Regulatory Management and Reform in India*

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Background Paper for OECD

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1. Introduction

Regulation refers to “controlling human or societal behaviour by rules or regulations or alternatively a rule or order issued by an executive authority or *regulatory* agency of a government and having the force of law”.[1] Regulation covers all activities of private or public behaviour that may be detrimental to societal or governmental interest but its scope varies across countries. It can be operationally defined as “taxes and subsidies of all sorts as well as explicit legislative and administrative controls over rates, entry, and other facets of economic activity”.[2] The rules laid down by regulation are supported by penalties or incentives designed to ensure compliance

There are two main theories regarding the genesis of economic regulation. One is the "public interest" theory which conceives regulation as arising from the need to rein in the free exercise of market forces and consumer and producer impulses in cases where such a display can act as an obstacle to the maximisation of societal well being or to remove externally applied obstacles to market forces when their play is desirable. In certain cases, regulation is also justified by this school on equity grounds. An alternative theory is that of ‘capture’ espoused by a variety of realists drawn from varied professional and academic backgrounds who see regulation as being supplied in response to the demands of interest groups struggling among themselves to maximise the incomes of their members.[3] This school, therefore, gives importance to political economy factors which get manifested in the unequal bargaining powers of different vested interest groups which in turn result in their unequal influence over regulatory rules/norms and hence outcomes. In other words, regulation is seen as a tool which can be manipulated by different interest groups to their advantage using their respective bargaining powers with the regulating machinery.

It would be overly simplistic to label one theory as ‘superior’ to the other on the basis of their abilities to characterise reality, given the complexities typifying economic activity. While the ‘public interest theory’ can be defended on normative grounds (i.e. regulation as conceived by it is necessary to maximise welfare and bring about equity) the ‘capture theory’ reflects quite well how regulatory frameworks can be manipulated by powerful interest groups to their own advantage. In other words, the former focuses on what “should be” whereas the latter concentrates on what “could be” in real world situations. The relevance of these schools to real world situations would vary across countries and within each country across sectors depending on the strength of regulatory institutions, often seen as being positively affected by the level of economic development, and the spread and relative strengths of vested interest groups

India started developing regulatory institutions with the introduction of reforms in 1991. But the regulatory environment which has developed over a period of time does not seem homogeneous across sectors. India still ranks very low in terms of the enabling nature of its business environment and unnecessary regulatory burdens are imposed upon business and investors.

The objective of this paper is to evaluate the regulatory structure and status of regulation in India. It is structured as follows. Section 2 explains the rationale for regulation and details its typology. Sections 3 and 4 examine in detail business and sector regulation respectively as well as associated institutional landscapes. Section 5 elaborates on and evaluates the drivers of change in regulation and the underlying institutional landscape. Sections 6 and 7 carry this discussion further by looking at the factors which affect the regulatory environment. The rationale for and current status of interaction between policy makers and regulators is examined in Section 6 while participation of stakeholders in the regulatory process is examined in Section 7.

1. Regulation (2009), Merriam-Webster Online Dictionary, www.merriam-webster.com/dictionary/regulation

2. Richard A .Posner (2004), “Theories of Economic Regulation”, *Working Paper*, No. 41, *Center for Economic Analysis of Human Behavior and Social Institutions*.

3. *Ibid*.

Sections 8 and 9 are devoted to a study of actual regulatory practices prevailing in the Indian economy: practices of sector regulators for tackling market failure and anti-competitive practices (Section 8) and management practices in regulation (Section 9).

Having examined the details of sector regulatory processes through selective illustration, the management of the overall regulatory environment is examined next. Mechanisms for ensuring regulatory coherence are discussed in Section 10; institutional weaknesses leading to gaps between promulgation and implementation of regulation are discussed in Section 11; and the government's plans for the future are elaborated in Section 12. Section 13 examines the gaps in the literature on regulation in India. Section 14 concludes.

2. Rationale for Regulation and its Typology

In its most common context, regulation is an attempt to control or influence private behaviour in the desired direction by imposing costs on or proscribing undesirable behaviour. Since regulation can have important consequences for economic efficiency and private incentives, it is usually justified only under special conditions. Accordingly, there are three sets of justifications for regulatory interventions -- prevention of market failures, restriction or removal of anti-competitive practices, and promotion of public interest. Each set is elaborated below.

- **To prevent market failure**

Market failure is a condition in which the market mechanism fails to allocate resources efficiently to maximize social welfare. Market failures occur in the provision of public goods, in case of natural monopolies or asymmetric information, and in the presence of externalities.

A natural monopoly occurs when an entire market is more efficiently served by one firm than by two or more firms due to increasing returns to scale. Natural monopolies enjoy scale benefits that protect them from competition; entry by other firms tend to lead to inefficient production i.e. the average cost of output is much higher with entry by multiple firms than with the existence of just one firm. In such cases, regulation may be necessary to protect consumer interests. In doing so, regulation might bar the entry of new firms into the sector and protect the monopoly status of the incumbent operator. Examples include water distribution and railway lines.

In India, because of the adoption of regulatory reforms, rising demand and fixed cost reducing technology, telecom is no longer a natural monopoly. The electricity sector was originally a bundled monopoly but unbundling has led to the introduction of competition in certain segments. Two segments, transmission and distribution, are still natural monopolies. The water sector is still a natural monopoly and completely controlled by the government.

Asymmetric information is a situation where one party to a transaction knows more about the product than another. This prevents the market mechanism from achieving an efficient allocation of resources. For example, a patient at a clinic knows less about his ailment and necessary treatment than his doctor, a situation the latter can manipulate to his advantage. This creates a role for regulation of market transactions or provision of information by a third party to remove or minimise information asymmetries. In India, considerable information asymmetries exist in the health and education sector.

Externalities constitute another source of market failure and are defined as the effects of production or consumption activity – positive or negative -- on actors not involved in the relevant product market. For example, an industrial plant discharging waste into a river imposes a negative externality (costs) on users downstream. These costs are not factored into production decisions at the plant but are instead borne by society. Regulation, in such circumstances, may be considered appropriate to restore economic efficiency. Unregulated production and consumption externalities are common in India, as in other developing economies.

- **To check anti competitive practices**

Firms may resort to anti competitive practices such as price fixing, market sharing or abuse of dominant or monopoly power. Laws that empower officials to take action can help deter such practices. Regulation through a set of transparent, consistent, and non-discriminatory rules can create a competitive and dynamic environment in which market players can thrive. In its absence, anticompetitive practices and regulatory failures may not allow the market process to yield socially optimal outcomes.

- **To promote the public interest**

A third set of justification arise from concerns about the promotion of public interest which is an important policy objective for governments. Ensuring fair access, non-discrimination, affirmative action, or any other matter of public importance can provide an important reason for regulation. Some major regulations in this regard in India are:

- Support pricing i.e. government offering to buy wheat or rice from farmers at a price which is higher than the market price

- Public distribution system: supply of food grains at a price which is lower than the market price

- Free distribution of piped water and free power to agriculture – these are regulatory decisions to levy zero tariffs which stem from policy stances

- Free power to agriculture which happens before elections -- a policy with regulatory

Note that public interest regulation can always be manipulated by lobbies to further their vested interests.

2.1 Typology of regulation in India

Post independence, India experimented with a 'socialist mixed economy model' with the state retaining control over the commanding heights of the economy – heavy industries and utilities. While private sector activity was allowed, the government tried to control it through a web of controls such as licensing and quotas in regard to intermediate good imports and outputs. Such controls were complemented by high tariff walls. Thus, the government was not only a producer and regulator of strategic and important goods and services, it also exerted direct control over the output, and sometimes even associated prices, of private sector activity. Given that electoral pressures exerted by various interest groups did affect regulatory actions by the government, such regulation can hardly be labelled as 'independent'.

After 1985, the Indian economy embarked on a process of domestic reform which involved the following elements – delicensing of industries and abolition of output quotas or bounds on outputs of firms, permission for private entry into sectors which were hitherto the monopoly of the government, and liberalisation of quotas and tariffs on capital good imports. From 1991 onwards, liberalisation of the external sector meant that tariff reductions were extended to almost the entire spectrum of merchandise trade and conditions for foreign investment were simplified and liberalised.

The process of domestic reform and external liberalisation is still ongoing. However, the producer profile in various sectors has undergone a significant change with private firms co-existing with government firms in many sectors which were previously government monopolies (e.g. electricity, telecommunications). The consensus among decision makers has been that independent regulation is required in such sectors to guarantee a level playing field. As a result, independent regulators have been constituted in various sectors, starting with electricity and telecommunications, and the number is still on the rise.

