain market power.

While strategic partnering activity has opened new opportunities for enhanced learning in the short term, it has also created the possibility of using knowledge-based networked oligopolies at the global level to channel and shape technological change over the longer term. In this sense, these new oligopolistic market structures create dynamic barriers to entry for newcomers and affect the ability of competitors to keep up with a rapidly moving frontier. In combination with traditional strategies of merger and acquisition, which raise size barriers to entry and affect the distribution of gains from knowledge, a powerful selection mechanism is created that results in differential access to learning across firms and geographical space. The potential anti-competitive effects of these new oligopolistic market structures make the evaluation of inter-firm R and D networks on the lines suggested above somewhat difficult. Obviously, the skill requirements for such an evaluation also increase significantly. Some of the potential welfare losses due to technology lock-in and other problems discussed above can be mitigated through anti-trust action on the misuse of IPRs and other practices.

**Competition Policy and IPRs**

In recent judgments in Europe and the US, the need for competition has been regarded as more important than protection of intellectual property per se, especially in those cases where adoption of standards is vital for development. The key premise of these judgements seems to be that innovation should be part of the competitive process and not impede it. Overall, case law and experiences elsewhere provide enough scope for competition authorities in countries like India to use competition law to delimit the abuse of market power emanating from the monopoly conferred by IPRs. These options can be very useful in the case of standards (e.g., in telecom) and for interfaces relating to computer telecom software or information technology, in general. Such options may find ready utility in the near future. For example, the amendment to the Telecom Regulation Authority of India (TRAI) Ordinance will result in two administrative bodies: TRAI to fix tariffs, etc., and a Dispute Settlement Board to telecom related disputes. The TRAI is also expected to ensure inter-operability (inter-connectivity) of various service providers. This may require resolution of issues relating to IPRs of the type discussed above. Cross-licensing is the route suggested in the European Telecom Standards Institute (ETSI) initiative and if one prefers this option, a standard rate for cross-licensing may be desirable as in the case of many potential users, it may become too costly to negotiate individual licences. But one may also explore the possibility of disclosure of standards or interface related information and use the fair use doctrine (as in copyright law) to redress the economic imbalance the increases in transaction costs entail.

With the signing of the TRIPS agreement, IP protection in all the WTO member countries will be enhanced. It is expected that stronger IPRs will increase FDI flows and the transfer of technology. However, it is also feared that IPR holders may increase prices and act in ways that is detrimental to competition. Market dominance and abuse of market power emanating from IP protection can adversely affect sequential and cumulative innovation processes curtailing thereby the diffusion of technology. With growing dependence on foreign sources of technologies such abuses may have a negative influence on technological capability building in developing countries. Therefore, countries like India should explicitly recognise the interplay between IPR and competition policies. Many of the remedies discussed in the report are available in the MRTP Act. It might be desirable to explicitly include the anti-competitive practices arising out of IPRs in the new competition law of the country. The provisions in the Canadian Law can be used as a benchmark.

At our levels of technological development, while intellectual property needs to be protected, at the margin, the diffusion should take precedence over the incentive to create. Over and above these, it may be useful for policy-makers to evaluate other legal responses to anti-competitive practices arising from abuse or misuse of IPRs. These laws need to be TRIPS compatible. Besides, in general, it needs to be recognised that overzealous use of competition law can increase uncertainty and limit incentives for technology related investment, both by local and foreign firms. This, in turn, can also raise contracting costs in technology agreements. India needs to utilise this flexibility to appropriately define abuse/misuse of IPRs. Once again the Canadian law provides a useful framework, wherein undue lessening of competition through IPRs is censored.

Member states also have a great deal of flexibility in designing appropriate TRIPS compatible legislative mechanisms to deal with anti-competitive practices associated
with licensing of IPRs. In this context, it may be useful for the Indian competition authorities to evaluate the Guidelines developed by the Japanese Fair Trade Commission (JFTC) for the regulation of intellectual property licensing agreements. Adoption of such guidelines significantly reduces the uncertainties relating to anti-trust action among the parties entering into licensing arrangements. Admittedly, the JFTC guidelines emphasise the rights of the licensee or the recipients of the technology. One can argue that overemphasis on the rights of the licensee while ignoring those of the licensor may adversely affect the quantum and quality of knowledge flows. However, while some balance is essential, given the present status of Indian technology development a relatively larger emphasis on the licensee’s interest in the intellectual property licensing arrangements may be desirable.

