AN ABSTRACT

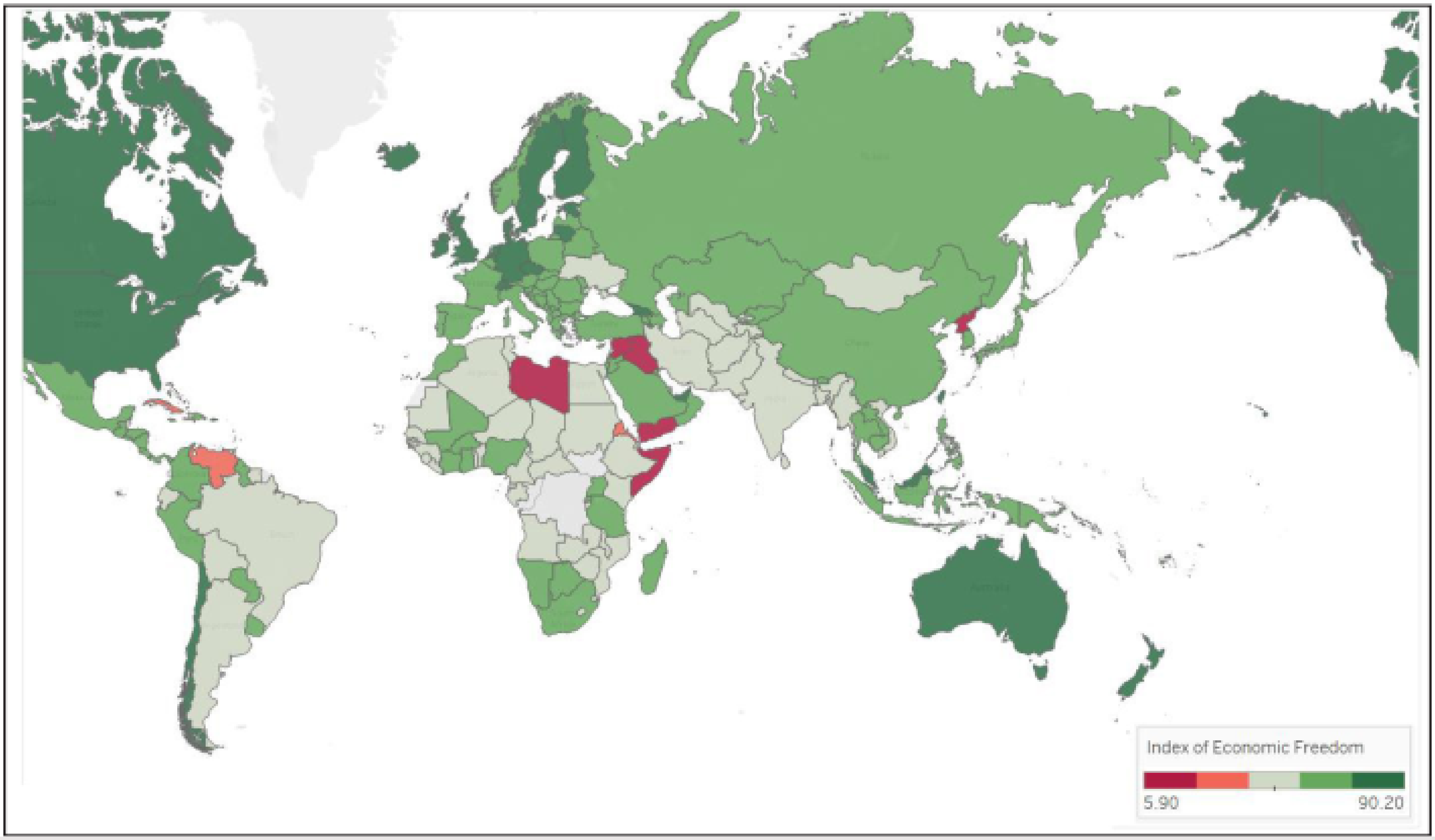
ECONOMIC SURVEY 2020

BRIEF SUMMARY: CHAPTER 4

UNDERMINING MARKETS: WHEN GOVERNMENT INTERVENTION HURTS MORE THAN IT HELPS

- Economic freedom enhances wealth creation by enabling efficient allocation of entrepreneurial resources and energy to productive activities, thereby promoting economic dynamism. However, in the Index of Economic Freedom, India was categorized as 'mostly unfree' with a score of 55.2 in 2019 ranking the Indian economy 129th among 186 countries, i.e., in the bottom 30 percent of countries.

Figure 1: Relative Economic Freedom in India



- **The survey makes a case against competition and freedom distorting practices (like price control by Essential Commodities Act, grain procurement, debt waiver) and certain other legislations by the government.**

Box 1: Essential Commodities Act, 1955

Essential Commodities Act (ECA), 1955 was enacted to control the production, supply and distribution of, and trade and commerce in, certain goods considered as essential commodities. The Act itself does not lay out Rules and Regulations but allows the States to issue Control Orders related to dealer licensing, regulate stock limits, restrict movement of goods and requirements of compulsory purchases under the system of levy. The Act also provides for action to confiscate the stock seized; to suspend/ cancel licences, if any and impose punishments like imprisonment. The Act also gives the power to fix price limits, and selling the particular commodities above the limit will attract penalties. Most of the powers under the Act have been delegated by the Central Government to the State Governments with the direction that they shall exercise these powers. Food and civil supply authorities in States execute the provisions of the Act.