However, the consensual nature of decision making in the Indian democracy has also implied that changes in the direction of greater independence and better targeting of market failures have been slow so that the regulatory framework is still complicated. Gradual changes are being ushered in to reduce the level of complexity but elements of such complexity introduced in the period stretching from the country's attainment of independence in 1947 to the 1970s, which in turn can be attributed to the adoption of a 'socialist mixed economy model' for economic development, still remain. However, the regulatory climate in India can still be described as being in transition.

Regulation in India can be mapped under three broad categories: economic regulation, regulation in the public interest and environmental regulation.

2.1.1 Economic regulation

Economic regulation aims at preventing or tackling market failure. This is achieved with rules that proscribe and punish market distorting behaviour. Examples in the Indian context include The Foreign Trade (Development and Regulation) Act, 1992 for facilitating imports into and augmenting exports from India and the Electricity Act of 2003, which allows State regulators to fix tariffs for power consumption, thus preventing suppliers from taking advantage of natural monopolies.

2.1.2 Regulation in the public interest

This covers areas where industries are failing to meet a standard or uphold something of public importance. This is different from market failure. A classic case is of health and safety, where firms can fall short in protecting employees or the general public from harm. Although market competition can make firms more willing to address such issues, the standards adopted may not be adequate or uniform across the industry. In India, there is very little evidence to suggest that competition in its existing form has had a positive impact on quality.

The Bureau of Indian Standards (BIS) created by the Bureau of Indian Standards Act, 1986 has been setting quality and safety standards for various products, some of which are mandatory. The existence of an authority like BIS helps in laying down rules, especially in a situation of low consumer awareness about quality. In fact, mandatory standards can help to enhance quality awareness and protect the consumer. A large number of mandatory standards are in force but the desired extent of enforcement has not been facilitated. Generally, business is more partial to standards developed internally – the so called voluntary standards.

A related problem which calls for public interest regulation is the low level of consumer awareness on issues such as safety, which means there is not enough demand pull to make industry interested in implementing safety standards.

Apart from poor quality and low consumer awareness, skewed income distribution and lack of capacity of majority of the population to pay for essential services might call for regulation in the public interest. In fact this is often the ostensible reason for regulation in the public interest in India.

Yet another reason is the satisfaction of essential needs such as food security. This calls for support pricing of food grains and encourages farmers to maintain a higher acreage under food grain cultivation, thereby enhancing food security. Such produce bought by the government are then sold at prices much lower than the purchase price. The difference between government expenditure on and revenue from food grains is borne by the government as a subsidy burden.

2.1.3 Environmental regulation

Environmental regulation covers actions to protect the environment from harm. A healthy environment is desirable not just on aesthetic grounds but because environmental degradation imposes costs on land, labour and resources that have important consequences for economic development. Unsafe water, unhealthy air, species and habitat loss, and degradation of soil are some concerns with real world effects sought to be addressed through environmental regulation.

In India, environment protection has been given constitutional status. The Directive Principles of State Policy state that protecting and improving the environment is the duty of the State as well as citizens of the country. The Government of India has enacted various laws to protect the environment through the Environment (Protection) Act, 1986 as the umbrella legislation. These set standards for emissions and discharge; regulation of the location of industries; management of hazardous waste, and protection of public health and welfare.

According to the Act the term 'environment' includes water, air and land and the inter-relationship among and between them. A policy framework to complement the legislative provisions has also been developed. Further, sector specific policies have also been evolved.

Under the EPA, statutory clearances relating to pollution control and the environment are necessary for setting up units in 31 categories of industries. This list includes petrochemical complexes, petroleum refineries, thermal power plants, cement, fertilizers, bulk drugs, dyes, papers etc.

Such environmental clearance is not necessary for projects requiring investment less than Rs. 1 billion (approximately $20 million), except in cases of pesticides, bulk drugs and pharmaceuticals, asbestos and asbestos products, integrated paint complexes, mining projects, tourism projects of certain parameters, tarred roads in Himalayan areas, distilleries, dyes, foundries and electroplating industries[4]. However, setting up industries in certain locations considered ecologically fragile (e.g. Aravalli Range, coastal areas, Doon Valley, Dahanu etc.) is guided by separate guidelines issued by the Ministry of Environment and Forests.

[4]. *www.indembassy.org.pe/ecorelations2008/fdiprocedure.html#10*

Ministry of Environment and Forests is the nodal agency for environmental legislation. However, several states have also enacted their own legislation besides the major ones enacted by the central Ministry. The State Pollution Control Board (SPCB) established in each state, is responsible for implementing these legislations as well as issuing rules and regulations prescribing the standards for a clean environment. The activities of SPCBs are coordinated by the Central Pollution Control Board (CPCB).

Environmental clearances for investment projects in India take a huge amount of time, and for certain types of investment projects such as power, the number of approvals required is higher than for others. Environmental issues around any industrial project are highly sensitive and quite often lead to civil society activism.

Therefore, this aspect requires careful handling both by the central and state governments. Due to corruption, administrative delays, technical faults, popular protests etc., such clearances are time consuming and costly.

2.2 Listing of major regulations

Some major regulations – economic or in the public interest – enforced in India are listed below:

Table 1. List of major regulations in India

Act	Purpose
Securities Contracts (Regulation) Act, 1956	To prevent undesirable transactions in securities by regulating the business
The Foreign Exchange Management Act (FEMA), 1999	To facilitate external trade and payments and to promote the orderly development and maintenance of the foreign exchange market.
The Foreign Trade (Development and Regulation) Act, 1992	To provide for development and regulation of foreign trade by facilitating imports into and augmenting exports from India and for matters connected herewith.
The Industries Act, 1951	To empower the Government to take necessary steps for the development of industries; to regulate the pattern and direction of industrial development; and to control the activities, performance and results of industrial undertakings in the public interest.
The Indian Contract Act, 1872	Governing legislation for contracts, which lays down the general principles relating to formation, performance and enforceability of contracts and the rules relating to certain special types of contracts like Indemnity and Guarantee; Bailment and Pledge; as well as Agency.
The Sale of Goods Act, 1930	To protect the interest of buyers and sellers.
Indian Patents Act, 2005	To grant significant economic exclusiveness to manufacturers of patented products with some in-built mechanisms to check extreme causes of competition restriction.
The Company Act, 1956	To regulate setting up and operation of companies in India: it regulates the formation, financing, functioning and winding up of companies.
Competition Act, 2002	To ensure a healthy and fair competition in the market economy and to protect the interests of consumers: aims to prohibit the anti-competitive business practices, abuse of dominance by an enterprise as well as regulate various business combinations such as mergers and acquisitions.

Act	Purpose
The Trade Marks Act, 1999	To amend and consolidate the law relating to trade marks, to provide for registration and better protection of trade marks for goods and services and for the prevention of the use of fraudulent marks.
The Information Technology Act, 2000	To provide legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication, commonly referred to as "electronic commerce", which involve the use of alternatives to paper-based methods of communication and storage of information; to facilitate electronic filing of documents with Government agencies
The Consumer Protection Act, 1986 (amended 1993, 2002) COPRA	To protect consumer rights and providing a simple quasi-judicial dispute resolution system for resolving complaints with respect to unfair trade practices.
The Industrial Disputes Act, 1947	To facilitate investigation and settlement of all industrial disputes related to industrial employees and employers.
The Factories Act, 1948	Umbrella legislation to regulate the working conditions in factories.
The Indian Trade Unions Act, 1926	To facilitate the registration of trade unions, their rights, liabilities and responsibilities as well as ensure that their funds are utilised properly: it gives legal and corporate status to registered trade unions and also seeks to protect them from civil or criminal prosecution so that these could carry on their legitimate activities for the benefit of the working class.
The Bureau of Indian Standards Act, 1986	To set standards (quality, safety etc) for various kinds of products to protect consumer safety.

3. Institutional Landscape for Business in India

Business regulation, as we have defined it, is regulation that cuts across sectors. In certain cases, business regulation is discriminatory in nature and treats different sectors differently. Our definition of 'business regulation' also encompasses 'industrial regulation'.

3.1 Business regulations enforced by the Government of India

The liberalisation of industrial and trade policies during the 1980s was accompanied by an increasingly receptive attitude towards regulatory reforms. The Industrial Policy Resolution of 1956 and the Statement of Industrial Policy of 1991 provides the basic framework for the overall industrial policy of India. Reforms which are being progressively implemented relate to investment licensing, taxation, particularly indirect taxation, prices and distribution systems, and trade. We outline below some regulatory requirements that cut across states:

3.1.1 Licensing

With progressive liberalisation and deregulation of the economy, industrial licensing requirements have been eliminated except for certain select sectors. Industrial policy reforms have also removed restrictions on investment and expansion and facilitated easy access to Foreign Direct Investment (FDI). Areas earlier reserved for the public sector have mostly been opened for private sector participation as well. Notable exceptions are atomic energy and railways which are still exclusively reserved for the public sector. However, licensing is mandatory in the following cases:

- Industries retained under compulsory licensing (alcoholic drinks, cigarettes and tobacco products, electronic, aerospace and defence equipment, industrial explosives, hazardous chemicals such as hydrocyanic acid, phosgene, isocynates and di-isocynates of hydro carbon and derivatives, and drugs and pharmaceutical (according to modified Drug Policy of 1994 as amended in 1999).