Apart from the options to exploit the available flexibility discussed above, more analysis is necessary in order to come with an appropriate response to the TRIPS agreement. It is useful to know in this context that even the US Fair Trade Commission (USFTC) explicitly recognises that broad patents (especially in the field of bio-technology) can hinder the development and commercialisation of technology apart from reducing the incentives for (and feasibility of) follow-on and incremental research. It is also accepted that anti-trust remedies are required to correct these tendencies. There are interesting cases where competition law has been used to curb efforts to artificially extend the life of a patent, or to permit ‘parallel importation’ to enhance intra-brand competition among different dealers of the same goods. And finally, there are cases where compulsory licensing of intellectual property has been used to reduce the potential anti-competitive effects of mergers. Policy makers in India can learn from these and several other cases of this kind. The key objective of the legislative response should be to increase competitiveness of Indian industry through appropriate technology transfer.

In addition to anti-trust concerns over bilateral agreements between firms on the exploitation of IPRs, the competition authorities will increasingly have to deal with complex issues relating to multilateral cross-licensing, R and D joint ventures between competing (or potentially competing) enterprises and several other types of inter-firm arrangements. Thus, dealing with the interface between IPRs and competition law would become a high-skill intensive area. It would require knowledge of both general anti-trust theory and intellectual property law. Apart from seeking help from other countries, it would require significant investments in skill development.

**Competition Law and its Administration**

With the increase in the complexity of the issues at stake, skill requirements for the adequate functioning of a competition authority too, have risen significantly in recent years. The issue of administrative structures and skills is not independent of the nature of competition law a country should adopt. There is a basic tension between complexity and simplicity. The administrative and resource costs of simple per se rules are likely to be lower than a more elaborate rule of reason approach. However, as we have noted earlier, most of the new laws are complex and all encompassing, and often contain consumer protection provisions as well. Such sets of regulations may be difficult to handle for a resource poor competition authority in any country. At the same time, simple easy to administer rules may not be able to take account of dynamic efficiency effects of various ‘anti-competitive’ practices and may result in significant costs to the economy.

Whatever model of competition law one chooses, it is extremely important to develop: (a) An independent competition law authority with adequate financial and skill resources at its disposal; (b) Institutional structures which minimise the overlap between various regulatory authorities and competition authority; and (c) Cooperative links with other agencies at the regional and the global level, to access to online data bases and help handle international cartels. Moreover, it is also desirable to institutionalise a continuing process of assessment and adjustment in competition laws. As the experience of Japan and Korea suggests, these laws should be allowed to evolve and change to suit the changing economic conditions. The laws, once written should not be considered sacrosanct.

India does not have most of the administrative structures/procedures in place, which developed countries have evolved over the years. The importance and relevance of these administrative mechanisms in a transition economy is evident. The competition policy in India is in a state of flux; with the abolition of Chapter III of the Monopolies Restrictive Trade Practices Act (MRTP Act), the scope of coverage of the MRTP Commission, India’s competition authority, was restricted to Restrictive and Unfair Trade or Business Practices (RTPs/UTPs) alone. What should be the administrative dimensions of the competition policy reform in India?

The Indian competition authority (MRTPC) lacks the requisite professional competence to deal with emerging competition policy issues. Besides, their record of using outside experts to complement their own human capital resources has not been very good. Overall, MRTPC is seen as an agency which has the capability to do a fair, expeditious and transparent assessment of competition related problems. These factors and the absence of various other mechanisms in place in other countries, have been partly responsible for the distrust with which the regulatory authorities in India are seen by the general public.

