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## Policy Engagements and Blogs

### Why you should 'Know your Regulator'?

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Event on: Why you should 'Know your Regulator'?



At the State Capacity Initiative at the Centre for Policy Research (CPR), we were pleased to launch a new talk series titled: 'Know Your Regulator' on 15 September 2021, in collaboration with the National Council of Applied Economic Research (NCAER), the Forum of Indian Regulators (FOIR) and the Indian Institute of Corporate Affairs (IICA). In this talk series, we are talking to chairpersons and members of India's regulatory agencies about regulation of Indian markets and the economy.

**Dr M. S. Sahoo**, Chairperson, Insolvency and Bankruptcy Board of India (IBBI) and Honorary Chairperson, Forum of Indian Regulators (FOIR) was the speaker for our inaugural event. He was in conversation with **Dr KP Krishnan**, IEPF Chair Professor in Regulatory Economics, NCAER and **Dr Mekhala Krishnamurthy**, Senior Fellow, CPR and Director, State Capacity Initiative. **Arkaja Singh**, Fellow at the Centre for Policy Research, along with **Dr Abha Yadav**, Director of the Forum of Indian Regulators (FOIR) Centre at IICA made a brief presentation titled 'Regulating in the Public Interest', which was followed by the discussion and audience Q&A.

In this note we provide a brief summary of the conversation<sup>[1]</sup>:

#### Regulators and their role in free markets

Regulatory agencies play a major role in the policy outcome of the state. The key functions of regulation (such as legislation and execution of regulatory mandates) are discharged through agencies existing in different forms across different levels of government. They can be seen as separate departments within a ministry or as separate entities with their own statutory foundation (independent regulatory agencies) or they can be supra national bodies. The actions of these regulators are of critical importance in the design and execution of regulatory functions. The regulatory bodies were established to create a transparent, accountable system free of political interference and protect consumer interests while allowing for market freedoms to exist.

Regulation is a specialised form of administration. Regulators have special powers and there is a formal separation from the ministries indeed but within an institutional mosaic. The regulatory bodies also provide a structure for making settlements and negotiating contentious and unsettled questions of public policy.

### A short history of regulatory agencies in India

**Why are there many statutory regulators in India? Why is there an increase in the number of this new form of organisation of government? (Dr Sahoo refers to these agencies as a “mini state” or “neo state”)**

In the 1990s, market participants were given economic freedoms. From 1900-1957 when there was no economic freedom, India's growth rate was under 1% and from 1947-1992 when we had only civil freedom, India's growth rate was around 3.5%, but between 1992 and 2021 (except for the covid event), our growth rate has been on an average around 7%. There are several empirical studies that have tested the benefits of liberalisation and we have embraced these institutions to regulate market freedoms in order for them to work.

There are many kinds of regulators, and their functions are linked to economic reforms. When India liberalised her economy, her goal was to move away from control and towards regulation. We moved from a control regime (licensing) to a regulating regime (registration) where we specified the requirements for doing business. This led to a creation of market regulators to regulate businesses. Before the 2000s, we were not in favour of monopolies, and this was reflected through the Monopolies and Restrictive Trade Practices Act. The Act did not allow for businesses to do business beyond a scale. But in the early 2000s, India recognised that monopolies aren't bad, but abuse of dominance is bad. This thinking led to the legislation of the Competition Act for businesses to compete at a marketplace.

The rationale for regulation is that businesses must be free to compete in a marketplace without interfering in each other's freedom. In 2015-16, we also made laws for businesses to exit a marketplace (“the ultimate freedom”) if they were unable to compete in the ecosystem. These set of reforms brought about one category of regulators called the resource allocation regulators. The securities law, competition law and insolvency law are non-sectoral laws because they are meant to ensure the right allocation of resources. We have other kinds of regulators that are sector specific too.