- Manufacture of items reserved for the small-scale sector: Small-scale undertakings are those units, which involve an investment of not more than INR 50 million (approx. US$ one million) in fixed assets such as plant and machinery. There are 21 items reserved for the small scale sector ranging from the food and allied industry to plastic and chemical products. Small scale industries (SSI) units enjoy a number of concessions such as tax exemptions/concessions, inapplicability of labour laws etc.

- Industrial undertakings located within 25 kms of the standard urban area limit of cities having a population of one million and above as per the 1991 census require an industrial license unless the unit is located in an area designated as an industrial area before 1991 or belongs to non-polluting industries such as electronics, computer software, printing and other specified industries.

The list of items reserved for SSI is ratified by the Central Government and industrial licenses are granted by the Secretariat for Industrial Assistance (SIA), Government of India on the recommendation of a Licensing Committee. Industrial undertakings exempted from industrial licensing need to file only Industrial Entrepreneur Memoranda (IEM) with the SIA.

Once an investor gets central approval, it needs to approach the relevant state government for allotment/acquisition of land, permission to change land use, approval of building plan, release of water and electricity connections etc.

3.1.2 Tax regulation

As India is a federal State, taxes are levied and regulated by both Central and State governments. However, the respective authority of Central and State governments is clearly demarcated. The Central Government levies and regulates income tax, customs duties, central excise and service tax.

Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC) are part of the Department of Revenue under the Ministry of Finance, Government of India and deal with matters relating to levy and collection of direct and indirect taxes respectively. These are also responsible for policy formulation and administration of various related matters.

The State governments levy and regulate value added tax (VAT), state excise, stamp duty and taxes on professions and land while local bodies are empowered to levy and regulate tax on properties and utilities like water and drainage etc.

After reforms, tax rates have been rationalised and tax laws have been simplified resulting in better compliance, ease of tax payment and better enforcement. There are specific statutes for different taxes. Central tax statutes are passed by the Parliament and state tax statutes by the respective State Assemblies. Tax rates and duties are reviewed annually through budgets.

Business entities residing in India are taxed on their world wide income arising from all sources in accordance with the provisions of the Income Tax Act while non-resident entities are taxed on the income earned from a business connection in India or from other Indian sources. A business entity is deemed to be a resident if it is incorporated in India or its control and management is situated entirely in India.

In order to facilitate the computation of reasonable, fair and equitable profits and tax burdens for business carried out by multinational companies, there are provisions relating to transfer pricing. Transfer pricing is the process of adjusting the prices of cross-border transactions between related parties. The transfer pricing provisions generally follow OECD guidelines. However, there are certain fundamental differences.

To facilitate proper planning and avoid any future disputes under the Income Tax Act, a non-resident can approach the high powered Authority for Advance Rulings (AAR) to determine the income tax aspects of any proposed or current transaction. AAR can also be sought by a resident to determine the tax liability of a non-resident with whom transaction has been made or proposed.

India also has Double Tax Avoidance Agreement (DTAA) with various countries and tax rates are determined by such agreements. While calculating tax liability, domestic companies are granted credit on foreign tax paid by them. India has entered into a DTAA with various sovereign states. However, the government is planning to expand the scope of this cooperation by entering into DTAAs with non-sovereign territories such as Hong Kong, Taiwan and the Cayman Islands. Such treaties will come in handy for the revenue department when Indian firms enter into cross-border deals.

Policy on incentives

Tax incentives are provided for corporate profits, accelerated depreciation allowances and deduction of certain expenses, subject to certain specified conditions. These incentives are provided for new investments in infrastructure, power distribution, industrial parks or special economic zones (SEZ), mineral oil, food processing, rural hospitals etc.

Indian states also give a number of incentives for attracting investment (domestic as well as foreign) such as tax concessions, exemptions on the payment of electricity charges, registration fee, and stamp duty. In addition to this, concessions on land are also provided. There is a strong competition among the states for investment. Often many incentives at many levels create confusion among potential investors. The following general fiscal incentives are provided for SEZs:

- Exemption from custom and excise duty.
- Excise duty drawbacks
- Exemption from service tax, securities transaction tax and taxes on the sale or purchase of goods other than newspapers.
- Income tax concessions
- Sales tax holiday for the prescribed period by the state government.

3.1.3 Foreign exchange regulation

Foreign exchange controls have been liberalised after reforms. The rupee is fully convertible on the current account and almost fully convertible on the capital account for non-residents. Profits earned, dividends and proceeds out of the sale of investments are fully repatriable for FDI.

The Reserve Bank of India administers the Foreign Exchange Management Act 1999 (FEMA) which regulates transfer or issue of any security by a person resident outside.

3.2 State government business regulations

The State governments deal with subjects of law & order, agriculture, irrigation, water supply, electricity, roads, minor ports, health, education, VAT etc. under its exclusive jurisdiction. With liberalisation, the entrepreneurs mainly require to interact with state governments and local bodies to seek various regulatory approvals and for getting land and necessary infrastructure. Therefore, the state government's role and practice becomes important in the implementation of the project. In this context, red tape is an important factor constraining project implementation.

At the state level, there are regulatory constraints manifested in opaque and burdensome labour laws, inefficient land acquisition process and poor implementation of policies and procedures which are subject to political underpinnings and administrative inefficiency. Often, there is a disconnect between laws and implementation. For example, in Special Economic Zones, the function of administering compliance with labour laws is vested in the Development Commissioner of the Zone. Yet in some zones, visits from inspectors of the State Labour Department continue to take place.[5]

In general, the following regulatory approvals are required at the state level for setting up a unit (Table 2 captures these as well as those required from the Central Government):

[5]. An Assessment of Potential Costs and Benefits of SEZs in India (p. 58) *www.cuts-citee.org/pdf/RREPORT07-05.pdf*

Table 2. Approvals/clearances required for doing business and corresponding agencies granting the same

Approvals/Clearances required	Department/Agencies to be approached and consulted
Incorporation of Company	Registrar of Companies, Ministry of Corporate Affairs
Registration/IEM/Industrial license	DIC for SSI/SIA, Department of Industrial Policy & Promotion for large and medium industries
Allotment of land	Concerned State DI/SIDC/Infrastructure Corporation/ SSIDC
Permission for land use (In case industry is located outside an approved industrial area)	State DI Department of Town and Country Planning Local authority/District Collector
Consent under Water and Air Pollution Control Acts Environment Impact Assessment	State Pollution Control Board Ministry of Environment and Forests, Government of India
Approval of construction activity and building plan	a. Town and country planning b. Municipal and local authorities c. Chief Inspector of Factories d. Pollution Control Board
Sanction of Power and power safety	State Electricity Board/Companies and state electricity inspector
Use and storage of explosives	Chief Controller of Explosives
Manufacturing pharmaceutical products.	Drugs Inspectorate
Boiler Inspection	Chief Inspector of Boilers
Finance	SFC/ State Industrial Development Corporation for term loans For loans higher than Rs. 15 million, all India financial institutions like IDBI, ICICI, IFCI etc.
Registration under State Sales Tax Act State Excise Act Central Excise Act	i. Sales Tax Department ii. State Excise Department iii. Central Excise Department.
Extraction of Minerals	State Director of Mines and Geology
ISI (Quality) Marking	Regional Office of the Bureau of Indian Standards (BIS)
Quality Marking Certificate	Quality Marking Centre of the State Government
Labour Act	Labour Department
Weights and Measures	Inspector of Weights and Measures
Code Number for Export and Import	Regional Office of Director General of Foreign Trade.

Note: SIDC: State Industrial Development Corporation; SSI: Small Scale Industries; SIA: Secretariat of Industrial Assistance; SSIDC: Small Scale Industrial Development Corporation; SFC: State Finance Corporation; DIC: District Industry Centre; GOI: Government of India; IDBI: Industrial Development Bank of India; ICICI: Industrial Credit and Investment Corporation of India; IFCI: Industrial Finance Corporation of India.

- Land acquisition and building plan approval by local body.

- Permission under Factories and Boilers Act from the Inspectorate of Factories and Boilers.
- Permission from Inspectorate of Electricity for safety of power systems.
- Permission from State Pollution Control Board for certain types of industries.
- Approval from the Labour Department.
- Approval from Drugs Inspectorate for manufacturing pharmaceutical products.
- Power connection from the State Electricity Board[6]
- Water supply connection from the local body/water authority or the relevant agency.[7]

At the state level, the Directorate of Industries is the nodal agency for guiding new investors. It provides an interface between the investor and other agencies to assist the former to get different approvals and clearances from various state level departments.