**More Autonomous MRTPC**

The MRTP Commission needs to be much more autonomous than it is today. The Company Law Board is authorised under Section 2-A of the MRTP Act, to exercise the powers of the Central Government. In other words, the MRTP Commission is part of the Department of Company Affairs, Ministry of Law, Justice and Company Affairs. This does not make it independent, nor is it insulated from political interference and influence. Nor can it freely build as an expert staff of career lawyers, economists and analysts. Government rules and hierarchy and rigid pay scales would undoubtedly constrain its working unless independence in not only politically, but in staff selection and salaries is granted to the MRTPC.

The MRTP Commission performs a double role of being an investigatory agency as well as an adjudicatory one. A splitting up of these two roles is clearly desirable. The original MRTP Act provided for a Director of Investigation, as well as for a Registrar of Restrictive Trade Practices. Following a Committee’s recommendation, the two offices were unified and one now has a Director General of Investigation and Registration. Rule 13-A of the Monopolies and Restrictive Trade Practices Rules, 1970, suggests that the Director General is primarily entrusted with the job of investigation. It is not entirely clear what purpose the registration of restrictive trade practices serves in the current context, apart from adding to unnecessary paperwork. Such a registration will, how-
ever, make sense if it is done for authorisation and notification purposes, as is done in Australia. One solution is to break up the MRTP commission into an investigative wing and a separate adjudicatory wing. The registration requirements can either be scrapped altogether or converted into the Australian type of facility. Further, it also needs to be stressed that one of the reasons why the enhancement of Commission’s powers has been resisted so far is the clubbing together of the investigative and adjudicatory roles. If a separation takes place, such an enhancement in powers will be easier.

**Budgetary Support for Competition Authority**

It is important to address the question of the compatibility between independence and infrastructure of the competition authority. The issue of scope of policy, access, independence and adequacy of the infrastructure requirements need to be addressed in the context of the kind of case load that is going to be brought to the competition authority in a developing country. The Indian system, (Monopolies and Restrictive Trade Practices Act, MRTPA), does provide independence to the Director General, Investigation and Registration [DG (I&R)]. The DG (I&R) has statutory status and suo motu powers for taking up areas of investigation. However, the available expertise and infrastructure does not permit her/him to exercise these powers adequately, which in turn adversely impinge on her/his independence.

There has been a spate of mergers, amalgamations and takeovers in India since 1991. The horizontal mergers have generally been driven by a desire to exploit economies of scale and cut out overlapping activities. In other words, industry was too fragmented to begin with. Vertical integration has mostly been driven by an attempt to internalise transaction costs. Evidently, the abolition of Chapter III from the MRTP Act has resulted in a situation that there is virtually no pre-merger examination of proposed mergers. The MRTPC can only analyse the post-merger practices of the merged entities to find out if they are anti-competitive. If they are found to be anti-competitive, the MRTPC can recommend divestiture or other actions to correct the situation.

The merging entities still have to apply to the Company Court (High Court) for merger and the Court is expected to examine public interest implications of the proposed merger. In practice, however, this is not done. The only mechanism which can result in the MRTPC analysing the proposed mergers is through public interest litigation or an appeal by a plaintiff (e.g., customers, share holders, employees of the merging entities) to make a prima facie case that the merger is against public/consumer interest.

A transparent, fair and expeditious pre-merger assessment can be extremely useful. Since the liberalisation of 1991, there have been several major mergers, which should have had a pre-merger assessment and may not have been allowed in other countries. Besides, the view that with mechanisms in place to check the abuse of dominance and to foster international competition, regulation of mergers and acquisitions is not necessary, does not hold water for another reason. Unscrambling a merger or an acquisition is an extremely difficult task and restructuring is even more difficult. It is, therefore, important for a country to have mechanisms for pre-merger notification and assessment. Finally, in the era of liberalisation, foreign firms will be engaged in many of these M&As activities and a system in place will ensure fair competition for domestic players.

