

Regulatory Independence

The Indian Arrangement

For most people, as they grow older, energy levels tend to flag, passion begins to wilt and quietly a degree of cynicism begins to creep into their attitudes. But Pradeep Mehta is one of the blessed few for whom it has been quite the other way around. In the 30 years that I have known him, from the time that he used to go about in *khadi kurtas* and carry a *jhola*, to now when he hangs about in suits smoking cigars, I have never ceased to marvel at how much intensity he has brought to his chosen vocation, namely, argue the case for the hapless consumer who is usually left holding the short end of the stick. He has had his detractors, of course, as any super achiever must. But even the worst of them has not failed to admire his dedication and commitment to the cause.

Now, as he rounds the bend where the road ahead gets dominated by grandchildren, whose pictures he unfailingly posts on Facebook, it seems fitting that CUTS, the organisation that he founded, nurtured against severe odds and built into a formidable storehouse of knowledge and tireless advocacy, should bring out a festschrift in his honour. Since my own association with CUTS has been in matters of regulation and competition, the editors asked me to write on regulatory independence, a term much bandied about but not quite fully understood by its champions who normally fail to answer the most obvious question: independence from whom?

* I am grateful to CUTS for permitting me to reproduce some sections of a longer paper that I had written for them some years ago.

“The government, of course,” is the slightly delayed response which sounds right if you assume that governments are all bad. But when you break it down to the components of government, politicians and bureaucrats—there is acute discomfort. The same thing happens if you ask “independence from the State or the government?” My unhappy experience has been that bluster replaces reasoned argument and judgement. And bluster gives way to expostulation when regulatory capture is mentioned. Not always but often enough. So it is best to start with a working definition, namely, “Institutional efficacy demands functional independence which implies an arm’s length relationship from interest groups.” The question, of course, is how to ensure this.

In some countries, such as Britain, structures have evolved out of a particular set of historical circumstances. For example, by the end of the 16th century, when the reign of Elizabeth I ended, a large number of persons not belonging to the privileged, aristocratic, landed classes had become prosperous and were demanding a say in political and economic power. For instance, where the latter was concerned, they had begun to protest over the King’s right to tax anything that he pleased. They wanted it subject to some scrutiny and, where necessary, abridgement. The first constitutional case involving the independence of the Judiciary was fought in 1618, in which the Chief Justice ruled that the King did not have such an absolute right. That judgement set the tone for what was to follow over the centuries.

The 17th century in Britain also saw the emergence of the struggle for independence of the Parliament. It claimed the sole right to pass legislation, which the King disputed. This is more clearly understood when we see that, by the 1630s, the Lower House of the British Parliament, the House of Commons, was dominated by the merchant class. They eventually rose up in arms against the King, Charles I. After a bloody civil war, the King was beheaded in 1649. This ensured the independence and supremacy of the Parliament for all times to come—including when, 38 years later, it even felt enabled to invite a foreign king, William of Orange, to come and rule Britain, because it did not agree with the religion of James II, who was a secret Catholic.

In the US, which had learnt its lessons from the events in its mother country, Britain, such independence was guaranteed in the Constitution. India has followed the US example. And whether Britain in the 17th century or the US in the 20th, the context in which the term independent is defined has remained virtually the same: not serving vested interests, regardless of whose interests they are—the government, the business, the politicians or all three acting in collusion.

The questions we need to ask in India arise from this overall context. First, it is necessary to ascertain if such pressure for regulatory independence exists in requisite measure; second, whether the political response can be positive; if not why not; and third, what should be done about it in terms of creating the context that will result in a positive political response.

At its core, the governing imperative in a developing country democracy is that people cannot be excluded from consuming something because they cannot afford it. This holds true for everything, except the obvious luxuries. This is called populism and, whether we approve of it or not, it is a fact that requires to be accommodated, while managing the several transitions. The Indian paradox is that, while the so-called luxuries require relatively small investment, the public goods, which now include electricity and transport, require massive investments.

This means that the eventual responsibility to arrange relative prices in a manner that is fair to all, consumers as well as producers, falls on the government and the Parliament, because both are accountable to the electorate in a manner that those charged with delegated legislation are not. And, as the interactions between central banks and governments the world over show, a great deal is predicated on the trust that exists between finance ministers and the governors of central banks.

One final factor needs mentioning here. This is the issue of the 'hierarchy' of institutions. It is important to distinguish, in this context, between institutions that are created by the Constitution of the country and those that are created by the Parliament. The former are higher in the hierarchy and expect their authority to be

respected by the latter. However, a fundamental problem can arise here, especially in democratic countries with large numbers of poor people: this is the conflict between equity and justice.

On the face of it, the distinction between the two appears thin, but is, in fact, critical to the manner in which outcomes are determined. The Judiciary, in particular, is concerned with justice, whereas the political establishment, including the Parliament and the Executive, to which some of the second-order institutions report, is concerned with equity. This can give rise to varying degrees of friction.

The cooperative and mutually deferential relationship between the first and the second-order institutions is a matter of concern. Each accuses the other of encroaching on its territory and matters get worse when the Executive or the government joins in. Therefore, each begins to scrutinise others more closely and this also creates difficulties, to the detriment of institutional independence.

We can distinguish between three types of institutions. Tier I institutions are those that are created by the Constitution, as opposed to the Parliament, which is itself a creature of the Constitution. Some of these constitutional institutions are on par with the Parliament, although the latter does not always accept this position, claiming instead, a slightly higher position. This can bring it into conflict with the other institutions, most notably the Executive and the Judiciary. Here we shall not deal with the former, as most of the other institutions also come into conflict with it. Indeed, it is usually the Executive *versus* the Rest, for the simple reason that the rest have been created to provide a check against the Executive.

Tier II institutions are those that have been created by the Parliament, rather than by the Constitution. This difference is crucial in determining the degree of independence they enjoy. Overall, institutions created by the Constitutions are fully independent and, if constraints exist, they are self-imposed. The same however, cannot be said of the institutions created by the Parliament, which suffer from a number of externally imposed constraints. Broadly, these relate to the appointments and removal

from office, on the one hand, and funding on the other. Both eventually have the same effect: an abridgement in the degree of the freedom the institution is allowed.

Tier III institutions are those created by administrative fiat and these report to the government through the minister. These tend to be the least independent.

In the years ahead, resolving the conflicts and differences of opinion that arise amongst and between these three will tax the country's ingenuity greatly. But I have no doubt that India will work out a unique model that will become a template for other democracies.