Table 3. Business registration process

Company Formation ↓
Obtaining approval for the proposed name of the Company from the Registrar of Companies ↓
Drawing up the Memorandum and Articles of Association ↓
Getting the appropriate persons to subscribe to the Memorandum (a minimum of 7 for a public company and 2 for a private company ↓
Submitting papers for Registration & Payment of Registration Fee to the Registrar of Companies ↓
Receipt of Certificate of Incorporation ↓
Obtain a certificate of commencement of business from the Registrar of Companies in case of a public limited Company

The first obstacle that investors face in the implementation period is the tedious and time consuming procedure of business registration (see Figure 1). While rules across states are more or less the same, there are differences in practice, efficiency levels of the bureaucracy and political factors. Typically, approvals in most states take about 2 months (sixty days); however, in some states approvals can take between 7 and 12 months. Land acquisition and land allotment is a very sensitive issue and has political overtones. However, the Government of India is planning a comprehensive policy on land use, including rehabilitation and resettlement of displaced people. To achieve this, the government is considering amending the Land Acquisition Act of 1894.

6. Most of the electricity companies in states are under government ownership and control.

7. Water supply is also under government ownership and control except in rare cases.

3.3 Trends

The economic reforms in India have improved the overall business environment through market oriented policies. With the implementation of various reforms, India is certainly becoming an attractive destination for doing business. However, certain factors such as institutional imperfections (multiplicity of procedures, bureaucratic delays in business registration etc) and lack of business friendly regulation and policies adversely impact business and prevent it from realising its true potential.

Domestic regulations are viewed as excessive and burdensome. However, the central government and various state governments are reforming their policies though the process of decision making is still very slow and not clear. In spite of a highly structured legal system, dispute settlement and contract enforcement procedures remain time consuming due to the overburdened and understaffed judicial machinery.

Various regulatory obstacles to business lead to a very low ranking for India (122nd out of 181 economies in "ease of doing business" according to The World Bank's *Doing Business 2009* report) in business indicators. Though there has been some improvement over time, multiplicity of procedures and clearance granting agencies still remains, especially at the state level

4. Sector Regulation in India

Because of market failures induced by anti-competitive actions or specific technical characteristics, the development of the sectors cannot be left to unregulated markets. Thus, some form of regulation of the market process is needed. Sector regulators are important as individual sectors have their own characteristics which, in turn, determine the nature of regulation. These provide orderly procedures and protect consumer and investors from market failures and anti-competitive actions in a particular sector.

Before the reforms of 1991, government owned monopolies provided most of the infrastructure and utilities. "These monopolies were established under the rationale that facilities required for rendering infrastructure and utilities are natural monopolies and a single provider would offer these services more economically. It was believed that vertically and horizontally integrated units would be better placed to provide these core services. It was also believed that monopoly power in such core areas should rest with the public sector to protect the consumer from exploitation by the profit motive of a private provider."[8]

The above model did not work for long and led to operational inefficiencies and poor quality of service which forced the government to alter its stance. The government introduced reforms in 1991 after realising that market forces and competition can improve the production and delivery of services without affecting economies of scale.

The present Indian regulatory system owes its origins to the mentioned processes of liberalisation, privatisation and globalisation initiated in 1991 as well as the more limited domestic reforms which preceded these in the eighties. Prior to 1991, public interest was sought to be served more through direct regulations that required the prior approval of government for many commercial decisions. Post 1991, in most sectors of the economy, the protection of public interest objectives rests with laws governing competition and regulatory regimes that have been set up for natural monopolies and network industries.

[8]. O.P. Agrawal "Role of Independent Regulation in Economic Reforms" http://www.teriin.org/upfiles//pub/papers/ft25.pdf

"Government efforts have been progressive in promoting competition in the market place. In some areas such as telecom, civil aviation, insurance, railway container traffic, gas distribution etc, government monopolies have been curbed by allowing the private sector to enter. However, if one examines each sector in detail we find that principles of competitive neutrality (providing a level playing field) have been given the short shrift. In the airline sector, there is some evidence of the reverse – the public sector incumbent has been hamstrung in acquiring new aircrafts, while private players have galloped home."[9]

Regulatory trends can be better evaluated by examining performance indicators in business regulation and regulation of key infrastructure sectors.

4.1 Trends

Each sector might have its exclusive regulatory law and policy which is shaped by sector realities. Thus, the telecom regulator might advocate for the lowering of entry barriers (for example, multiple and cheaper licenses) to promote competition; however, the water sector might be regulated appropriately to maintain the natural monopoly of the state. While policies/regulations relating to market reforms which apply to the economy as a whole are important, so are sector specific ones. Sector regulation can take account of specific technical nuances that characterise a sector and modify the behaviour of actual and potential participants.

Table 4. Status of sector specific regulations[1]

S. no.	Sector	Status of regulation
1.	Power	Electricity Regulatory Commissions (ERC's) exist in almost all states and at the centre.
2.	Energy	There is no energy sector regulator.
3.	Oil & Gas	The Petroleum & Natural Gas Regulatory Board (PNGRB) regulates refining, processing, storage, transportation, distribution and marketing of petroleum products.
4.	Coal	The government owns the operators, the coal companies, and regulates.
5.	Telecom	Telecom Regulatory Authority of India (TRAI). Facilitates competition through regulation and introducing pro-consumer elements relating to quality and access.
6.	Ports	Tariff authority for Major Ports (TAMP), having limited authority in determining tariffs for major ports. There is no recourse, or performance standards, or consumer protection or competition.
7.	Airports	The Airport Authority of India (AAI) is an operator and regulator of airports; and the Director General of Civil Aviation (DGCA) along with the Bureau of Civil Aviation Security is responsible for safety and technical aspects.
8.	Roads	There is no regulatory authority as such and the National Highways Authority of India (NHAI) acts as one
9.	Railways	The government owned Indian Railways is both operator and regulator
10.	Water supply and sanitation	There is no regulatory authority. Central Ground Water Authority exists for control of ground water, pollution control and protect environment.
11.	Social sector	The social sector is lacking in any independent and transparent regulation. Higher education is regulated by the autonomous bodies like UGC, AICTE and self-regulatory bodies. Independent Regulatory Authority for Higher Education (IRAHE) is under consideration.

1. Note: "Eleventh Five Year Plan (2007-2012)", Volume I, *Inclusive Growth, Planning Commission*, Government of India.

[9]. "Competition and Regulation in India 2007" edited by Pradeep S. Mehta, CUTS International.

Before reforms the important sectors, including infrastructure and public utilities, were regulated by the immediate line ministries which were also the operators. The rationale for not allowing private participation was the urgency to expand service coverage towards universality. However, the shortcomings of state ownership became increasingly visible with time.

After reforms, the government made a paradigm shift in its policies and governance structure in some key infrastructure sectors. Specialised regulatory agencies were established in the telecom, electricity and oil & gas sectors. However, outcomes so far have been mixed and in many cases have fallen short of expectations, one important reason being the lack of actual independence of regulators despite legislative provisions. The status of regulation in different sectors is explained through Table 4 above.

The issue of independence of regulators is important in almost all these sectors as the government holds a major share in operations leading to the problem of competitive neutrality. Independence and accountability are properties that are required for good regulatory governance. 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.

4.2 Sector studies

This section delves into the mentioned issues through a study of the telecom, power, and higher education sectors. These sectors illustrate a case each of regulatory success (telecom), partial success (power) and failure (higher education).

4.2.1. Telecom

The achievements of the Indian telecom industry are considered a landmark achievement of the reform process. Since liberalisation, India has seen growth in the cellular network take off and tariffs fall across the board. The impact of reforms and successful regulation are quite visible in this sector.

The reforms in the telecom sector were initiated in 1992. However, the independent regulator, TRAI (the first independent regulator in India) could be established only in 1997, after five long years. After the establishment of TRAI, there have been definite changes in this sector. TRAI was supposed to ensure proper functioning of markets and protect consumers. However, the power to issue licenses remained with the government.

Since the inception of TRAI, its independence has often been challenged. For a regulator to be independent in the true sense it needs to have functional and financial independence from the government. In the case of TRAI there has been a weakening of functional independence over time. Political barriers to such independence are quite evident from a study of the sector's regulatory history, as relations between the government and the TRAI have been characterised by a rollercoaster ride.

TRAI's independence to take decisions relating to key policies and licensing has always been limited by the government. For example, the Department of Telecommunications (DoT) has made various decisions without even seeking consultations with TRAI. In 2000, the bruising disputes and turf battle between DoT and TRAI ultimately led to a legislative decision to clip the wings of the latter. While the new legislation of 2000 ostensibly made an attempt to re-establish a credible regulator, the new Act led to weakening of the security of tenure for the chairman and members of TRAI. The term of the authority was reduced to three years from five years. The conditions for the removal of any member of the authority or its chairman were also made less stringent.

