
Law and Economics

My friend Pradeep Mehta has been a pioneer in the field of consumer rights and protection, a sound and balanced voice on trade policy and matters relating to competition law and regulatory regimes. He is also an institution builder and has created a formidable one in CUTS and is in the process of repeating the exercise in the newly established CUTS Institute for Regulation & Competition (CIRC). His many contributions to the policy discourse have one common characteristic—they deal quite directly with the interface between law and economics. Hence, this contribution to commemorate his 65th birthday focuses on some conceptual issues relating to this link.

Economics is about transactions that involve the production and exchange of goods and services between individuals and enterprises. These necessarily have to rest on some notion of binding contracts and property rights. In some ways economic activity can be conceived of as an exchange of rights to the ownership and use of goods and services. Put in these terms the connection between economics and law stands out clearly, for rights have to be recognised in law, formal or customary, if they have to be exchanged.

Laws are made, administered and adjudicated by the instruments of State—the legislature, the executive and the judiciary. All the three branches therefore need enough economic understanding to ensure that their formulation, implementation and interpretation of the law are consistent with the needs of the economy. These needs change over time and hence, law also has to do the same.

The state is not just the maker of laws. With the doctrine of eminent domain, it is the ultimate repository of all property rights

that devolve on individuals only to the extent to which it has transferred them through land grants, recognition of occupancy rights or traditionally exercised property rights, mining leases and so on. In a constitutional republic, this power of the state has to be exercised within the framework of law and due process, while in a despotic system, it may rest on the discretionary powers of the sovereign.

In practice the actual exercise of State power in the economic sphere is a mix of rule based and discretionary authority. But even discretionary power has to be subject to some constraints of accountability and transparency in any open democratic society. The contrast between rule based and discretionary systems narrows if the latter are required to observe certain basic principles of justice like the right of representation for all claimants, ensuring that all of them have equal access to relevant information, a procedure for appeal and redress if a claimant is aggrieved and so on.

We recently had a spate of controversies arising from a concern that the exercise of State power in the allocation of natural resource rights for mineral extraction, use of the telecom spectrum and public lands was less than transparent, sometimes corrupt and violated basic principles of natural justice. The Supreme Court took up the matter and in its most recent judgement had recognised that how such allocations are made is a matter for the executive to decide; but the procedure followed must be transparent, must ensure fair competition amongst potential claimants and must maximise public revenue and serve the public interest. One can question some elements of this like the belief that maximising public revenue and serving the public interest will lead to the same decision. But in essence, it is a well-conceived restriction on how the State exercises its ownership function over natural resources.

Economic analysis can contribute to the elaboration of the criteria laid down by the court by subjecting different procedures like first-come-first-served, alternative modalities for auctioning resource blocks, implementing a pay-per-use system instead of allocating ownership rights and so on. Along with political scientists, economists can also play a role in teasing out a clear

measure of public interest to evaluate alternative outcomes of the allocation process. For instance, if the dominating policy concern is rapid development, a plausible definition of the public interest for a networked service, whose value to each user goes up when there are more users, could be the impact of alternate allocation procedures, on the speed with which usage will increase. But the same measure of rapidity of development may be inappropriate, if the public concern is congestion.

A dominant consideration in a capitalist market economy is the need to maintain competitive considerations in all markets. The natural tendency of a well-established profit maximising business is to do what it takes to prevent new entrants from eating into its market. The temptation to collude with other players for market sharing and price fixation is also quite obvious. At the same time, do not leave each other alone. There is a market for corporate control, which manifests itself in mergers and takeovers. But, the market for corporate control does not work for the consumer interest or some other public interest like technology development, but more for corporate growth. Hence, a key responsibility is the broader task of ensuring that all markets remain contestable and that collusion is prevented. This is the task of the apex competition regulation body, which in our case is the Competition Commission of India, whose 'first-among-equals' status has recently been confirmed by the government.

This broad area of regulatory regimes has become a proper subject for economic analysis as the policy system shifts from an opaque exercise of discretionary powers to say yes or no without giving reasons to independent, rule-based regulation. But more than that, the regulatory organisations will also need a measure of economic literacy in order to fulfil their responsibilities of protecting the public interest. This need for economic, in fact also commercial literacy is particularly acute when issues about tariffs, competition impacts or collusion in the market have to be investigated. It is absolutely vital when public-private partnerships (PPPs) for service delivery are being negotiated.

The link between law and economics is not just about ensuring that the exercise of economic authority and power is based on sound legal principles like non-discrimination, fair competition and transparency. It also matters the other way. The exercise of legal authority and judicial decisions in certain areas could benefit from a closer consideration of economic principles. One such area is the appellate jurisdiction of the higher courts on the decisions taken by regulatory agencies. It is essential that the economic logic that underlies the regulatory bodies decision is well understood by the higher courts that may then focus their scrutiny more on any violation of basic judicial principles. But for that the regulatory agency must spell out the economic logic clearly enough to convince the court.

All of this will require a class of analysts, administrators, lawyers, accountants and judges who are familiar with basic legal principles and with economic analysis. In many ways the work done by CUTS and CIRC is an effort in this direction. But what has been done so far is only a small beginning and much more work is needed in educating lawyers in economics and economists in law. Pradeep Mehta, who has done so much already in this area, may well wish to turn his skills in analysis, articulation and institution building to this end. This call for yet more hard work, and is my gift to him on his 65th birthday!