The major commodity groups included in the Act are

(i) Petroleum and its products, including petrol, diesel, kerosene, Naphtha, solvents etc

(ii) Food stuff, including edible oil and seeds, vanaspati, pulses, sugarcane and its products like, khandsari and sugar, rice paddy

(iii) Raw Jute and jute textiles

(iv) Drugs- prices of essential drugs are still controlled by the DPCO

(v) Fertilisers- the Fertiliser Control Order prescribes restrictions on transfer and stock of fertilizers apart from prices

(vi) Onion and Potato

(vii) Seeds of food crops, fruits and vegetables, cattle fodder, Jute seeds and Cotton seeds

- **Dead-weight loss:** Dead-weight loss is the income that is lost for forever. According to the survey in both the cases whether the price is too high or too low, enough goods are not sold since in the first case the consumers are not ready to buy and in the later case the supply is less.

Figure 7: Agricultural Market distortions due to ECA

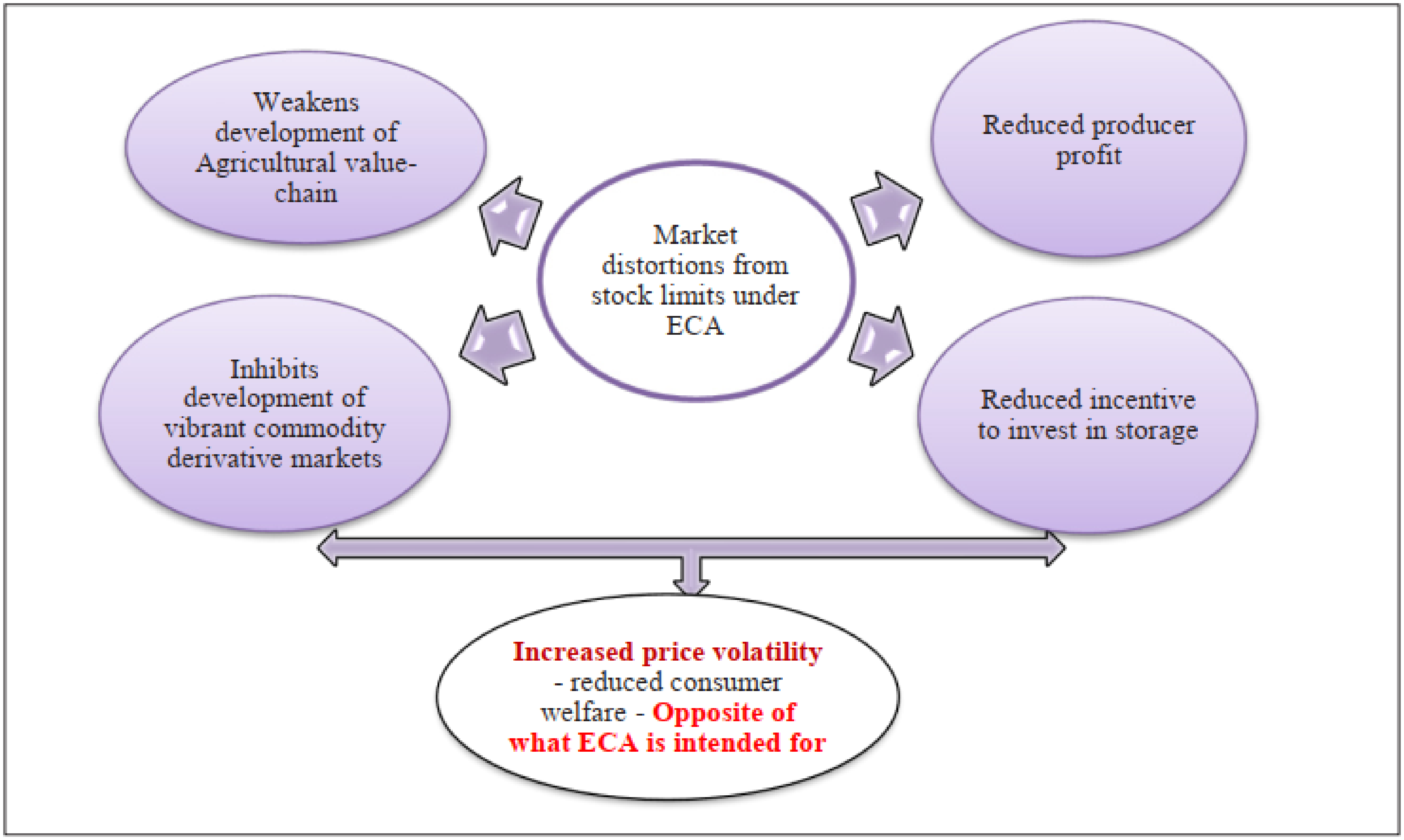


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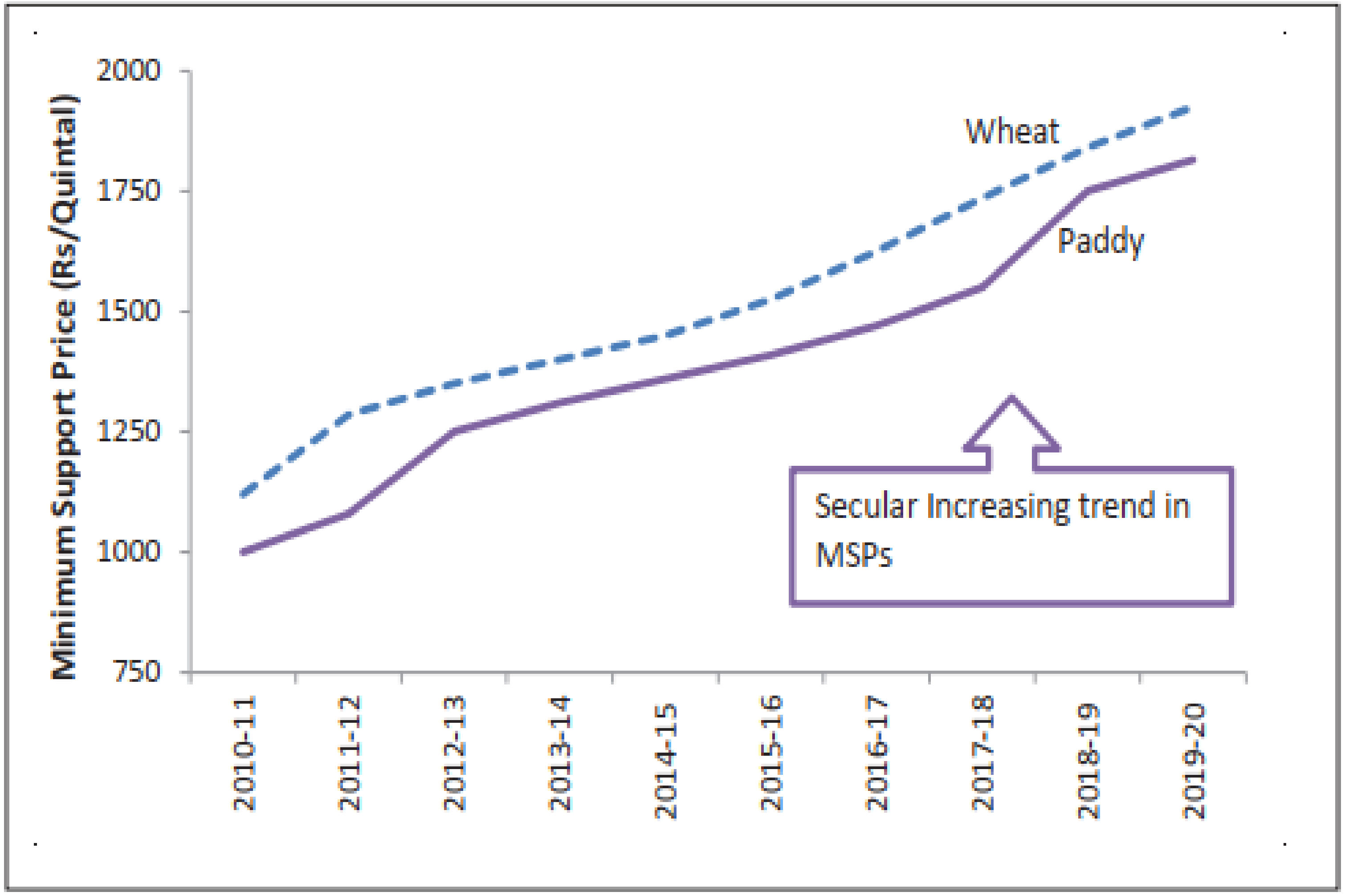
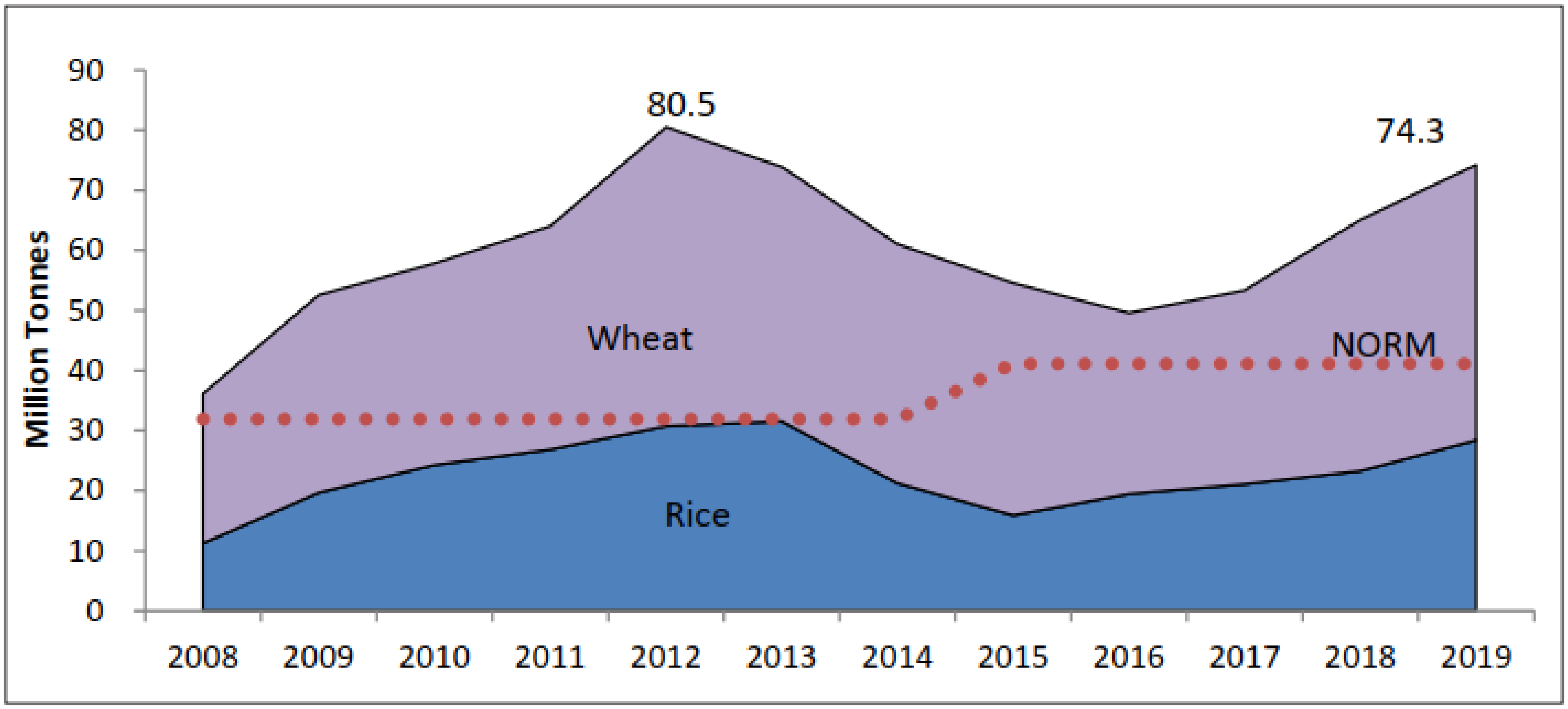
Figure 17: Increasing MSPs leading to Higher Procurements