"At that time, independent economic regulation was at a nascent stage in India. The experience with TRAI made the government extra cautious while delegating functional independence to regulatory authorities. In the amended Act, the government assigned itself overriding powers to issue policy directives and supersede the Authority in certain situations. The government still continues to the be the policy maker and seller of telecom operating licenses while it also owns India's biggest telecom company, BSNL."[10]

Another dimension of independence relates to financing of the regulatory body. As mentioned, if there is no assured and independent funding for the regulator, its decision may be constrained due to its dependence on the government, thus introducing scope for abuse and manipulation. TRAI has been weak on this front also as it has had to depend on the line ministry for funding.

Again, as mentioned, a regulator also needs to be transparent and accountable to consumers. The prime purpose of a regulator is to defend and promote consumer choice, welfare and quality of service. TRAI has made efforts to buttress participation by regularly consulting consumer groups among other things. But consumer participation is lacking as mostly service providers attend these meetings and very few consumer groups participate actively. TRAI is not authorised to impose penalties and therefore all its directives are not followed by operators.

However, despite these inadequacies, TRAI has been successful in widening access and reducing price by introducing competition in the market.

4.2.2. Power

Given the importance of the government's role in the electricity market, it is not easy to identify the impact of regulators. So what we get at best is a fragmented view. The view that we do get is that regulation in the electricity sector has not been effective. The reason is the persistent refusal by the political class to view electricity as a private good and therefore empower the regulators properly. The very concept of independent regulation has still not been fully accepted.

In the pre-reform period, the power sector was dominated by the state. Power generation and distribution throughout the country was controlled by state owned enterprises. In the early 1990's India opened this sector to private investment recognising that the public sector alone was unable to generate the required resources. To attract private investment, the need to create an appropriate regulatory environment that minimises unwanted political interference in the sector was felt.

[10]. "Comparative study of regulatory framework in Infrastructure sector: Lessons for India", CUTS C-CIER.

As a follow up, independent regulatory agencies -- Central Electricity Regulatory Commission (CERC) and State Electricity Regulatory Commissions (SERCs) -- were constituted at the central and state levels respectively. The major regulatory functions of these bodies were licensing, setting tariffs, ensuring maintenance of service standards and promoting competition in the sector. Later, the government enforced the Electricity Act, 2003 for further reforms in the sector.

However, outcomes across states have not been very encouraging as political interference has adversely affected the quality of regulation. As electricity is an essential service and used by all sections of society, it provides wide scope for electorally profitable political intervention in the regulatory decision making process. As a result, decisions relating to tariffs and investment have been highly influenced by political interests. A review shows that the regulatory system in this sector lacks independence, accountability, transparency and stakeholder participation[11].

A regulator needs independence from the government to discharge its functions in a free and transparent manner. On paper, the role of the government (central as well as state) is to issue appropriate policy guidelines in consultation with the respective regulator but there are overlaps in the respective jurisdictions of the government and regulators. For example, ERCs are empowered to fix tariffs for end users but the government has not allowed them to determine tariff at their discretion. The Act allows the state governments to provide subsidy to deserving consumers but the respective governments have to pay the subsidy amount in advance to the utility. In practice, the governments provide subsidy but do not make equivalent payment to the utility which adversely affects it financial health and quality of service.

An important aspect of regulatory independence is financial independence. Dependence on uncertain budgetary allocations reduces the independence of regulatory bodies. “In India, ERCs, with few exceptions, depend upon state exchequers although the Electricity Act 2003 empowers them to generate revenue through license fees etc. The lack of financial independence also leads to problems relating to quality and capacity of personnel. The ceiling on salaries imposed by governments prevents the ERCs from appointing quality personnel. At the same time, financial constraints prevent them from conducting adequate training programmes to enhance the capacity of their staff.”[12]

Policy guidelines require regulatory bodies to adopt transparent and participatory decision making processes. The ERCs provide a platform for consumer participation in the decision making process but due to lack of awareness and inadequate capacity of consumers, public participation has been weak.

However, on the brighter side, ERCs have been successful in ensuring fast redressal and this in turn has led to an improvement in the quality of service. To sum up, political issues have played a very important role in the regulation of this sector; by and large, political interests have been able to regulate the regulators. However, ERCs have been able to augment transparency and accountability to some extent.

4.2.3. Higher education

Higher education in India is going through a transitory phase with rapid changes in a sector used to stagnation. However, the changes are not uniform; two contrasting trends are emerging in higher education with a rapidly expanding private sector at one end, and a public sector at the other in terminal decline. The regulatory system has failed to hold new private institutions to standards while erecting formidable barriers to competition and quality.

[11] “Competition and Regulation in India 2009” ed. Pradeep S Mehta, CUTS International, 2009

[12] “Competition and Regulation in India 2009” ed. Pradeep S Mehta, CUTS International, 2009

The sector is tightly controlled by the government and as a result, regulatory bodies are poor at enforcement. In effect, the University Grants Commission (UGC), professional councils, a few research councils and state governments are the main regulators of the higher education sector. In addition, there are almost fifteen ministries/departments in the Government of India that establish, finance, or regulate higher education institutions and hence interfere in their working.

"The government has not armed regulatory bodies with the powers mandated by the Constitution. The regulatory bodies have also failed to devise a mechanism at their own level and have not framed appropriate rules and regulations; they have also not developed a system of supervision and control over the institutions they are required to deal with. These bodies have been hampered by low levels of independence, both functional and financial, in discharging their functions. For example, the UGC is vested with the responsibility of coordination and provision of funds and, determination and maintenance of standards in higher educational institutions. The UGC does not have the means to control the quality of teaching and recruitment of faculty, ensure minimum infrastructure for all institutions and engage in the monitoring and promotion of research."[13]

In all, the higher education institutions and regulatory bodies are maintained and funded by the government and key appointments are also made by the government. This enables the government to have a final say on major issues.

To improve the regulatory environment in this sector, the National Knowledge Commission (NKC), an expert group, has recommended the establishment of an Independent Regulatory Authority for Higher Education (IRAHE) that would be an umbrella organisation founded under a separate statutory act. The IRAHE is expected to foster competition as well as accountability in institutions.

The IRAHE would be the only agency to accord degree granting power to higher educational institutions and monitor standards, settle disputes, and license accreditation agencies. IRAHE would provide single window clearance and replace multiple existing regulatory agencies which have often been inconsistent in their adherence to principles.

To sum up, regulatory reforms are important for attracting investment to creation of infrastructure and promoting consumer satisfaction to the extent possible. In India, (so called) independent regulators have been established in certain sectors but the government has continued to encroach on the domains of various regulators in the name of achieving policy objectives. A clear distinction between policy and regulation and its use in practice is required.

Coordination between the regulator and the line ministry is missing. Rather the line ministry has tried to limit the regulator's independence. In some cases, the line ministry continues to be answerable to the legislature even for functions that have been transferred to the regulator. This makes the line ministry continue to want to perform the same functions and interfere in the domain of the regulator, which impairs regulatory functioning and consequently, its efficacy.

Regulation in India has certainly not matched the naive expectations of the designers but it has led to a process of re-thinking governance, opening doors to the construction of regulation as a new democratic space.

[13] Ibid

5. Drivers of Change

The reforms in India deregulated domestic business and gradually reduced tariffs to integrate India into the global economy. But the policymakers have, by and large, not made radical moves to alleviate the bottlenecks constraining competition in markets.

Nevertheless, economic reforms have been a continuous process in India. Various obstacles to doing business imposed at the national level have been removed. But the procedures at the State level are still very cumbersome and time consuming leading to delay in project implementation.

Within the government, various key drivers of change can be identified in regard to the regulatory scenario. An important driver is the political and administrative leadership at the Centre embodied in the Prime Minister, the Finance Minister and high ranking officials of his ministry, the Commerce Minister and high ranking officials of his Ministry etc. Given that regulations have to be passed by majority vote in Parliament where multiple parties are represented, the various leaders of important political parties can often play an important role in inducing regulatory change. Similarly, given the important role played by the Planning Commission of the Government of India in the economic affairs of the country, its Deputy Chairman and Members can also serve as key drivers.[14]

Some regulations are also enacted at the state level as mentioned above. In regard to these the drivers of change are very similar to those at the centre.

One of the key development priorities of the government is to improve the quality of government-business interface at all levels across ministries. The government has assigned a great deal of importance to initiate a range of regulatory reform initiatives to fast track private sector investments and enable significant cost savings for the private sector.

5.1 Business regulation

The business environment in India has a number of problems that adversely impact business. Aside from persisting bureaucratisation leading to delay in approvals and clearances for business and structural factors such as poor quality of infrastructure, there are some policy and legal constraints that affect business.

