Opinions

Making business laws that adapt to economic changes

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A government has three wings: the legislature, executive and judiciary, each with specific responsibilities. It is relatively easier to expand the executive by adding departments, regulators, ministers and secretaries and the judiciary by adding courts/tribunals and judges. It is, however, difficult to expand the legislature's capacity, as the entire legislature must work together to make a law.

Foreseeing the future and legislating for all likely situations is impossible. The laws made yesterday are obsolete today as society, technology, business, economy, and environment keep evolving. The range as well as the complexity of matters that require legislation have been increasing. Consequently, the demand for legislation—new laws, amendments, and repeals—is huge, often urgent and beyond the legislature's capacity.

This limitation of the legislature was realised long ago. Without compromising the core legislative function, the legislature roped in the executive to discharge its non-core functions, subject to its oversight, in various ways.

First, it empowered the executive to make subordinate legislation to deal with matters of detail, which rapidly changed with time. For example, the Pension Fund Regulatory and Development Authority Act, 2013, empowers the regulator to make regulations to carry out the provisions of the Act.

Second is the adoption of an 'almost incomplete' form of law. The legislature empowered the executive to fill up the gaps in laws as they emerge. For example, the SEBI Act of 1992 empowers the regulator to regulate a, b, c, d, and "any other intermediary associated with the securities market". This enables the regulator to extend the law to an intermediary not listed today should a need arise tomorrow. Similarly, the Companies Act, 2013, allows the executive to exclude any class of companies from the purview of the Act.

Third, the legislature vested power in the executive to modify the provisions in the legislation itself. An example is Section 227 of the Insolvency and Bankruptcy Code, 2016, which allows the executive to modify provisions of the Code for the resolution of financial service providers.

Globally, there is a growing feeling that the volume of legislations made by the legislature is shrinking while that by the executive is exploding. The balance of power is shifting away from the legislature to the executive, indicating a growing democratic deficit in making legislations.

One way out could be in-built flexibility in the legislation so it can adapt itself to a new situation. This works well when the legislation prescribes numbers that may get outdated soon. For example, the Competition Act, 2002, requires approval of combinations of entities having a threshold value of assets, turnovers, or transactions. Such a threshold could lose significance quickly. If the threshold is not modified promptly, significant combinations may escape scrutiny, or insignificant ones may be scrutinised. To address this, the Act requires the executive to modify the thresholds every two years based on the wholesale price index or fluctuations in the exchange rate.

Legislations enacted way back provide for numerous penalties. These fail to serve as necessary deterrents today. It is a humongous task to identify and modify every such penal provision to update the penalties. So, the Jan Vishwas (Amendment of Provisions) Bill, 2023, provides for an automatic increase of 10% in penalties every three years for violations under several legislations.

However, there are difficulties in dealing with situations for want of appropriate legislation. During Covid-19, every country ran helter-skelter to rewrite the insolvency law. In India, on March 24, 2020, the day before the first nationwide lockdown, the executive raised the threshold of default for initiating insolvency proceedings. However, on June 5, 2020, an ordinance was promulgated using emergency powers to prohibit insolvency proceedings against Covid-19 defaults. The legislature regularised the ordinance on September 23, 2020. The legislature took six months to deal with an emergency.

A business/economic law can have different effects at different times. The legislature may wish to use the same law to pursue different objectives at different times. Hence, such laws need to change rapidly in sync with the changes in the economic environment. They should reset themselves without legislative intervention when the macroeconomic environment changes significantly, as reflected by parameters such as GDP growth, unemployment rate, etc.

Take the example of the Insolvency and Bankruptcy Code. Anant Agarwal's recent paper argued for counter-cyclical insolvency law. The Code allows the executive to modify the trigger for an insolvency proceeding from a default of `1 lakh to `1 crore. It would require legislative intervention to cross either limit. It should be possible to provide in the law that if a parameter, say GDP, changes by X% in a quarter, the default trigger shall change by Y% for the next quarter.

Similarly, the law could provide that insolvency proceedings cannot be initiated during the next quarter if a parameter or a combination of parameters increases by X% in a quarter. An increase by Y% but less than X% can initiate an insolvency proceeding, but the process would change to debtor-in-possession. Similarly, an increase by Z%, but less than Y%, can initiate only pre-packaged insolvency proceedings. Even a sector could be treated differently if its parameters differ from the rest of the economy. Thus, the trigger, process, outcome, etc., can be programmed to macroeconomic variables.

Business/economic laws comprise the bulk of laws today. Most of these laws, including monetary penalties for contraventions, could be linked to macroeconomic variables, which need to be determined by sound economic research. This is akin to counter-cyclical/pro-cyclical monetary or fiscal policies. This would reduce the load on the legislature, and the economy will not suffer for want of appropriate legislation.

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