- **Indian economy is replete with examples where the Government intervenes even when there is no risk of market failure, and in fact, in some instances its intervention had created market failures.**
- **The most recent example of this "unintended consequences" is the rise in onion price. In view of a sustained increase in onion prices, stock limits under the ECA were imposed across the country on September 29, 2019.**

- However, the imposition of stock limits has had no effect on the volatility of the wholesale and retail prices for onions after September, 2019. The lower stock limits must have led the traders and wholesalers to offload most of the kharif crop in October itself which led to a sharp increase in price volatility from November.
- The Survey highlights the serious limitation of the Essential Commodities Act as it hinders the efficient development of the agricultural market by disincentivizing investment in warehousing and storage facilities due to frequently imposed stock limits. Contrary to its objective, the Act increases price volatility and reduces consumer welfare.

Figure 18: Trend in Buffer Stocks with FCI



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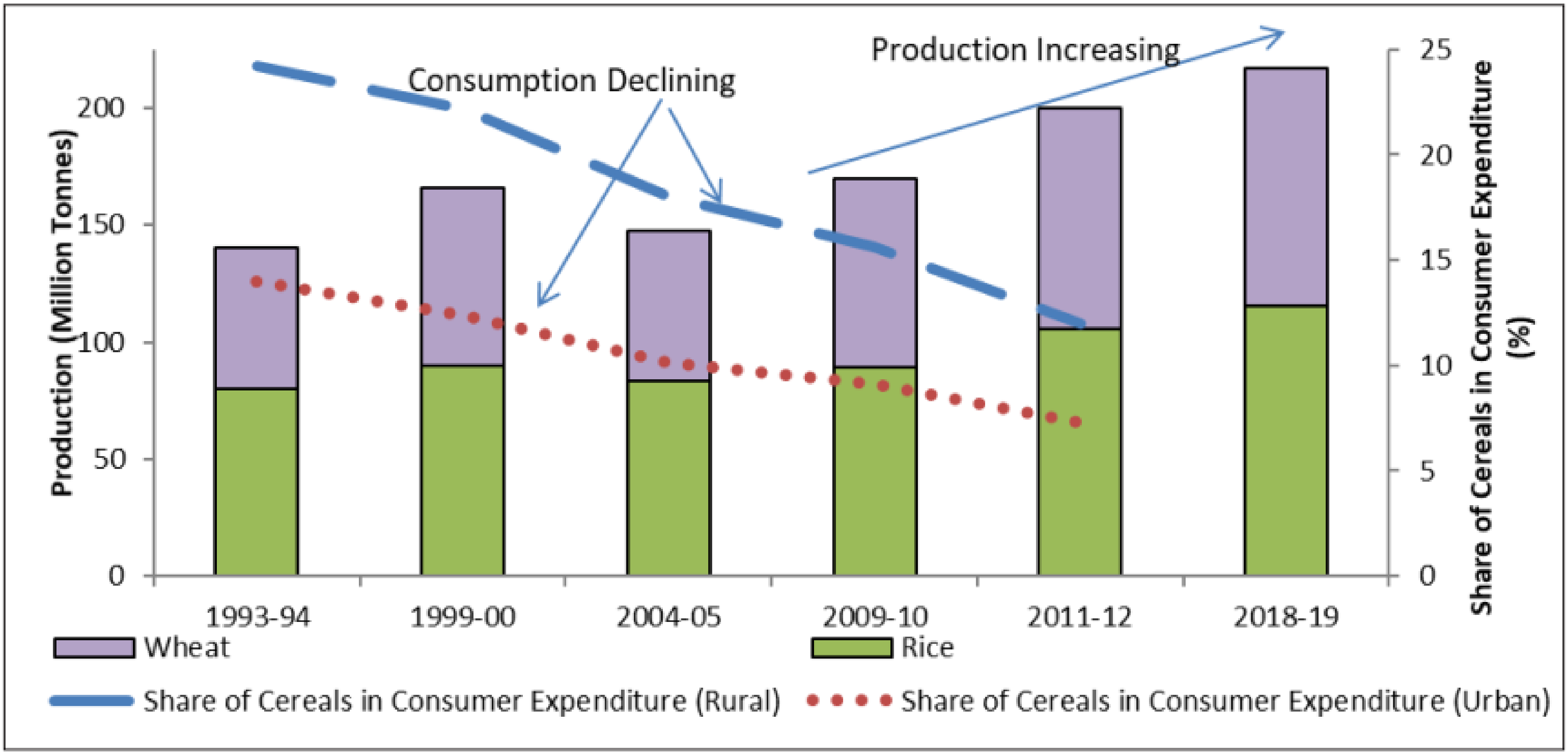
- According to the Survey, the Price Stabilization Fund (set-up in 2014-15) should be strengthened further as it supplement market forces and not substitute them like the ECA does. The PSF provides for maintaining a buffer stock of agro-horticulture commodities like onion, tomato etc.