Another crucial priority area is to start building institutions on which the successful operation of the existing or the modified competition law would depend. Integral institution building would require recruitment of people for the new agency. A large staff of thousands is not required. An effective competition agency can be built around a core of 5-10 truly good people. A significant number of personnel heading competition authorities in developed countries and fast growing developing economies have been drawn directly from academia/universities. The competition agency in India is headed by a person from the judiciary and the members are drawn from different fields — law, economics, taxation, public administration, public service, etc. The general impression is that persons with legal background dominate the MRTPC. Ideally, persons with a background in law and economics should be part of the core teams involved in investigation and adjudication. Unfortunately, the educational system in India does not systematically produce such people.

In the coming years, this skill gap is likely to be a major problem for adequate implementation of competition policy in India.

Institution building outside the competition agency will have to address three groups that are responsible for making the law work over time; judges, lawyers and academics need to be trained on the intricacies of the competition law. Judges and lawyers would have to take care of the present and ensure an early absorption of the law in the society. The academics would...
have to generate the requisite intellectual capital for the future through their teaching. Such an exercise will also build a cadre of people whose services can be sought to analyse cases involving potential anti-competitive effects. This in turn will mitigate the skill constraints faced by the competition authority.

Further, process related safeguards have to be set up. It is essential that the agency has in place procedures that give the business community confidence that it is a conscientious organisation which is acutely aware of the need to be fair, and to be quick and transparent in its dealings. Vitally the confidentiality of the information asked upon from firms would have to be protected. It must carry conviction with firms (and consensus), that the rule of logic and analysis and not the form of analysis and influence, would matter. Simultaneously, a process to develop an institutional memory has also to be put in place. Most of the active competition agencies in liberalised environments experience high employee turnover, with antimonopoly officials and analysts becoming hot property for the private sector. Such a process will ensure that the agency’s activities and ideas persist over time and not just disappear when one official leaves the agency. Finally, a conceptual framework and the protocols will have to be put in place to implement the statutes.

In this context, it may be useful to note some salient characteristics of the French competition authority. As against per se regulation, the French, like other European countries, use the rule of reason approach to enforce competition policies. The latter approach, though not inconsistent with legal certainty, requires high standards of proof based on careful analysis of much information. This, in turn, requires experts in law and economics. Such expertise can be acquired in two ways: rely on expert witnesses or set up bodies which act as a court but also have expertise (through economists and judges) within the institution. The latter model has been adopted in France, Italy, Australia and Spain. The French Competition Authority has 17 members, nine judges and eight legal and economic experts. These officials are appointed for a period of six years and cannot be removed from office. The authority/commission has its own budget, which is discussed directly with the parliament.

Another issue linked to institutional independence relates to mechanisms for raising resources to fund the operation of the competition agency. Various mechanisms can be used through which the authority enforcing anti-trust law can capture some of the benefits for self-financing. This is possible because potentially the benefits would be large, especially in the case of privatised utilities. In some experiments the competition agencies have been given some freedom to generate revenues on their own:

- Competition agencies have been permitted to recover some amount of the fines and penalties that they impose in the course of enforcement; and
- Imposition of user fees on transacting parties have been allowed for certain types of transactions that the agencies are required to review, such as the mandatory review of certain types of mergers.

It is generally believed that a high user fees may become a deterrent for certain transactions that might be valuable for the economy. The fee should be modest, just adequate enough to generate some additional resources for the agency. Moreover, a mechanism which provides a share of its collections to the agency may become counter-productive as it may result in over-enforcement and harassment. Overall, one should probably start with some form of transactional tax for mergers that an agency reviews, but keep that tax at a relatively low level. There is also value in the argument that resources for the enforcement of competition law should be raised from those who will get the advantage of these regulations. And since the entire society benefits from competition law, it is desirable that a general tax should pay for its enforcement. The first best approach is to use general revenues for the costs of competition agency as it brings in transparency and puts the price tag where it belongs. Ideally these budgetary allocations should be not votable.

While using general revenues to fund competition agencies is the first best solution, it is very difficult to allocate funds for regulatory agencies in situations of very large budget deficits. Given the experience of most of the regulatory agencies in the infrastructure sectors, which have some avenues to raise resources, user fees seems an obvious option for the competition authority. Over time, as has happened in many industrialised economies, there is general recognition that there should be some user fee for the people that make more use of the system.

