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Regulators as neo-governments

By C K G Nair and M S Sahoo, Last Updated: Apr 22, 2006, 12:00:00 AM IST

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Synopsis

Given the complex nature of the neo-governments as new mechanisms of governance, it is important that their design and location have to be the result of a larger vision.

Along with policy reforms, India has been on an ambitious path of building/restructuring of institutions for over a decade. This is particularly striking in the regulatory arena.

Regulators on banking, commodity futures markets, capital markets, insurance, telecom and power are now well established. Others, in the area of competition policy, pension, etc, are at different stages of formation and still some others (petroleum, civil aviation, railways) are in the pipeline.

The list is a long one and there are differing views on their mushrooming and the lack of vision or a framework on regulation.



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Regulators are curious animals, entrusted with legislative, executive and judicial functions simultaneously. More curiously, they are subordinate

authorities endowed with supernatural powers resulting from the fusion of these functions. So, one has to be more than a visionary when creating these structures.

In other words the placing or location of regulators as institutions of fusion should be clearly understood to avoid confusion emanating from the doctrine of separation of powers as well as in avoiding inter-institutional bargaining.

To put the issue in perspective, let us examine the concept of law. There are two basic forms of law, namely the almost complete law and almost incomplete law.

The almost complete form endeavours to enact the law with perfection, which can deal with all possible circumstances for a long time. An example of such complete law is the Indian Penal Code enacted in 1860.

Take the definition of theft given therein which has not been amended yet. Any activity satisfying the ingredients specified in the definition is construed as theft. Once legislature lays down the definition of theft and prescribes the penalty for it, it is for the executive to administer the law.

In case of any violation, the executive or any affected party brings it before the court which penalises the guilty if it is satisfied that it was a case of theft and there was sufficient evidence that the guilty has committed it beyond all reasonable doubts.

In this form of law, there is almost complete separation of powers among the governmental agencies the legislature frames the laws; the executive administers and judiciary enforces them.

The almost incomplete form believes that it is not possible to visualise all circumstances and provide for the same in the legislation. Here, the legislation tend to be skeletal. An example is the Securities and Exchange Board of India Act, 1992.

It empowers Sebi to register and regulate intermediaries listed in the Act and also such other intermediary who may be associated with the securities market in any manner.

This allows Sebi to regulate the intermediaries who are not listed in the Act, should the need arise in future and also the new intermediaries that may emerge in future, without amending the law.

At the time of enactment, the legislature could not visualise all such intermediaries who need to be regulated in future.

Similarly the Act mandates Sebi to take such measures as it thinks fit to

protect the interests of investors with an illustrative list, as at the time of enactment, it could not visualise all possible measures that may be necessary.

The Act also confers substantial powers of delegated legislation on Sebi to make regulations to fill up the gaps in laws and deal with the matters of detail, which change rapidly with time. This enables it to strike at the right time and keep the laws in tune with the time.

The Act further confers the enforcement, including judicial, powers on Sebi to enforce the laws made by the legislature and also by itself.

In this form of law, separation of powers is completely blurred  the same entity is vested with legislative, executive and judicial functions to enable enforcing the laws proactively and preferably before any harm has been done.

This form works well in a market environment where the economic agents take decisions on their own in accordance with the regulations prescribed by the regulators.

Under the almost complete form, there is almost complete separation of powers among the different wings of the government. Under the almost incomplete form the powers of the government are very limited, while regulators exercise most of the powers.

The regulators essentially exercise the same, even more, powers under the incomplete law regime. They are the neo-governments, governments within the government; imperium in imperio. Governance by neo-governments through incomplete laws is eminently suitable for an evolving market.

The law has to evolve continuously to meet the emerging deficiencies, accommodate new products and market designs, deal with innovative

transactions by the market participants and improve the safety and efficiency of operations in the market by overcoming the legislation lags and inter-temporal information lags.

Hence the legislature creates neo-governments and vests them with a suitable combination of legislative, executive and judicial powers to deal with the evolving markets proactively on a continuous basis.

The success of such governance, however, depends on the architecture of neo-governments. Three aspects specifically need to be taken into account while designing and  neo-governments.

Since both government and neo-government operate in the same space their respective responsibilities need to be clearly demarcated in the interest of harmonious relation between them and to avoid shifting of responsibilities, particularly during crises.

Second, as the neo-governments are the offspring of the government the umbilical cord needs to be severed so that the latter grows up to take responsibility for its actions. If government is also a market player, it should be subject to discipline of the neo-government.

If, on the other hand, the government has to intervene in the working of the neo-government in public interest, it must do so in a transparent manner. Third, there is almost complete separation of powers within the government to address the public law concerns.

Similarly, the neo-governments must ensure that their three wings exercise legislative, executive and judicial powers with independence and without intra-institution bargaining.

(The authors are directors in the Planning Commission and finance ministry respectively. Views are personal)

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