"Competition Law and Regulatory Regimes:

Modern Drivers of Infrastructure Led Development "

I am happy to welcome you all to this Round Table. The focus of the discussions today is on how to make the regulatory framework serve the cause of promoting infrastructure sectors without compromising on the rigours of regulation. CIRC has been set up as an institution to promote research and teaching in the areas of competition and regulation. These are new areas as far as India is concerned. Some of the industrially advanced countries have a lot of experience in this area. We need to draw on them. Until 1990-91, the Indian economy and more particularly the industrial and commercial sectors were subject to a lot of controls. Competition law had no place in such a scenario. In fact the MRTP Act had a different orientation. The major thrust of the new economic policy is to improve the productivity and efficiency of the system by injecting a greater element of competition. Hence, the need for competition laws and regulatory oversight to ensure that competitive conditions prevail in a market. Sectoral regulations are needed only in those sectors where public policy considerations are dominant and where quasi monopolies emerge because of the nature of the products supplied.

In the real world well functioning markets and cases of market failure coexist. Unnecessary regulation of well functioning markets and the lack of such intervention in the case of market failures are both associated with serious consequences. Governance systems therefore need the services of a specialised set of regulators. The regulator is required to wield the tools at his disposal with precision, accuracy and promptness. Wrong application or delayed interventions invariably condemn sectors to prolonged stagnation or even contraction.

Among the various sectors in the economy the regulation of infrastructure sectors is extremely critical for the entire economy. This is because of three major reasons: first, the role of infrastructure as the backbone of the economy; second, the higher incidence of market failure in key infrastructure sectors; and, third, the high commercial stakes often involved in these sectors leads to manipulation of competitive forces through predatory pricing, cartelisation and other anti-competitive measures.

Since the infrastructure sector constitute the backbone, the neglect of the sector can have severe deleterious consequences for the entire economy. This is illustrated by the empirical relationship between electricity consumption and the rate of economic growth: A one per cent increase in GDP is associated with a one per cent increase in power consumption. Telecommunication is another major driver of economic growth as it reduces coordination costs in all social and economic processes and facilitates timely interventions by individual actors. Similarly, good roads result in cheaper, safer and faster transportation of goods and inputs, thereby stimulating both consumption and production.

Broadly speaking, there are three objectives before regulation. These are:
first, promotion of investment in infrastructure, second, protection of consumers
to ensure that the services provided are of an appropriate quality and at

appropriate prices, and third, attainment of efficiency in the production of services.

All these are interrelated. The need for regulation of pricing as in the case of power sector arises because of the quasi monopoly nature of the producers of these services. It is from this angle the need for protecting consumers from high costs becomes relevant. But the regulator has to ensure that legitimate costs are adequately covered. Otherwise, it will impede the flow of investment into that sector.

The regulation of individual sectors has to be consistent with the overall framework of maintaining competition. The modern competition laws seek

(a) to prohibit anti-competitive agreements such as cartels,

(b) prohibit abuse of dominant positions through unfair or discriminatory pricing, and

(c) regulate combinations such as merger and acquisitions.

The existence of a large number of sectoral regulators together with competition authority may raise issues of overlap and friction. In general, it is best to leave the determination of competitive principles to competition authorities and for sectoral regulators to focus on specific issues relating to their sectors. The productivity and efficiency benefits associated with the markets can be reaped only if the markets remain competitive. However, there could be sectors in which competition among several producers may not always be possible. In that case, the regulator has to act to ensure that the pricing of products is not exploitative. In India, the regulators of the power sector in various States are faced with this problem. Examination of costs to determine whether they are legitimate or not is not always an easy thing. But power regulators have to build up this expertise.

While the regulator needs to intervene to overcome genuine problems in markets he should also desist from over-regulation. For instance, while regulating entry unnecessarily, the regulator may restrict competition leading to over pricing and poor quality. For example, in the case of financial sector while prudential regulations including minimum capital requirement may be appropriate, they should not be stretched to such an extent that they inhibit entry of new institutions.

The competition laws visualizes that no incumbent should have unfair advantages over new entrants. Regulators have to enforce some rudimentary form of cooperation between competing players such as interconnect agreements which are needed to sustain the benefits of fair competition. That is why many competition regimes recognize the doctrine of essential facilities. It will be worthwhile to have a general formulation in India as well since it would also result in optimal use of resources while guaranteeing fair competition.

In any economic system State can play many roles. One can identify three important roles:

(1) as a producer of marketable goods and services,

(2) as a regulator of the system, and

(3) as a supplier of “public goods” and “merit goods” like primary education and public health.

While the role of State as a producer of marketable goods and services is decreasing, its role as a “regulator” is becoming increasingly important. The regulator role comes into play in order to maintain competitive conditions in the market and to ensure that everyone follows the basic rule of the game.

The need for expertise in the regulatory institutions has become obvious in the current international financial crisis. What stands out glaringly in the current episode is the regulatory failure in the developed countries. The regulatory failure has been of two types:

(1) regulation was soft or almost absent in relation to certain segments of the financial markets, and

(2) there was an imperfect understanding of the nature of the derivative products.

In one sense, derivative products are a natural corollary of financial development. They meet a felt need. However, if the derivative products become too complex to discern where the risk lies, they become a source of concern. Rating agencies in the present episode were irresponsible in creating a booming market and suspect derivative products. What is, however, important to understand is that there was a mismatch between financial innovation and the ability of regulators to monitor them. It is ironic that such a regulatory failure should have occurred at a time when intense discussions were being held in Basle and elsewhere to put in place a sound regulatory framework. Nevertheless, it is unpardonable that the regulators were not able to grasp fully the implications of the financial products which they approved implicitly. All these point to the need for building up appropriate expertise in the regulatory institutions.

Principles of competition laws are well known. What is needed is to apply these principles to specific sectors taking into account the special characteristics of each sector. Therein lies the skill and expertise.