The administrative structure facilitating the implementation of competition policy should be equipped to tackle two inter-related issues. One, differences in the requirements to ensure competition in sectors producing tradables vis-a-vis those producing non-tradables. Two, competencies needed to administer competition policy in these sectors. One can argue that in the case of tradables, consumers may not get a raw deal due to a variety of factors. Import liberalisation in the form of reduction in tariffs and removal of quotas can significantly improve the contestability in the markets dealing with tradable goods.

It is more difficult to ensure competition in the markets dealing with non-tradables. The technical competencies required to deal with non-tradables are also probably more significant. For example, in-depth understanding of shifting demand and cost curves may be required to determine an appropriate price cap formula or an access charge to a common facility as in power and telecom. These prices need to be fixed in such a manner that quality does not suffer. The price cap approach is a high powered incentive mechanism for near natural monopoly non-tradable sectors with increasing returns to scale, inelastic demand curves and homogeneous products. Capabilities required for such pro-active regulations are usually not available with the civil service personnel in charge of regulatory authorities resulting in a reverse kind of regulatory capture by bureaucrats of the authority.

**Sector Specific Regulatory Bodies and Competition Authority**

Since elements of natural monopoly will continue to remain, at least in a period of transition, some sort of price regulation remains a necessity. In such a case, the exercise of price determination is best left to the sector specific regulatory bodies, with conduct policies overseen by the regulatory body that looks after restrictive and unfair trade practices. But such a division of labour does not exist in India. With the proposed amendment to the TRAI bill, dispute settlement board will be set up for telecommunications. What will be the role of the competition authority in such a scenario?

Regulation and competition policy can be mutually reinforcing but the instruments are different. In deregulating environments, where natural monopolies actually do not exist, or where technological change is most rapid, there is more room for competition policy. Regulation could also craft markets through unbundling.
creating a role for competition policy. The mutually re-enforcing nature of these two sets of policies requires that there is some coordination between the agencies which implement these policies. The relationship between competition agencies and telecom authorities can be used as a context to discuss these linkages.

Telecommunications in France has been liberalised and the industry has been opened to competition. France Telecom, the government operator of the telecommunications system has been partly privatised; the government still owns the majority share. A regulatory agency for this sector was created before the privatisation exercise began. The regulatory agency is responsible for identifying firms who could be licensed, and for determining the interconnection rates. The actual conduct of firms is monitored by the competition authority. Given the relationship between the interconnection rates and the price of services (which will depend on competition), the authority will have to make sure there is no ‘dumping’ at the level of services.

While this separation of functions based on a priori determination of who gets into the field and the ex post verification of firms’ behaviour appears neat, in practice it is unlikely to be so. For example, some constraints that operators have to face are more stringent when they have a dominant position in another sector from which they have diversified into telecommunications, or if they have a dominant position in the telecommunications sector itself.

The French system seems most promising as the roles between the regulation and competition authorities are clearly defined. The possible areas of overlap have also been identified. Unfortunately, the proposed amendment to the TRAI Act does not appreciate the possible conflict of roles between the TRAI, Dispute Settlement Board and the competition authority. These conflicts will need to be identified and resolved.

Cooperation with Competition Authorities of Other Nations

Should economies in transition participate in international cooperation among competition authorities? Globalisation is a fact of life for most developed as well as transition economies. However, resource constraints may inhibit significant participation on the part of developing economies. Besides, the level of cross-border activity may vary significantly across countries and for countries where such activity is of a low order, such cooperation arrangements may not make much sense. On the positive side, participation in such arrangements provides a tremendous opportunity for learning and exchange of information that may be critical for competition agencies in developing economies. The economies in transition may also want to participate in order to influence the directions which cooperation arrangements take.

