BRIEFING PAPER

CUTS Centre for Competition, Investment & Economic Regulation
CUTS C-CIER

2/2014

Regulatory Performance
Independence and Competence Matters

Independent regulators insulate economic decision making from political control and contribute towards a consistent and rational policy environment that provides a level playing field to competitors and reduces regulatory uncertainty amongst private investors. However, to be truly independent from the government, not only must the regulator be an independent statutory authority, but also be financially and administratively independent from the government.

The Briefing Paper makes an attempt to provide an overview of India's current scenario on the level of functional independence of regulators and presents the reason for its failure with a way forward.

Introduction

Plethora of laws governs many regulatory agencies in India. However, institutional efficacy and optimal performance is missing. Institutional efficacy and optimal performance *inter alia* demands competent personnel and functional independence. To be truly independent from the government, the regulatory authority must also be financially and administratively independent from the government. The executive cannot be allowed to either interfere, or arm-twist the regulator, to force the latter to toe its line. More importantly, since the onus of meeting the regulator's objectives lies with the regulator, the government cannot be allowed to have unbridled discretion in how the regulator hires and manages personnel, and uses its finances.[1]

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Introduction of Economic Reforms in India

Previously, like most developing countries, India was characterised by significant government involvement in their economies marked by dominance of large state-owned enterprises (SoEs) and private sector was limited to producing only selected goods. Cross-border trade was not encouraged and strict restrictions were imposed on imports. As a result economy continued to reflect low growth rates. Reliance on foreign borrowing increased substantially and the impact of 1990 Gulf war on oil prices compounded the problem and led to a severe balance of payment crisis in 1991.[2]

The introduction of New Economic Policy (NEP) of deregulation, privatisation and trade liberalisation in 1990s changed the pattern drastically. Market intervention policies were replaced by privatisation, trade and financial market liberalisation, deregulation and decentralisation of government structures. The increase in private participation in the newly liberalised economy pointed towards need for independent sector regulations. The first few sectors where economic regulation was then ushered included telecom, electricity, water, oil and gas with the aim to eliminate public monopolies or open up strategic sectors for private participation.

In the process, a new form of economic governance Independent regulatory regimes was set up with the expectation of insulating economic decision making from political control, ultimately contributing towards a consistent and rational policy environment; providing a level playing field to competitors; and reducing regulatory uncertainty amongst private investors.

By 1994, the government decided to open up the telecom sector to private firms, which led to the establishment of Telecom Regulatory Authority of India (TRAI). Other sectoral regulatory authorities included Central Electricity Regulatory Commission (CERC) at the federal level and State Electricity Regulatory Commissions (SERCs) in most states, Securities and Exchange Board of India (SEBI) to regulate the capital market, etc.

Are Regulators Truly Independent?

The standard arrangement of post-regulatory reform was to leave the development of policy framework in the hands of the government, whilst implementation was the function entrusted to the regulatory agencies. Whether the purpose was fulfilled or not is a tricky question that this briefing paper makes an attempt to answer.

Reforms and regulations are always dynamic. Although governments chooses the regulators that should be independent in their functioning, regulatory laws have provisions of empowering the government to issue policy directives and also remove the regulator, thus keeping the regulator virtually under government control. The independence of the regulator is also adversely affected by the confusion between policy and regulatory matters lurking in the government departments.

For instance, confusion over difference between a policy matter and a regulatory matter, has often found the government departments to deal with typical regulatory issues under the garb of policy matters.

Institutional independence has an inverse relationship with external influences over the authorities. The lesser the influence, higher will be the scope for functional autonomy.

The core objective of setting up regulators outside the government control so that regulatory functions can be redefined and demarcated away from policy making. However, it appears that the government is yet to articulate its vision and objectivity cogently for optimising the degree of independence to be delegated to these institutions.