Figure 21: Trends in Consumption and Production of Cereals in India

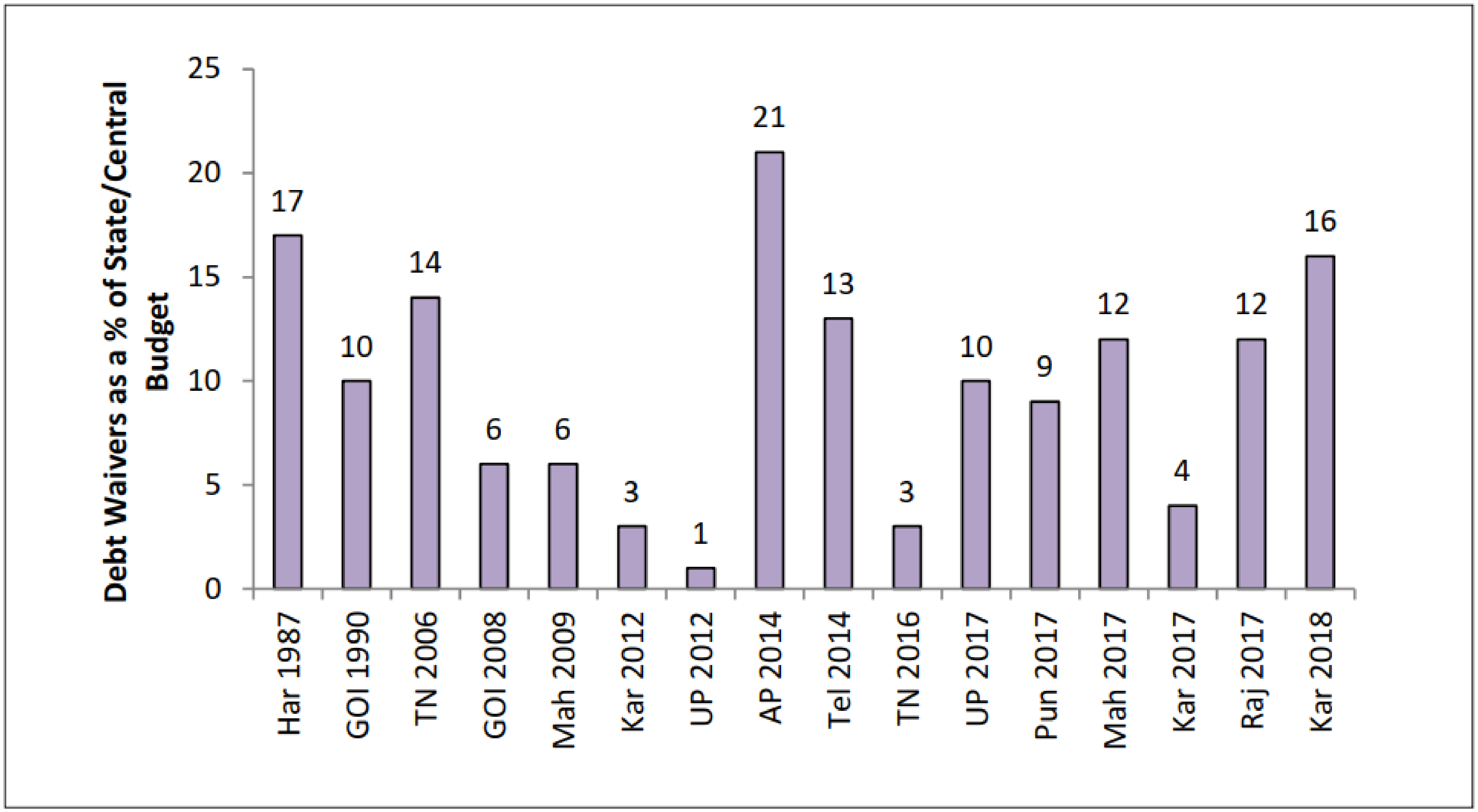


Source: DACF&W and NSS 68th Round

Note: Cereals consist of Rice, Wheat and Coarse cereals wherein Rice and Wheat comprise more than 80 per cent of total production of cereals Data for Consumption is available only till 2011-12 drishti

- In India, the Government has historically relied on price controls to regulate the prices of pharmaceutical drugs through the National Pharmaceutical Pricing Authority (NPPA) and Drug (Prices Control) Order (DPCO). The National List of Essential Medicines (NLEM), prepared by the Ministry of Health and Family Welfare, is a list of medicines considered essential and high priority for India's health needs.