India is at a stage of development where cross-border activities are growing rapidly and are likely to grow in the near future. The country is also reviewing its competition policy apart from trying to influence international agreements on competition policy related issues. Besides, since 1991, competition policy in India has not received adequate political attention. As a result, the competition agency is understaffed, under-funded and armed only with weak investigational tools. At the same time it is faced with an increasing number of cases in which cross-border market effects will need to be analysed. Given all this we should seriously consider entering into cooperation agreements. More information and skill generation through this process may reduce the risk of regulatory capture of the competition authority by the regulated parties. One will, however, need to guard against the regulatory capture by the competition authorities of the developed economies!

Clearly cooperation can be closer and more effective the more similar are the laws and procedures of the countries involved. Our analysis suggests that convergence, and therefore cooperation, is most likely on issues relating to (i) cartelisation; (ii) other horizontal restraints; (iii) mergers and acquisitions; (iv) price fixing; (v) voluntary export restraints, orderly marketing arrangements; and (vi) national treatment for foreign direct investors and services. It may be useful for India to anticipate discussions on these issues and develop an informed perspective on what its stand should be, in case negotiations for convergence for competition policies do take place.

International Cartels and International Cooperation

There is virtual consensus on the fact that cooperation should initially revolve around discovering and checking international cartel activities. While it is difficult to get an international agreement on the core principles of competition law and policy, as mentioned, there is likely to be a fair degree of agreement that certain kinds of cartels have no redeeming features.

It is generally recognised that restrictions on the exchange of confidential information inevitably limit the extent of cooperation in enforcement of the respective authorities’ competition laws. Problems with sharing information may make such cooperation difficult. While the appropriate means for cooperation on such and other cases are being devised, India needs to participate in the sharing of experiences. An endeavour to identify areas where cooperation is feasible without legislative changes should be explored. Informal inputs or reactions to draft legislation may also be sought from other agencies. The policy-makers should consider adding a clause in the new competition law regarding sharing of information. Initially, cooperation on a few substantive competition law areas may make more sense. Apart from cartels, some cooperation on mergers may also be useful. Such cooperation could initially take the form of minimum standards and general principles and build on that in an evolutionary manner.

Harmonisation of Competition Policies across Nations

In general, multilateral rules and transparent implementation of such rules of the game would be preferred by smaller, less powerful trading partners to bilateral action which might more easily result in unilateral pressures by larger partners. Hence, a multilateral framework would probably better serve the interests of developing countries than the absence of such an agreement. Of course, such an agreement should as much as possible reflect the development dimension that is referred to in the Singapore Declaration. However, if unilateral instruments like US 301 and Super 301 remain legal and the bilateral arm twisting continues, the efficacy of such a multilateral mechanism will get undermined.

In evolving a universally acceptable framework for harmonisation as well as cooperation, preparedness of developing countries will have to be ensured. For doing so, a pragmatic general understanding of the development dimension will have to emerge. India can probably work towards such a goal. The launching of Working Groups on Investment and Competition in WTO have caught many coun-
tries, including developing countries, unprepared for eventual negotiations. This is reflected by the rejection of the ‘new’ proposals before the Singapore Meeting by a number of important developing countries. Latin American and Caribbean (GRULAC) countries are more acquainted with competition and liberal investment regimes and hence were more favourably to bringing the competition issue at WTO.

The European Commission proposal on competition, which envisages an initial plurilateral agreement among countries ready for negotiation, while others could join later as they become familiar with competition issues, suffers from the same problem for the developing countries as the OECD negotiations vis-à-vis Multilateral Agreement on Investment (MAI). Most developing countries would be outside of the negotiations and once the text is agreed by the few selected participants, an agreement might then be forced upon countries which would not have been involved throughout the negotiating phase. These countries are concerned that, if such a scenario were to become a reality, an agreement on competition would run the risk of not reflecting their concerns sufficiently, and of not taking into account adequately the development dimension. In this sense, if negotiations do start on the harmonisation of competition policies, India must be part of the negotiations and try to influence the content of the ‘international competition policy’.

