

# Regulating the regulators

A broad framework, like the Companies Act, is needed to spell out a common set of principles for all such bodies

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In his Budget speech of 2015-16, the finance minister talked about the absence of a common approach and philosophy in the regulatory arrangements for the infrastructure sector. He expressed his intent to introduce a regulatory reform law that would bring about cogency of approach across various sectors.

The timing of this initiative is perfect as India has now more than two decades of experience in governance through regulators. They have become an important plank of the institutional edifice.

A key differentiator between nations is the quality of their institutions. That explains why one economy innovates and progresses while another, similarly endowed, does not do well.

There is plenty of literature explaining how institutional variations impact people, society and economies. Therefore, a renewed emphasis on building/recasting institutions as India embarks on higher quantity and quality of growth is not surprising.

## A significant reform

Institutions include institutional environment (values and norms, laws and regulations) and institutional arrangement (firms, markets, authorities). While to the institutionalists it is a catch-all, institutional arrangement is probably what is closest to the normal use of the term 'institution'. The rise of regulators to share governance with the government is a reality; governance through regulators constitutes one of the most noticeable institutional reforms in the last century.

The regulator is an institution

with many unique features. It sits in the middle of a hierarchy of agencies: government and economic agents. It is simultaneously a principal and an agent. It provides public goods in public interest. It has responsibilities – consumer protection, development and regulation – similar to those discharged by the government. It has powers – legislative, executive and judicial – similar to those of the sovereign state. It carries out governance on behalf of the government in a pre-defined framework.

There are, in fact, significant advantages of governance through a regulator. It generally does not share the 'social' obligations of the government; nor is it expected to be affected by the pressures of 'interest' groups. It can provide a level playing field to all participants without fear or favour. It can build expertise matching the complexities of the task and evolves processes to enforce authority rapidly and proactively. It is better placed than the government to take unpleasant, but necessary decisions.

## Some concerns

However, there are also significant concerns. The fusion of legislative, executive and judicial powers in one entity carries the tension of potential misuse. It suffers from democratic deficit as it is not directly accountable to people or their representatives.

While in theory regulators are neutral in practice, as economist George J Stigler wrote decades ago, "regulatory capture" is a reality. Government continues to remain accountable for the governance carried out through the regulator, which poses a classic example of the principal-agent problem.

In case of exigencies, govern-



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ment is called upon to explain and carry out rescue operations. The challenge is to minimise the trade-off between the advantages of governance through the regulator and the apparent threat to democratic accountability.

Given the complex agency and accountability issues posed by regulators as new mechanisms of governance, their design has to be an integral part of a larger vision and unifying goal of public interest. Despite this, every administrative ministry follows its own approach to establishing regulatory institutions.

Ministries experiment with composition of the board of the regulator, qualifications, age and expertise of the members, relation between the government and the regulator, powers and finances of the regulator, scrutiny of its quasi-legislative and quasi-judicial actions, and so on. Such fundamental differences impact the very foundation of a delegated model of governance as it creates more uncertainties, reducing the effectiveness

kind of business or activity it is engaged in.

An example is *Executive Agencies: A Guide for Departments* of the UK cabinet office (2006). The governance of regulators is as important as the governance of the government. Good governance of the regulator is necessary for effective regulation.

The charter should contain the thumb rules. It should ordinarily provide for: (a) a conducive legal framework to enable the regulator to enforce its authority promptly and proactively; (b) an appropriate level of independence in terms of resources and powers to enable the regulator to build the capability and processes commensurate with the task; (c) institutional mechanism to ensure accountability of the regulator to avoid its possible failure or abuse of power; (d) internal architecture of the regulator to avoid intra-institutional bargains; (e) effective partnership between government and regulators to work in unison for a common purpose; and (f) the spacing of a regulator vis-à-vis government and other regulators to avoid gaps and overlaps in coverage and shifting responsibilities in times of crises.

Following up on the Budget speech, it is time to introspect on the quality and cost benefit of the regulatory experience. An analysis of the relative achievements, strengths and limitations would provide an ideal platform to start the revamping exercise. However, this exercise needs to cover non-infra regulators to ensure quality governance services and sustain economic growth.

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