Figure 22: Loan Waiver Allocation as a per cent of State/Central Budget



Source: Adapted from Phadnis and Gupta (2018)

- By taking example of two medicines Glycomet (Metformin) and Glimiprex-MF (Glimepiride+Metformin) both of which are used for controlling high blood sugar, the Survey states that the effect of DPCO, 2013 in increasing prices created more expensive formulations than for cheaper ones – reinforcing the effect opposite to what it was instituted for i.e., making drugs affordable.

Table 1: Traversing the 'Full Circle' – From 'Control' to 'Market'

Act	Market Distortion created	Transformation towards Developing a Market Economy
Capital Issues (Control) Act, 1947	The Government decided which company could raise how much capital - Control over the amount as well as pricing of shares led to ineffective valuation of capital	Repealed and replaced by The Securities and Exchange Board of India (SEBI) Act, 1992 as a regulator of the capital markets. SEBI has steered the capital markets to ensure price discovery, governance of securities, allowing efficient mobilisation and allocation of capital, protecting the interest of investors in mind enabling enormous wealth creation (as detailed in chapter 1)
Oil and Natural Gas Commission (ONGC) Act, 1959	ONGC was created with the mandate to plan, promote, organize and implement programmes for the development of petroleum resources – created a Government monopoly in this sector	On 4 September 1993, the Act was repealed and ONGC was converted into a company. The evolution of hydrocarbons policy has been from state monopoly in 1948, to the beginning of deregulation in 1991 through nomination, to competitive bidding and profit sharing under New Exploration Licensing Policy (NELP), 1997, to gas pricing guidelines in 2014, to discovered small field policy in 2015 and, finally, to a uniform licence for exploration and production of all forms of hydrocarbon and revenue sharing under Hydrocarbon Exploration and Licensing Policy (HELP) in 2016.

Banking Companies (Acquisition and Transfer of Undertakings) Act of 1970 & State Bank of India Act, 1955	To provide for the acquisition and transfer of the undertakings of certain banking companies created – created 27 nationalized banks – Private sector banks were allowed only after 1994	Merger of banks announced which will reduce public sector banks from 27 to 12. Further, attempts to create a level playing field between private sector banks and public sector banks are in place.
Monopolies and Restrictive Trade Practices (MRTP) Act, 1969	MRTPC was constituted to prevent concentration of economic power, control of monopolies, prohibition of monopolistic practices, prohibition of restrictive and unfair trade practices. This restricted companies to grow and achieve a global scale and led to proliferation of small companies.	Repealed to give way to the Competition Act in 2002. The Competition Act aims to "*promote and sustain competition in markets, protect interests of consumers, ensure freedom of trade carried on by other participants in markets and prohibition of abuse of dominant position*". The focus has shifted from 'prevention of dominance' to 'regulating abuse of dominance'
The Coking Coal Mines (Nationalisation) Act, 1972 and Coal Mines (Nationalization) Act, 1973	Government took over the management of coking and non-coking coal mines as energy sector became a crucial sector	Repealed in 2018. Private firms have been permitted to enter the commercial coal mining industry. The mines will be auctioned to the firm offering the highest per tonne price. The move broke the monopoly of Coal India Limited over commercial mining.

- **Subsequent to the set-up of FCI in 1964 , the Government has emerged as the single largest procurer and hoarder of food-grains. Thus the government, as the single largest buyer of rice and wheat, is virtually a monopsonist in the domestic grain market and is a dominant player crowding out private trade.**

Nationalisation of Life Insurance, 1956 and General Insurance Business (Nationalisation) Act, 1972	Acquisition and transfer of shares of Indian insurance companies and undertakings of other existing insurers to create LIC and GIC – led to cheap mobilisation of resources for investment in sectors decided by Government	Amended various times Insurance Regulatory Development Authority of India (IRDAI) Act, 1999 enacted to open the insurance sector. This was a journey from nationalisation to creation of a monopoly to opening up to private competition.

- **This disincentivizes the private sector to undertake long-term investments in procurement, storage and processing of these commodities. Thereby, the market prices are not remunerative for the farmer and they chose MSP which also dictate their crop choices.**

Act	Market Distortion created	Transformation towards Developing a Market Economy
Foreign Exchange Regulation Act, 1973	Imposed restriction on foreign equity in companies to 40 percent and permission was needed from RBI to operate, if their shareholding was higher. This restricted access to foreign capital and technology	Repealed and replaced by Foreign Exchange Management Act (FEMA), 1999 to facilitate external trade and payments. Under FERA, everything was prohibited unless special permissions were received, while under FEMA, everything was permitted unless specifically restricted or regulated to enable development of forex market.
Maruti Limited (Acquisition and Transfer of Undertakings) Act, 1980	The purpose was to modernise the automobile industry and ensure higher production of motor vehicles	On 14 May 2007, the government exited the company through a two-stage process: a rights issue of Rs. 400 crore followed by the sale of its existing shares through a public issue