What could the development dimension represent in the context of an agreement on competition law? One feature can be a kind of preferential treatment for developing and least developed countries as is the case in the WTO Agreements which basically gives more time to these countries to comply fully with the agreements. In addition, a few other special considerations need to be looked at:

– Non-imposition of a standard industrial organisation paradigm. Firm organisation and inter-firm linkages evolve differently in various countries depending on their socio-cultural and economic profile. The insistence that only specific types of firm organisation exemplify pro-competitive conditions is too restrictive; the heterogeneity of industrial organisation across countries needs to be recognised and factored into any multilateral framework that is being considered.

– Modern competition legislation is applied in a non-discriminatory manner (principle of national treatment), to MNCs as well as domestic enterprises. This helps tackle major FDI concerns in countries where liberal FDI regimes exist as in small developing country markets, many MNCs are likely to be dominant firms. Therefore, while respecting the principle of national treatment, competition law would enable these countries to control possible abuses of dominant positions by large, dominant undertakings. These economies should be allowed to exempt small and medium-sized enterprises, when the impact of their RBPs is insignificant in the relevant market. The EC, for example, applies a 5 per cent market share de minimis rule, whereby practices by firms having less than 5 per cent share of a given market fall outside the purview of the law.

– Permit protection for certain specific dynamic and growth-oriented sectors, deemed to need temporary shielding from fullfledged competitive forces. Such exceptions from competition rules should be time-limited, in order to allow infant industries to progress along the learning curve, and all enterprises in an exempted sector should be treated equally, in order not to distort competition within the sector in question.

– Some exemptions (time limited or otherwise) may also be necessary for sectors which generate bulk of the employment in developing countries, or are of strategic importance.

Although the establishment of the WTO Working Groups does not prejudge whether future negotiations will be launched in the areas of investment and competition, the mere fact that WTO has established two Working Groups, respectively in investment and competition, increases greatly the chances that negotiations on multilateral frameworks in these areas will start sooner or later. Keeping this in mind, India should take advantage of the present preparatory phase to make all efforts to devise a positive agenda for itself in these areas. Of course, competition policy harmonisation does not make sense for countries like India if contingent protective measures like anti-dumping duties are permitted to continue.

**Work to Be Done**

We have highlighted some of the major dilemmas faced by economies in transition in the context of competition policy, and argued that some of the solutions to these dilemmas are not simple. Broadly, competition policy is essential for an economy in transition as it complements other liberalising initiatives. However, the scope, sequencing and timing of competition and other policies will have to be determined by each economy according to its own compulsions and needs.

Like other countries, India will have to explicitly take into account its historical and the socio-economic context while contemplating competition policy reforms. Many of the current distortions in the market have been caused by earlier policies/institutions. In such a scenario, simultaneous dismantling and creation of institutions to safeguard competitive forces is a difficult task. There are different perceptions about the major competition related problems facing the country today. Consequently, developing a consensus on competition issues will remain a complex task. The analysis strongly suggests that significant efforts are required at the policy level to explicitly recognise the links between policies relating to competition, trade and investment on the one hand and macro-economic policy initiatives on the other. It is time that the ministries of finance, industry, commerce and Law work together!

It also needs to be recognised that due to contextual and other differences, no single institutional model is applicable everywhere. While such differences will remain, certain basic principles in institution building like independence of the competition agency, adequate resource availability, significant analytical skills and transparency of its actions would be crucial for deterring anti-competitive behaviour in all countries. Selection of personnel is one of the most important parts of institution building. It may also be crucial to ensure that the regulators do not become over-enthusiastic, resort to over-regulation and misuse their powers. Capture of the competition agency by the regulators is as likely as the capture by the regulated. Such a fear seems more real in de-regulating environments like India. Ill-defined jurisdictions only facilitate such over-enthusiastic regulation.

**Summary**

This is an edited version of the executive summary of the report “Competition Policy In India: Issues for a Globalising Economy” submitted by the authors to the government of India, Ministry of Industry in March 2000. We are grateful to the government for supporting this study. We are much obliged to Rakesh Mohan, formerly economic adviser with the ministry of Industry, for having initiated this study. The responsibility of views expressed here lies with the authors alone.