Example of Regulatory Capture

TRAI, which in 1999, after holding extensive consultations issued its first order of setting tariffs to reflect costs more closely. After an uproar in the Parliament, and opposition from other quarters, the Department of Telecommunications sent TRAI a 3 line note directing it to put its order on new phone rates on hold. In response to the refusal of TRAI, the government issued two gazette notifications, the first related to salaries, allowances and conditions of service of TRAI officials. It also cut down on the allowances for foreign travel of TRAI, ostensibly in the wake of a recent Comptroller and Auditor General (CAG) report.[3]

Independent regulation as a mechanism of governance in India has been captured by a cartel of bureaucracy, mostly from the Indian Administrative Service (IAS). It is a post-retirement perquisite usually given on the basis of how they had functioned when in service. Today almost all regulatory bodies are headed by retired IAS officers. Members are retired bureaucrats and other former government servants. Most are subservient to the opinions of ministers and bureaucrats in service. Only few function truly independently, for instance, RBI and SEBI are fortunate to not to have too much government control.

In India, there exist vast differences between mandated and delegated independence, with the latter much lower than the former, due to control exercised by the executives. The regulators are dependent on concerned line ministry for budgetary allotments, endorsement of staff appointments and need for former to report to the latter, etc. There is no uniformity on funding of regulators. Although a few government departments are proactive in providing adequate funding and resultant independence to the regulators reporting to it, this attitude is largely missing in many others.[4]

Independence and accountability go hand in hand. If Independence ensures that interests of various stakeholders are accorded due importance in formulating and implementing regulation and prevents regulatory capture by vested interests, accountability ensures that regulation is based on careful weighing of pros and cons; arbitrary decisions are not taken as consumers have access to facilities for redressal and appellate authorities and courts for remedial action against incorrect regulatory decisions. One basic form of accountability is transparency in the regulatory decision making process which, to a certain extent, can be achieved through public participation.[5]

Other than unavailability of functional independence with regulators there are few other reasons like absence of young, willing and competent regulatory professionals who are ready to take a strong stand, lack of transparent selection process of regulators, lack of laws limiting selection of retired civil servants to regulatory positions, ambiguous and incoherent sectoral laws, etc. which have compounded into overall regulatory failure.

Way Forward

There is a need to bring greater transparency which could be attained with clarity of functions, fiscal Independence. To check the confusion that prevails while deciphering the policy matter and regulatory matter lessons could be taken from Electricity Authority of Cambodia (EAC). The Act establishing EAC clearly separates EAC's function as a regulator from that of the ministry concerned and interaction between EAC and the ministry is clearly stated in the law and hence provides sufficient clarity. Laws establishing regulators must therefore, be drafted to protect against such conflicts. At the same time, there must also be mechanisms to ensure regulators remain directly accountable to the Parliament.

Another important aspect of regulatory independence is financial independence. To be truly independent from the government, not only must the regulator be an independent statutory authority, it must also be financially and administratively independent from the government. The executive cannot be allowed to either interfere, or arm-twist the regulator to force the latter to toe its line. More importantly, since the onus of meeting the regulators objectives lies with the regulator, the government cannot be allowed to have unbridled discretion in how the regulator hires and manages personnel, and uses its finances.[6] Following measures may be ensured to attain financial autonomy.[7]

- Regulatory agencies should be allowed to generate resources on their own through a reasonable fee, cess, etc. wherever possible, and be allowed to spend it;
- The financial requirements proposed by the regulator should be linked with their work plan for a certain time period and approved by the Parliament; the regulators budget should ideally be a charged expenditure on the consolidated fund; and
- Regulators should be given the liberty to hire required staff on contract and appoint consultants in a transparent manner.

Regulators functional independence can be prevented if their micro-management by line ministry is brought to a halt. In India, the only example of arm's length relationship between the line ministry and regulatory institution is the Commission on Railway Safety reports to the Civil Aviation Ministry and not the Railways Ministry, thus it is partially immune from pressures of the Railways Ministry to influence its work. The safety body is manned by experienced railway staff to carry out inspections etc, and the staff is also provided immunity from reprisals as they need not return to the Railways Ministry, but to serve the safety body until they retire.