Bureaucratisation of procedures is being gradually reduced with a corresponding reduction in the number of government employees. However, it is often the mind set and work culture of the government employees which creates problems. In spite of policies being framed to reduce bureaucratisation, the “go slow” attitude remains deeply embedded in the country’s bureaucratic culture which cannot be changed overnight. Only a gradual transformation is possible.

5.1.1 Plethora of regulations

The investment climate in any economy is determined by a mix of factors. Out of these one very important factor is the regulatory framework. The regulatory framework in India, particularly at the state level, has not been conducive for business, either at the entry stage or during operations.

[14]. The Prime Minister is the Chairman.

Among the major impediments to the improvement of the business environment are business regulations/legislations originally formulated under the ‘command and control’ regime - relics which have outlived their utility as India has become increasingly market oriented with time. A plethora of inspectors and government authorities continue to exercise wide discretionary powers, nailing business from their inception for minor procedural lapses. To illustrate the consequences, on an average starting a business in India takes twice as long as that in the region and OECD (Table 5) because of various rules and regulations, formalities and procedures. Enforcement of these regulations and associated licenses unnecessarily hampers the smooth operation of business, and thereby unnecessarily increases the transaction costs of doing business, thus putting India at competitive disadvantage.

Table 5. Doing business in India: a comparison[1]

Activity	Location	Procedures	Time (Days)	Cost (% of GNI per Capita)
Starting a Business	India	13	33	74.6
	Region	7.6	33.4	40.7
	OECD	6.0	14.9	5.1
Dealing with Licenses	India	20	224	519.4
	Region	16.3	247.3	3230
	OECD	14	153.3	62.2
Registering Property	India	6	62	7.7 (% of Property Value)
	Region	6.4	134.1	6 "
	OECD	4.9	28	4.6 "
Enforcing contract	India	46	1420	39.6 (% of Claim)
	Region	43.5	1047.1	27.2 "
	OECD	31.3	443.3	17.7 "
Activity	Location	(Recovery percent)	Time (Years)	Cost (% of GNI per Capita)
Closing a Business	India	11.6	10	9 (% of estate)
	Region	20.1	5	6.5 "
	OECD	74.1	1.3	7.5

1. Doing Business 2008: World Bank Report.

An unfriendly regulatory climate poses certain costs for business and reduces private investment. Indian states have improved considerably over the years but there are wide variations in facilitating business across states. Government efforts are marked by an absence of strategic thinking: there is no effort to identify, map and review business regulations that are more cumbersome than others and can be done away without too many legislative hurdles. The government is expected to take steps to develop a decisive and integrated action plan to enhance transparency, simplify bureaucratic procedures and modify or scrap regulations. Regulatory impediments need to be properly articulated and acknowledged and measures taken to minimise their adverse effect on the functioning of business.

5.1.2 Processing systems

There is multiplicity of procedures and many agencies deal with clearances especially at the state level. First, an investor has to seek approval and clearances at the central level. Once it gets central approval, it needs to approach the state governments for allotment/acquisition of land, change in land use, approval of building plan, release of water and electricity connections etc.

At the central level, for assisting foreign investors, the Foreign Investment Implementation Authority (FIIA) has been established in the Department of Industrial Policy and Promotion (DIPP) of the Ministry of Commerce and Industries to provide assistance in securing approval or tackling operational difficulties. The FIIA is assisted by sector-specific Fast Track Committees (FTCs) of the Government for monitoring and resolution of difficulties faced by sector-specific projects. A FTC is headed by the lead Administrative Ministry and includes representatives from all agencies, including the State government, concerned with implementation of the project. Specific responsibilities to follow up FDI cases in various states have been given to different senior officers of the Department who need to bring any difficulty in implementation to the notice of the FIIA.

As mentioned, states compete with each other to be preferred destinations for business investment from domestic as well as foreign entrepreneurs. State governments have taken initiatives to identify and remove avoidable roadblocks in this regard. Most states have set up single window services and investor escort services to provide a single point of contact to investors for all regulatory procedures. These help the investor in information collection, identification of project sites, conduct of feasibility studies, clearance of the project by financial institutions, etc. However, single window service often does not help in reality due to poor political commitment, bureaucratic inefficiency and corruption at all levels.

5.2 Sector regulators

Independent sector regulation is a relatively new development in India. After economic reforms, sector regulatory authorities have been set up in various sectors to produce competitive outcomes, i.e. foster greater efficiency in resource allocation and consumer welfare through promotion of competition.

India has regulators for telecom, power, ports and petroleum with a variety of powers to implement their brief which differ widely across sectors. Some regulators, such as TRAI, have been specifically mandated to regulate the entire sector as a whole and even recommend the timing of entry of players, licensing conditions, spectrum management etc. Similarly, the central/state electricity regulatory commissions issue licenses which enable entities to transmit, distribute or trade in electricity and enjoy other powers such as rule making, enforcement, imposition of penalties etc. However while one of the important functions of the telecom regulator is to promote competition, this is not a function specifically assigned to the electricity regulator.

Others such as Tariff Authority for Major Ports (TAMP) have powers that are more limited than both the electricity and telecom regulator as these only have the mandate to fix tariffs. Yet others such as regulators of professional services provided by lawyers and doctors are different in nature as these perform different functions such as setting and enforcing quality of service standards to protect consumer interests.

Other differences also exist across regulators. While both telecom and power have appellate authorities where appeals against the regulator's decision can be made, most other sectors have a specialised form of appeal. Further, the tenure of regulators varies between 3 to 5 years across sectors and even the selection process is not uniform across sectors.

"Thus, the existing regulatory framework in India has been developed in a haphazard and uneven way across and within sectors of the economy resulting in inadequate and expensive reforms."[15] This diversity can be explained by the fact that institutional arrangement regarding regulatory design and the powers given to a regulatory authority are both a political economy and a governance issue. However the efficacy of regulation in every sector depends on the extent of independence, accountability and transparency in procedures.

[15] Approach to regulation-Issues and Options, Consultation Paper, Planning Commission, Government of India.2006

5.2.1 Independence

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, the magnitude of which does not depend on the whim of the line ministry 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.

In India, sector regulators have been mandated with independence though such autonomy is limited in various aspects. Moreover, there is a difference between mandated and delegated independence with the latter much lower than the former due to control exercised by the executive. Functional independence is often curbed by the dependence of regulators on concerned line ministries for budgetary allocations and sanctioning of staff appointments as well as the need for the former to report to the latter.

Again on the lines of what has been mentioned above, there is no uniformity in the independence and funding of different regulators. While the Finance Ministry has been proactive in providing secure funding and resultant independence to the regulators reporting to it, this principle has been largely ignored by many other ministries. If this principle is indeed followed by other ministries, there would be improvements in regulatory effectiveness, efficiency, transparency and accountability.

5.2.2 Accountability

Independence must go hand in hand with accountability. Along with independence, all regulators need to be accountable. Appropriate mechanisms are required to make independent regulatory agencies accountable. Accountability is of two types: political and legal. Political accountability involves reporting to the line ministry/legislature which may have a special committee to scrutinise and debate its contents. Legal accountability enables those aggrieved by a regulatory decision to issue a formal complaint or appeal.

Parliamentary supervision seems to be the ideal form of political accountability as accountability to the line ministry can often be associated with pressure being exerted on the regulator to favour utilities being operated by the ministry. Similarly, vested interest groups often find it easier to effectively pressurise the regulator through the line ministry rather than through the Parliament. Therefore, replacing the line ministry's control by Parliamentary supervision across the board is necessary.

In general, regulatory bodies in India are required to submit their annual reports and/or audited accounts to the legislature. However, in most such cases, regulatory bodies are made accountable to the legislature through the line ministry. Legislative oversight over the regulator's performance does not seem to be effective as annual reports submitted by regulators are hardly discussed with any seriousness. The regulator's actions are questioned only when there is an impending crisis or a serious debate in the country. In fact, in most such cases it is the line ministry that is questioned, and not the regulator. Such misperception enables the line ministry to interfere in the functioning of the regulatory body.

As mentioned earlier, legal accountability allows review of a regulator's specific decisions. It is important to ensure that the review process does not create a second layer of regulation, as experienced in the telecom sector. In the telecom sector, the role of the appellate tribunal, Telecom Disputes Settlement and Appellate Tribunal (TDSAT), is quite wide. The TDSAT and not the TRAI has been empowered to settle disputes. This division of labour has adversely affected the performance of the telecom regulator as any issue can be presented as a 'dispute'. Nevertheless, there are some benefits -- judicial review is considered important in guarding against decisions by a regulatory agency which falls outside its statutory mandate or fail to follow established administrative procedures[16]. TDSAT has taken decisions in certain cases where TRAI has seemingly not followed due process.