If economic freedom is misused, it is likely to be abused. We were inspired to create regulators because we had seen the benefits of liberalisation and we wanted to make sure that market failures were avoided. Entry into a market, ease of doing business, and exit for businesses are functions that the regulators deal with. We started setting up regulators in 1992, and we are still experimenting within this frame. But there is a general understanding that if we pass something on to a regulator with a pre-defined framework, then the outcomes are better. The government also expects for the regulators to be insulated from political and other kinds of pressures and there should be stability in the regulatory regime.

### What does it mean ‘to regulate’?

The regulators focus on promotion of an industry, producers, and certain types of market structures. The acts have terms such as “promotion” (to promote a market where things are asymmetric) and “regulation” (to regulate a market where enterprises are encouraged to compete) that have a common end goal in mind, but promotion and regulation are slightly different functions. Similarly, “development” (where the state places a role in developing sectors) and “regulation” also go together but they are distinct functions. In the framing of our agencies and in our understanding regulatory purpose, sometimes all these ideas are conflated and have resulted in challenges in understanding the public purpose of regulation.

There is no textbook definition of a regulator. There are commissions, boards, authorities, but there is no agency that only does regulation. Those who call themselves as regulators such as SEBI or IBBI do not just regulate but they also have other functions. But within a particular sector, these agencies hold monopoly positions in regulating that sector. In the developmental space, the regulators are not monopolies, but they have a developmental role. SEBI is the

most evolved regulator and the oldest regulator in India. In the SEBI Act, they are responsible for the protection of securities, promotion, and regulation of the markets. The word here is not “to develop” because there was already a developed market to regulate.

In 1992 when we started the reforms, there were questions around what to regulate if there is no market. But markets also don't develop without comfortable regulations. Development and regulation must go hand in hand especially during the initial stages of reforms. As an example, in 1996, the Securities law was amended to include derivatives. We at that time thought that the derivatives market will develop, but it did not develop. We then released a regulatory framework in 1999 for derivatives that led to certain market developments. Similarly, in the insolvency space, we came up with a regulatory framework for regulating pre-packaged insolvency processes. It exists in the United Kingdom without any statutes, but in India, we needed a framework to start this process. Development and regulation must go together, and every regulator will also have some developmental role in their mandate. Development can mean many things. It can mean promotion, or it can mean just having a fair, simple trustworthy regulator. In some cases, the regulator could be the market player, or the regulator will offer incentives for people to do business. So, every policy must be neutral and consider what they are trying to develop in their relevant sectors.

There are three broad types of regulators.

- Regulators who regulate professionals (Doctors, Chartered Accountants)
- Regulators who regulate markets (SEBI, IBBI) and
- Regulators who regulate utilities (TRAI, PNGRB, RERA).

In the utilities sector, there are structural problems in developing ease of entry and exit and hence it is difficult to catalyse competition in this space. But the stock market is a great example for perfect competition. Millions of people simultaneously buy and sell, and trade happens in seconds, and no one has any control over the price. In utilities regulation, we have not been able to achieve perfect competition since there are structural issues.

### Powers of a regulator

In the constitutional scheme of things, we have fused three major functions in one body. The power to effectively legislate, the power to execute these legislations, and in many cases, the agencies also have the power to adjudicate disputes arising between itself and an entity in the market that is supported by the legislations. **Is it necessary and if so, are there adequate checks and balances to ensure that this is not an agency with too much concentration in power?**

CV Bhambhani used to say that the job of a regulator is to hit a moving target. Stock markets are too dynamic, and they cannot wait for the State's “almost complete law” for them to be regulated. We moved from “almost complete law” to “almost incomplete law”. An example of a complete law is the Indian Penal Code. There has not been a single amendment made for this law because this legislation is meant for static issues. In market situations, these kinds of complete laws cannot work because then, the whole purpose of giving freedom to businesses is lost. In dynamic markets, there are the regulators and the regulations, and we moved to the skeleton type of parliamentary legislations in sync with market developments.

There are many standard techniques that have come up to think about structural issues. For example, we have created three separate wings in the IBBI with three different full-time members to make sure that there are strong accountability functions where all the functions are subject to scrutiny. There must be checks and balances but there are benefits to giving these powers to regulators.