Another best practice in this regard is regulatory design followed in South Africa, Eskom, the dominant vertically integrated state-owned utility in power sector in South Africa reports to the Department of Public Enterprises and not the Ministry of Minerals and Energy, the line ministry for energy sector. In this scenario, the line ministry cannot protect Eskom, and the regulator is able to take action that affects SoE's interests. The regulators assertiveness was shown when in year 2004 it turned down Eskoms request for an above-inflation tariff hike of 8.5 percent and instead approved a low 2.5 percent rise, which resulted in Eskom appealing to the Ministry of Minerals and Energy (which then enjoyed appellate powers), but the Minister upheld the order passed by regulator.[8]

Another important requirement of sound regulations is to have the right people on board. Selections must be broad-based and consider other professions, not just retired government officials. Younger regulators and tenure of five years must be aimed. They must be skilled at understanding interdisciplinary connections. They must be intellectually honest and strong, possess the courage of conviction and be able to stand firmly against contrary government and public influences.[9]

Also, there is a need for transparent selection process. The draft Regulatory Reform Bill, 2013 has albeit brought out such arrangements but accurate implementation can only bring real changes.[10]

Independence must go hand in hand with accountability. Appropriate mechanisms are required to make independent regulatory agencies accountable. Replacing the line ministry's control by Parliamentary supervision across the board is necessary. Another mechanism to make regulators accountable is by having provisions for appeals against decisions of regulator. It is important to ensure that the review provision does not create a second layer of regulation, as is currently experienced in the telecom sector in India.

Desired accountability amongst these independent institutions could also be attained through activism on part of civil society organisations, as well as pressure from informed public. This would work as an effective deterrent against a possible institutional capture which varies with the degree of institutional independence.

Lastly, the proliferation of new 'independent' regulatory bodies adds another layer of clutter to our governance structure without improving it. Government departments must, with the creation of regulatory agencies, simultaneously downsize. Safeguards to keep both government and regulatory bodies effective are required. For this, ministries and departments must coordinate decision making. Combining responsibilities between regulatory bodies to reduce the number of regulators dealing with related subjects must happen.

While mandatory consultations between intra and inter regulatory agencies on specific issues that impinge on common jurisdictions should be in place, more important is commitment on the part of government, and clear and consistent policy objectives. The relationship between Ministry and regulator should be well defined, as it can become a source of tension and uncertainty. As stated above, it will be best to keep the regulators accountable to different ministry than the line ministry.

Given that regulatory bodies are often created to achieve predetermined policy objectives, an absolute divorce between the two is not desirable and proper interaction between them becomes very important. At the same time, it is equally important to ensure that the regulators domain is not encroached upon by the government in the name of achieving policy objectives. This calls for creating a clear distinction between policy and regulation, which is often missing in India.

Conclusion

Regulatory efficacy demands functional independence which calls for the regulator maintaining an arm's length relationship from interest groups. One aspect of such autonomy is the ability of the regulator to access funds, i.e. financial independence. However, independence requires satisfaction of other pre-conditions. Regulators once appointed should have fixed tenure and immunity from removal except in the case of incompetence and moral turpitude.

The government has recently approved the draft Regulatory Reform Bill 2013, which aims to make regulators across key infrastructure sectors accountable to the Parliament and also vests in them, the power to issue licenses (which hitherto lay with the ministries, majorly). Even though there are several issues that remain ignored in the draft Bill but being in consultative phase, it is hoped that the inconsistencies will be corrected in time.

To sum up, institutional independence should not be mistaken as an objective in itself. It should rather be seen as an important pre-requisite for achieving desired effectiveness, economy and efficiency in the system.

Endnotes

1 Burman Anirudh, "the narrative of Independent Regulators", September 04, 2013, source: http:/centreright.in 2013/ 09/the-narrative-of- independent-regulators/#.UIPUu9IzhqV. accessed on October 08,2013

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3 Supra note 1

4 Jain, Sunil, "*Is India's Regulatory System Bust?*", Competition and Regulation in India, 2011- Leveraging Economic Growth through Better Regulation, CUTS, 2012

5 Regulatory Performance: Independence and Competence Matters, 2013, ICRR report

6 "Competition and Regulation in India, 2009" ed. Pradeep S Mehta, CUTS International, 2009

7 "Competition and Regulation in India, 2007" ed. Pradeep S Mehta, CUTS International, 2007

8 Supra note 2

9 Supra note 6

10 http://planningcommission.nic.in/reports/genrep/reg_bill2711.pdf

This Briefing Paper prepared by Jyoti Katiyar, Research Assistant, CUTS Centre for Competition, Investment & Economic Regulation (CUTS CCIER) is based on Chapter 3: 'Regulatory Performance: Independence and Competence Matters' In Pradeep S Mehta (ed.) Competition and Regulation in India 2013: Leveraging Economic Growth Through Better Regulation, Jaipur: CUTS International & CIRC