Appellate powers are also not uniform across sectors. Unlike TDSAT, the Securities Appellate Tribunal (SAT) can only entertain appeals against the decisions of the capital market regulator, Securities & Exchange Board of India (SEBI).

5.2.3 Transparency

It is important to have a transparent regulatory process. The regulatory process must incorporate some crucial steps to ensure transparency. For example, stakeholders must be made aware of the regulatory process and should be given opportunities to present their views freely.

In certain cases, regulatory legislation in India has made provisions to guarantee a transparent regulatory process. For example, in the electricity and telecom sectors, it has been mandated that regulators should ensure transparency while exercising their powers and discharging functions. In the case of TAMP, no specific provisions regarding transparency exist in the legislation. However, TAMP has attempted to introduce transparency through guidelines. No provision in regard to transparency exists in the Competition Act, but a provision does exist in the general governance principles expounded by the government. Furthermore, the Right to Information (RTI) Act empowers citizens to seek information on any matter from any government department or undertaking.

6. Importance of Interaction between Policy Makers and Regulators and its Current Status

The role of the regulator is to achieve predetermined policy objectives and maintain competitive conditions in the market by ensuring that everyone follows the basic rules of the game. On the other hand, the role of policy makers is to provide long term objectives and vision to the development of a country. Policy makers issue policy guidelines which set out national priorities for sustainable development of sectors and measures for servicing disadvantaged areas of the country or sections of consumers.

However, while in theory policy makers and regulators have distinctly different roles, in reality the regulator and policy makers share common responsibilities – ensuring orderly and sustained growth of the sector, attracting private investment, enhancing consumer protection and so on.

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 regulator's 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.

[16]. CUTS International, October 2006, "Creating Regulators is Not The End, The Key is the Regulatory Process" – A Research Report

"The government has not made a policy decision to clearly specify the role of sector regulatory bodies, the degree of independence these should have, their accountability and so on. As a result, when the need arises, the concerned ministry drafts a Bill as per its convenience to change regulatory mandates."[17]

The resulting insecurity implies that regulators often work as an extension to the office of the ministry. Lack of interaction of the regulator with the policy maker resulting in confusion regarding respective domains coupled with inadequate empowerment has made regulators ineffective.

"To cite a case, the Department of Telecommunications (DoT) announced certain proposals (on Access Deficit Charges, one India call rate and inter-connection usage charges) to restructure the tariff regime in telecommunications, considering these to be policy issues. However, the sector regulator, TRAI, objected to these proposals."[18] After the objection, the DoT contemplated exercising its powers under the TRAI Act to issue 'policy directives' to the regulator although it finally refrained from doing so. This case highlights the need to clearly demarcate policy and regulatory issues. As mentioned, in certain cases the line ministry continues to be answerable to the legislature for functions that have been transferred to the regulator. This makes the line ministry continue to want to perform the same functions and interfere in the domain of the regulator, which impairs regulatory functioning and, consequently, its efficacy. Hence, a mechanism needs to be developed to make regulators directly accountable to the legislature

The mentioned lack of interaction is illustrated by the power given to the government to issue policy directives to the CCI without any consultation with the CCI or any requirement to follow a transparent process. Thus, having appropriate processes in place to facilitate proper interaction between the line ministry and the regulator is required to avoid a possible compromise on regulatory autonomy. The manner of consultations between the RBI and the Ministry of Finance is a good model: the RBI holds consultations with the latter on a regular basis, at formal and informal levels, without compromising its autonomy.

7. Participation of Stakeholders in the Regulatory Process

Sector growth should be the common objective of the government as well as the regulator. However, this is often forgotten. For the orderly growth of a sector, a regular consultation among the industry, the government, the regulators and other stakeholders such as consumers is essential. A mechanism for periodic meetings involving these can help the regulator understand stakeholder problems and concerns. Such forums also enable the regulator to explain the rationale of various regulatory decisions. However, not much thought has been given by most regulators to ensuring a representative consultative process.

There is another very important reason for having a representative regulatory process In India, regulatory reforms, which have accompanied economic reforms, have been marked by lack of consumer participation. Consumers, being largely unorganised, have been largely bypassed by the reform process (except in a few cases where consumer concerns have been highlighted by the media) which has been influenced by a strong business lobby.

In India, a few sector regulators such as Central Electricity Regulatory Commission (CERC) and TRAI have created participation mechanisms by constituting Advisory Committees with representation from consumers and other stakeholders. The telecom sector, among other things, has a Common Charter of Telecom Services, which requires service providers to promote consumer participation in the process. In electricity, even state level regulators have some consumer representation in certain cases.

[17]. "Competition and Regulation in India 2009" ed. Pradeep S Mehta, CUTS International, 2009

[18]. *Ibid.*

However, the Competition Act has not created a formal representation mechanism for consumers. This is a serious deficiency as the CCI is supposed to advise the Central Government on policy issues, when asked. "However, the CCI has formed an Informal Advisory Committee where consumer organisations are represented. The CCI has also established a Competition Forum to build and further strengthen the capacity of the functionaries of the Commission, where experts (including consumer leaders) are invited for presentations. However, informal committees and forums are not enough and what is needed is a robust representation mechanism."[19]

The participation of stakeholders, particularly consumers, can be made very effective through well designed and implemented public meetings along with distribution of accessible literature.

In addition to lack of proper consultation, there is lack of coordination between regulators and government departments responsible for formulating and implementing investment related policies. This has resulted in sub-optimal outcomes. For instance, the private sector has shown very little interest in investing in the power sector due to lengthy procedures for granting of licenses, despite there being a single window clearance facility in place.

Clear information may empower stakeholders and can inform the decision making process. However, such information should be taken into account by the regulator while making decisions. This can be ensured through accurate documentation of consultations and recourse to effective legal action against the regulator to redress bad decisions.

8. Prevailing Practices of Sector Regulators for Tackling Market Failure and Anti-competitive Practices

8.1. Competition Authority versus sector regulators

To strengthen the forces of competition in the market, both competition law and policy (to be enforced by Competition Commission) and market regulatory laws (to be enforced by the regulator) are required. These complement each other. The difference between the two forms of intervention in the market process lies in their nature. A regulator tells the firms what these have to do. A regulator examines issues of technology, cost and process in the industry regulated by it. Competition Authority, on the contrary, tells the firms what they should not do i.e. price fixing, predatory pricing, cartels, discriminatory treatment etc. The role of the Competition Authority is that of an adjudicator which acts against anti-competitive practices.

A regulatory law promotes healthy competition in the regulated sector through various structural and behavioural measures – for instance, it mimics competition in natural monopolies and regulates competition where the market fails. A competition law prohibits and penalises anticompetitive practices by enterprises functioning in the market. The aim of competition policy is to create a framework of policies and regulations to facilitate competitive outcomes in the market and ensure that economic measures are designed and adopted with competition principles at their core.

The separation between the ex-ante functions (the regulator's domain) and adjudicatory functions is not perfect and therefore characterised by confusion and disputes in regard to turf. This is especially true in the case of infringements of rules of the game stipulated ex-ante by the regulator – for instance, violation of interconnect agreements.

[19]. *Ibid*.

Further, a sector regulator has a narrow focus, whereas the competition authority has an economy wide remit. The differences in domain also result in differences in views and create tensions between the competition authority and the sector regulator.

Not only is there a need to encourage cooperation between the competition authority and sector regulators, there is a need to review the formally legislated working arrangements between the sector regulators and the competition authority to ensure coordination and avoid conflicts of jurisdiction and needless turf battles.[20]

8.2 Actual implementation of regulations

In India, on paper, sector regulators are expected to determine the level of competition in a particular sector. However, in practice, this might not be the case. It is essential to review the actual implementation of these functions.

8.2.1Tariff regulation and competition[21]

Tariff regulation is generally considered one of the primary functions of regulators. At the time of government control of utility pricing, there was heavy cross subsidisation of services. With reforms, control of tariff fixation was passed on to certain regulators such as the telecom regulator. However, in sectors such as power, tariffs are still determined rather than regulated.

Regarding cross subsidisation, very few regulators have taken pro-active measures to phase it out. Government interference in the affairs of service providers in most states ensures high level of cross subsidy.

In the telecom sector, competition was largely a result of technological progress. But without effective regulation, competition would not have furnished its benefits to consumers. While there has been a fall in long distance rates, increase in consumer choice and growth among other developments, anti-competitive practices are still conspicuous. There is a conflict of interests as the government which owns one of the largest operators (BSNL) is also involved in licensing, policy making and operations in the sector. Allegations of collusion among private operators have also been made.

On the other hand, in the power sector, not much of an attempt has been made to encourage competition. The government owned electricity boards have not been privatised in a majority of states and continue to run inefficiently. One major reason for the unwillingness of private players to enter the sector is regulatory uncertainty, especially regarding tariffs. For example, prior to elections, governments often grant free power to farmers for electoral reasons.