### Regulatory design and capacity.

The regulatory agencies must have greater depth of capacity to tackle the risks and benefits associated with regulating individual sectors. **What are the internal measures of effectiveness and impact since we know very little about the capacity of regulatory agencies?**

**How does one build-in into the regulatory design of these institutions adequate capacity to deal with technically complex functions and their associated risks, but also quickly and effectively solve for market conditions?**

Every regulator has two broad functions: the first is the legislative activity irrespective of the kind of business. The second is the subject matter knowledge required to regulate. Both these functions are critical to regulators, and one must start somewhere. Once a regulator is created, then we need to think about capacity. Regulation is a public good and regulatory capacity is vital to this function. Academics have a business opportunity here to come up with frameworks to build capacities. We don't have a course on how to inspect and investigate businesses. We create agencies and we are keen to put the cart before the horse, but we end up with sub-optimal outcomes. We want immediate outcomes, but it is hard to build capacities in a day or in one classroom in eight months. **How can one convince parliament and government on the need to hasten slowly?**

Every idea has a time. We can never have best conditions to make things happen and this is true for any democratic system. We need to catch on when the idea has its moment and follow it through.

We also draw on former civil servants and bureaucrats to run our regulatory agencies. The regulator is both the authority and the agents who regulate. **What is the relationship between the regulatory bureaucracy and public administration at large?** It will be useful to understand the kinds of people who need to come in to build regulatory capacity.

The impression that regulatory bodies are manned by bureaucrats is not correct. SEBI for example has its own cadre with 1000+ members now. The Government only appoints the top people, but these organisations build their own internal capacity. We need to give these bodies time to build capacity. There is a difficult tension between the insider outsider mix required within the regulatory agencies and these are going to be complex questions. Regulation is a cross cutting function and involves many realms of knowledge such as principles of law, constitution, economics, and relevant sectoral knowledge. but is there scope identify common skillsets that the regulators need? Can SEBI regulators, for example, move to the Competition Commission? These questions will gain more traction in the future.

Dr Subha Rao of the RBI was not a trained regulator, but he was a classic civil servant who had experience in a variety of finance roles. He was also not a trained lawyer. It is not easy to do regulation if you are not a trained lawyer but a lot of people with experience and wisdom can be excellent regulators. Dr Bhavé instinctively understood rule of law because they came from their own experience of government and principles of natural justice are ingrained in such people.

### **The 'Know Your Regulator' series**

A lot of discussions on economic governance in India centre around deregulation. The need to setup regulatory institutions came in in the 1990s when India's economy was liberalised. We have set up many regulatory bodies, but we have spent far little time to understand what it means to build effective public regulatory institutions in the country and the need to deepen public engagement with regulatory institutions. We need to discuss capabilities and transparency of regulatory institutions since we know very little about what we know it is to regulate. KYR is a series that will introduce a public dialogue with our regulators.

In this series, we aim to listen from regulators who are currently serving. Our aim is to make their challenges and functions visible.

There are different ways in which regulators are perceived by the public. There are some perception issues as well. In the early 1990s, people knew what SEBI did but that was because the regulators allowed themselves to be visible. Also, there are people do not allow regulators to be visible since they do not want their regulators to perform their functions. Different people also look at different aspects of the regulator. In the insolvency law, people who have lost because of these laws do not favour the regulator and those people who gained because of these laws will favour the regulators. There is very little visibility for the complete picture in these situations because people and groups project their interests. People judge regulators on some yardstick that is readily available. For example, people judge SEBI just

based on the market indices. We need to draw attention to regulators because the movement away from a producer state to a regulator state means there is going to be a proliferation of these agencies and regulators are going to touch our lives regularly. With services becoming a dominant indicator of our GDP, consumer protection issues will come to dominate our daily lives. Telecom, banking, insurance, security markets, technology etc are riddled with many issues, so knowing your regulator is intended to throw light on what is to be done when the consumer is frustrated with a particular regulation.

[1]. This is a summary of the main points discussed during the event. Views and quotes should not be identified as belonging to any of the individuals involved. To attribute points to specific individuals in the dialogue, please refer to the video recording.

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