- **The high economic cost and procurement cost at FCI results into a burgeoning food subsidy burden. Today, India has moved from being a food scarce country to a food surplus country with a substantial increase in production and has emerged as a net exporter of cereals. The trade distorting policies, therefore, need to move on now to incentivize diversification and environmentally sustainable production. The farmers need to be empowered through direct investment subsidies and cash transfers, which are crop neutral and do not interfere with the cropping decisions of the farmer.**

Food Corporation of India (FCI), 1965	FCI was created for purchase, storage, transport, distribution and sale of food grains and other foodstuff to safeguard the interests of farmers, maintain buffer stocks for food security and make grains accessible at reasonable prices to the weaker and vulnerable through the public distribution system (PDS).	With a comfortable production scenario of foodgrains, the role of FCI, with a total storage capacity of more than 80 million tonnes, must be re-examined. Procurement operations of wheat, paddy and rice need to be given to states. FCI should primarily focus on creating competition in every segment of foodgrain supply chain, from procurement to stocking to movement and finally distribution in TPDS. This would reduce costs and plug leakages in the food management system.
Sick Textile Undertakings (Nationalisation) Act, 1974	To acquire sick textile units, reorganize and rehabilitate them. 103 sick textile mills were nationalised and transferred to the National Textile Corporation (NTC). The Act was amended in 1995 to allow NTC to transfer, mortgage or dispose of land, plant, machinery or other assets for the better management, modernization, restructuring or revival of a sick textile undertaking.	Land of textile units has been monetised to create offices and residential buildings in Mumbai's Lower Parel area. However, the nationalisation of these mills failed to achieve the desired objectives of rehabilitating or reorganising them and failed to deliver yarn, cloth, fair prices or jobs. This Act, therefore, needs to be repealed and NTC should be divested.

Sick Industrial Companies Act (SICA), 1985	Timely detection of sick and potentially sick companies and speedy determination of preventive, ameliorative, remedial and other measures by Board of Industrial and Financial Reconstruction (BIFR). It put in place a debtor-friendly regime, in which defaulting borrowers could delay resolution for long periods of time and strip assets of value	The Act was repealed on 1 January 2004, and BIFR was dissolved on 1 December 2016 to give way to the Insolvency and Bankruptcy Code (IBC), 2016.

- **Cash transfers:** It may be noted here that internationally, there is a move towards conditional cash transfers (CCTs), aimed at tackling problems of food insecurity and poverty and for nudging people towards improved health and higher education levels.

Table 2: Need to complete the Transformation : Acts which need to be Repealed/ Amended

Act	Market Distortion created	Need for repeal/amendment
Factories Act, 1948	Regulates occupational safety and health in factories and docks. Gives prosecutor powers to a 'chief inspector' – Raises cost of such entitlements and may nudge capital away from labour. This may be merged with	It is proposed to be subsumed by the Occupational Safety, Health and Working Conditions Code, 2019 which is in the Parliament.
Essential Commodities Act (ECA), 1955 and Prevention of Black marketing and Maintenance of Supplies of Essential Commodities Act, 1980	Enables the Government to regulate the production, supply and distribution of 'essential' commodities such as drugs, oils, kerosene, coal, iron, steel and pulses. It imposes stock limits which discourages large-scale private investments in agricultural markets	These Acts owe their origin in times of shortage and inefficient linking of markets. With enhanced production and integration of markets, these Acts have become an instrument of coercion and inhibit proper functioning of markets of these essential commodities.

Air Corporations Act of 1953	Nationalise nine airlines to form Air India and Indian Airlines – intended to provide safe, efficient, adequate, economical and properly coordinated air transport services, whether internal or international or both. A market-driven, services-oriented, consumer-centric business was nationalised.	Replaced by Air Corporations (Transfer of Undertaking and Repeal) Act, 1994 wherein Private operators were allowed to provide air transport services. The Airports Authority of India (Amendment) Act of 2003 introduced the term "private airport" and authorised Airports Authority of India (AAI) to transfer operations and management of its existing airports by way of long-term lease to private players. The Airports Economic Regulatory Authority (AERA) of India Act, 2008 was enacted to regulate tariff and other charges and to monitor performance standards
Urban Land Ceiling and Regulation Act, 1976	Imposition of a ceiling on acquisition of vacant land in urban agglomerations for the acquisition to prevent the concentration of urban land in the hands of the few and bring equity to subserve the common good. This led to distortion of land markets in urban areas, rise in slums, creation of artificial land scarcity and skyrocketing land prices.	Repealed in 1999.

- **The phenomenon of granting debt waivers to farmers just before or after an election has become widespread after the large-scale farm debt waiver announced by the Union Government in 2008.**
- **Debt-overhang: This refers to a situation where all current income gets used up in repaying the accumulated debt, leaving little incentives to invest either in physical or human capital. It supports the idea of debt waiver.**

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Recovery of Debts due to Banks and Financial Institutions Act, 1993	Led to establishment of Debt Recovery Tribunals (DRTs) for "expeditious adjudication and recovery of debts due to banks and financial institutions". However, there are huge delays due to insufficient number of presiding officers, recoveries taking two years instead of the recommended statutory six months, lack of sufficient judicial experience by recovery officers, and inconsistency of the decision-making process between tribunals	With the IBC now firmly in place to fix the problem of non-performing assets, the DRTs can be phased out or integrated with the IBC.

