India’s regulatory hotch-potch

To ensure efficient functioning of markets, a thorough review of our regulatory institutions is of utmost importance

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As India globalises even more in the coming years, it needs to start paying serious attention to the efficiency of its markets. Such efficiency is critical for allocating labour and capital efficiently and to compete internationally. The world also needs to believe that our markets are regulated without bias, favouritism and unquestioned integrity.

All economies have three markets: the market for things, the market for labour and the market for finance. When each of these markets is in equilibrium, the economy can be said to be functioning efficiently.

Equilibrium is defined as a state where there is virtually no pressure to change. But that never happens because that’s how it is. So in order to make these markets properly efficient, we must have market regulators who make the operating rules for each market.

India didn't have real markets till the 1990s because Indira Gandhi had killed them off in the 1970s. But since then it has had both markets and regulators.

How have these regulators performed? Think about it and you will realise that we don’t really know. Regulatory capture happens quite frequently. Indeed our government is the biggest capturer. That is why I think the time has now come for setting up a commission (not just a committee, like the Srikrishna Committee for the financial sector in 2011) to prepare a detailed report on their functioning.

The difference lies in authority and credibility. To ensure the former, it is Parliament that should set it up. To ensure the latter, it should be staffed half-and-half by Indians and foreigners.

The chairman should be appointed by India but should not be an Indian. Some Scandinavian countries might be the best. There are at least four to choose from.

These countries have blended capitalism and socialism most effectively. And they don’t have an axe to grind.

Terms of Reference

The terms of reference should simply be best practice that aims at fairness. Both these concepts — best practice and fairness — are fully established and well understood.

Thus, best practice is not merely the best interests of the government, which is what India does and which is colonial in its origin, nature and application. And fairness is neither justice nor equity.

Justice is an abstract philosophical construct. Equity is a political practice. Fairness is a good combination of the two. It’s that balance that has to be struck.

That’s why, whatever happens, the terms of reference should not be left to Indian bureaucrats. Most of them just don’t know enough about markets and economics. When acting in a group they can make a dog’s breakfast of things. Their efforts have been known to damage the very governments they serve. We are actually very lucky because an excellent guideline for framing any terms of reference can be found in Article 280 of our Constitution. It provides for setting up of the Finance Commission and spells out its charter breathtakingly precisely in four short paragraphs which I have summarised thus:

“It shall be the duty of the Commission to make recommendations to the President as to the distribution between the Union and the States of the net proceeds of taxes; the principles which should govern the grants-in-aid of the revenues of the States out of the

Consolidated Fund of India; the measures needed to augment the Consolidated Fund of a state; and any other matter referred to the Commission by the President.”

Parliament is also empowered by Article 280 to “determine the qualifications which shall be requisite for appointment as members of the Commission and the manner in which they shall be selected.”

That’s 90 per cent of its substance and just one more thing is necessary. To this enabling power of appointment I would add a disabling one, namely, that no current or former bureaucrat or judge can be appointed. But a single politician would be fine, indeed necessary.

Review needed

The task before it: The starting point of the exercise must, of course, be a review of regulatory institutions and practices over the last three decades. This could start with the caste hierarchy in our regulatory institutions.

Some are mandated by the Constitution, some have been legislated by Parliament and the rest by the ministries. It should be a matter of the deepest concern that not all regulatory bodies are on an equal footing.

There is also the problem of vintages. Some are very old and some are very new. Reserve Bank of India is 90 years old. The Telecom Regulatory Authority of India is 27 years old and the Airports Economic Regulatory Authority just 15. Going by their records, they all all mostly what TTK called the RBI in 1957: subordinate departments of the government.

To cut a long and sorry story short, there are far too many shortcomings in our regulatory systems and institutions. These institutions need a thorough review so that the economy can perform efficiently, both domestically and internationally.

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