- **However, according to the Survey neither agricultural investment nor productivity increased after the waivers. Consequently, there was little impact on consumption as well. In other words, a stimulus worth close to 2 percent of the GDP did not have any meaningful real impact on the lives of the farmers.**
- **An anticipated waiver may also lead to moral hazard, destroy the credit culture and also lead to increased loan defaults on future loans with no improvement in wages, productivity, or consumption. A one percentage increase in exposure to the debt waiver increased the amount of non-performing assets by about 7 per cent.**

The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013	Regulates land acquisition with 80 percent of the land to be acquired through negotiations, with the government stepping in only for the balance 20 percent; for PPP projects, it is 70 percent.	This tilts the balance in favour of land owners who need to be made an equal partner in development of land and share the benefits and costs with the developer/acquirer.

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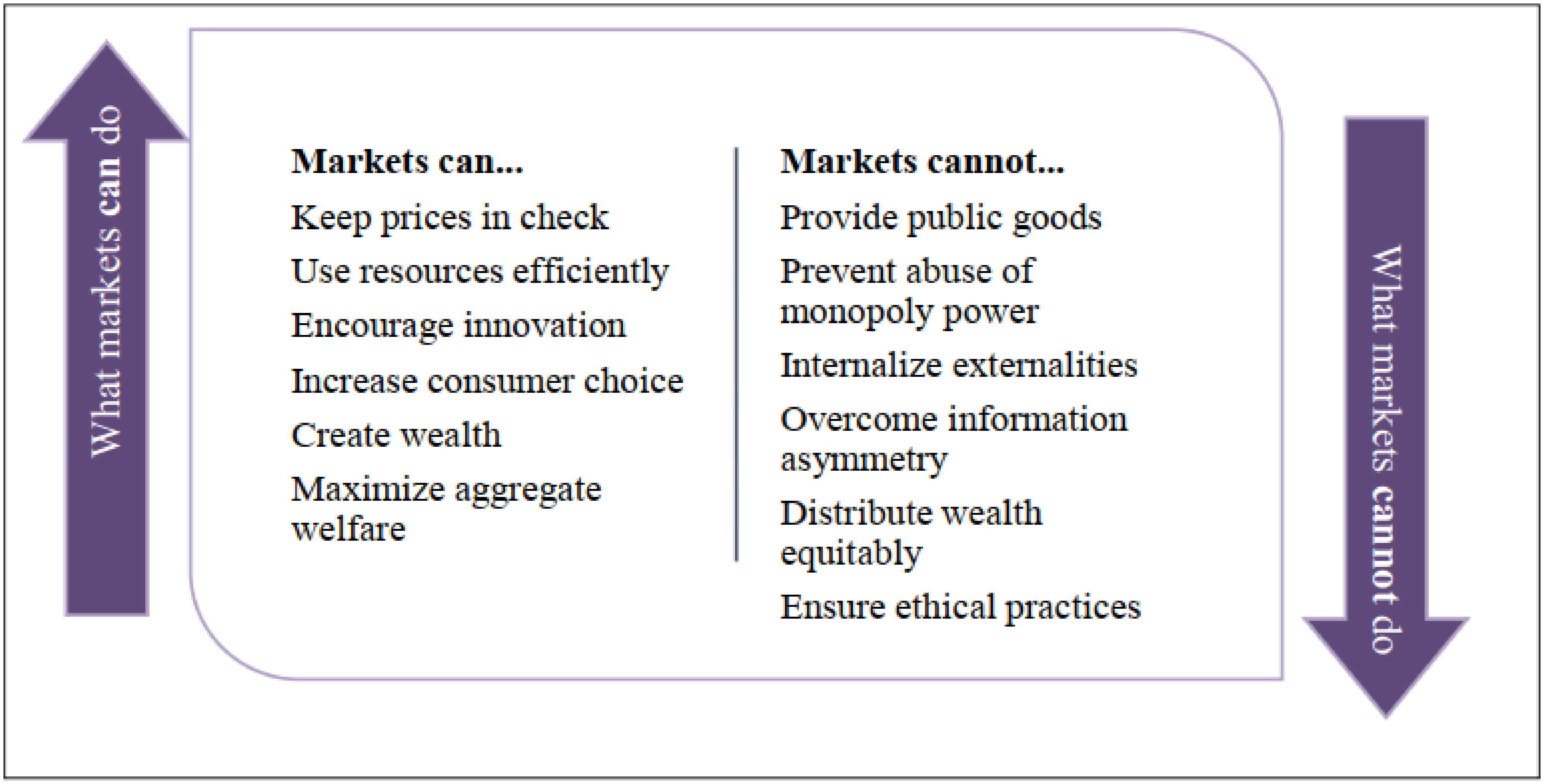
- India is still stuck with several forms of Government intervention that are anachronistic with today's economy. The Survey suggests that Acts, as low-hanging fruits to begin with, which have outlived their use, need to be repealed by one 'stroke-of-the-pen' as was done post-1990s or amended to enable functioning of competitive markets. Such Acts include: Factories Act 1948, Essential Commodities Act (ECA) 1955, Food Corporation of India (FCI) 1965 etc.

Figure 25: Strengths and Weaknesses of Markets



This was the summary for Chapter 4, we will share the next summary soon.