[20]. TCA Anant & S Sunder, "Interface between regulation and competition law" Towards a functional Competition Policy for India", ed. Pradeep S. Mehta, 2005.

[21]. Capacity Building on infrastructure Regulatory Issues, Discussion Paper CUTS C-CIER, 2004.

8.2.2 Quality of service

This is one of the most important regulatory functions but this has not received adequate attention from most regulators.

"In India, there is very little evidence to suggest that regulation has had a positive impact on quality. In certain cases, there is free competition without adequate consumer information and awareness about quality. This leads to price competition being associated with scant attention paid by firms to quality – a state of affairs which is far from ideal despite the presence of competition. The regulatory authorities laying down standards (safety, performance etc) do not have the teeth to implement the standards and penalise the providers/sellers for non-compliance. Without penalties, service providers are unlikely to have an incentive to invest in resources for improving the Quality of Service (QoS). A related problem with standards is the low level of consumer awareness on issues such as safety, which means there is not enough demand pull to make industry interested in implementing safety standards".[22]

In sectors such as telecom and electricity, there is a visible regulatory initiative to improve quality but without adequate legislative backing. TRAI is to be commended for at least drawing attention to QoS and establishing standards. TRAI provides guidelines for service providers and publishes periodical survey reports assessing quality of service and customer satisfaction.

A lot more needs to be done in terms of quality enforcement. On parameters like congestion, customer satisfaction etc, more efforts should be expended. However, TRAI cannot penalise operators for not meeting QoS benchmarks. Penalties can be imposed only by TDSAT if a matter warranting penalties is brought before it. TDSAT can adjudicate any dispute between a licensor and licensee, between two or more service providers and between a service provider and a group of consumers; and hear and dispose of appeals against any decision or order of TRAI. This window for consumer groups to file complaints of a generic nature before TDSAT is an option that should be used.

To summarise, the overall impact of regulatory measures is not visible in terms of either an improvement in efficiency or quality of services provided, except in the telecom sector. In fact, consumer satisfaction in the power sector is very low.

8.2.3 Information

Effective regulation requires good quality information facilitated through proper checks and processes. In its absence, regulators will be at the mercy of the regulated for supply of information. Some State Electricity Regulatory Commissions (SERCs) such as Karnataka Electricity Regulatory Commission have consumer cells which interact directly with consumers to get their views on various issues before decisions are taken. Similarly, TRAI solicited comments from various stakeholders while developing its tariff rebalancing plan to address the issue of cross-subsidisation.[23]

[22]. "Competition Regime as a Determinant of Consumer Welfare: Focus on Indian Telecom" Monograph published by CUTS International

[23]. Capacity Building on infrastructure Regulatory Issues, Discussion Paper CUTS C-CIER, 2004.

The Right to Information (RTI) Act is a mechanism for getting information from public authorities. The act also makes a provision for Information Commissions -- independent high level bodies at both central and state levels entrusted with the task of creating awareness among the public about the importance of the Act in their lives as well as enforcing the right. However, certain problems continue to limit the efficacy of the Act calling for fine tuning in text as well as implementation.

9. Management Practices in Regulation

Usually, the formulation of regulations and their enactment is a lengthy process. It starts with consultations organised by the regulators with consumers and other stakeholders. In order to aid the process and provide the stakeholders with important information, certain documents might be made available by the regulator. The recommendations thrown up by the consultations are incorporated suitably by the concerned ministry and the independent regulator, if one exists, in a draft regulatory bill. The draft regulatory bill is then debated in Parliament (legislature) and its finalised version voted on. A majority vote is required to pass the draft bill into law.

However, even enacted regulation might not be effective. Important factors determining the effectiveness of regulation are sensitisation of consumers and facilities for grievance redressal and consumer protection.

9.1 Consumer redress

A redressal mechanism is an essential component of the competition legislation of any country. In India, too, the MRTPA (Monopolies and Restrictive Trade Practices Act) has inbuilt grievance redressal provisions. However, over the years, because of factors like inadequate budgetary allocation and lack of autonomy the MRTPC (the predecessor of CCI governed by MRTPA) has not been very effective in providing redress and consequently pending cases have kept piling up.

The CCI is expected to serve consumers better in terms of redress. Among other things, the Competition Act allows individual consumers or their associations to present their grievances for redress before Competition Forum of the CCI. However, cost considerations and other factors may deter individual consumers or local consumer groups from approaching the CCI. The need for regional benches of the Commission is again felt in this context.

Other than competition law, COPRA[24] provides a three-tier, simple, quasi-judicial machinery – at the national, state and district levels – for the purpose of redress. While COPRA is a comprehensive piece of legislation its enforcement is plagued by inordinate delays in the delivery of justice, implementation of orders etc.

In addition to the above, some sector regulators such as telecom, electricity and insurance also have redressal mechanisms: generic complaint redress by TRAI, telephone *adalats* (courts), grievance redress mechanisms of state electricity commissions, the consumer grievance redress cell of the Insurance Regulatory Development Authority (IRDA), insurance ombudsman, banking ombudsman etc.

[24]. COPRA (Consumer Protection Act, 1986 amended 1993, 2002) - Enacted for the specific purpose of protecting consumers' rights and providing a simple quasi-judicial dispute resolution system for resolving complaints. Among other things the law deals with unfair and restrictive trade practices (like manipulation of price), which are anti-competitive in nature. The COPRA and MRTP Act between themselves play a complementary role with respect to unfair trade practices.

Box 1. Redressal mechanism in the telecom sector

- Service providers have appointed Nodal Officers in different service areas to deal with complaints. Individual consumers can approach Consumer Redressal Forum for redressal of their complaints

- A group of consumers can approach TDSAT for adjudication of any disputes with service providers

- All complaints made to the customer care helpline are assigned a unique docket number and communicated to the consumer

- Certain service providers such as BSNL hold Open House Sessions to establish direct channels of communications with customers. A press notification is issued in leading newspapers inviting customers to attend and submit their suggestions/complaints.

- Customers whose grievances remained unsettled are invited to make petitions for redressal of their complaints in Telephone *Adalats*

TRAI has put in place a number of mechanisms to protect consumers from exploitation by telephone companies but in the absence of follow up action to ensure redressal these become ineffective. At present, there is no system to know whether redressal has been done or not and if not, why not. Regulators such as TRAI are planning to set up a grievance monitoring system to seek updates from service providers on complaints made by customers which have not been addressed in a timely manner.

State electricity regulators in Himachal Pradesh, Haryana, Karnataka and other states have set up consumer grievance redress mechanisms including electricity ombudsman in some cases. The Ministry of Consumer Affairs has also set up a national consumer help line to provide information and register complaints. Some big companies including those in the banking, airline and hotel sectors have their own customer feedback and 'solution' mechanisms.

A suggestion for setting up a consumer ombudsman has often been voiced by consumer activists. A consumer ombudsman or a state level competition and regulatory agency could be helpful in dealing with local monopolistic/collusive practices often encountered by consumers. Such an ombudsman will also take the pressure off consumer courts and formalise and strengthen the prevalent practise of out-of-court settlements mediated through consumer groups. The banking and insurance sector already has such a system.

The regulators issue several directions to service providers to enhance and ensure transparency in service provision. The purpose is to provide consumers with opportunities to make informed choices and protect them from exploitation facilitated by information asymmetries. To ensure transparency, regulators ask service providers to provide detailed information on tariff and other value added services on their websites. The regulators also provide such detailed information through their own website, media and other publications.

However, service providers are not giving adequate importance to consumer transparency issues. For example, in the case of telecom, vital information pertaining to tariff plans is not made available explicitly to consumers while marketing these.

There is a need to address the issue of consumer satisfaction. Thus, regulators should ensure that printed material in English/vernacular language is made available to new consumers.

9.2 State of inventories of regulations

There are several rules and regulations framed by government agencies that create obstacles for business – for example, the clearances required for setting up a business and the time involved. As mentioned, a plethora of inspectors and regulatory authorities continue to exercise wide discretionary powers, nailing industrial enterprises from their inception for minor lapses or not even allowing them to be born. Such inspections have proved to be a fertile breeding ground for corruption and delays in initiation/operation of businesses.

In India, licenses required for doing business have been classified properly[25] at the level of the central government but not at the state level which makes it very difficult to identify ex-ante the licenses/approvals/clearances required by an entrepreneur to start and run a business.

Comprehensive inventorisation of all business licenses required for starting as well as running a business is a must though it is a difficult and time consuming process. The inventory should include information about the legal basis, procedures and costs relating to each individual license as well as the authority that needs to be approached to obtain the license.

Assessing the feasibility of licenses/approvals/clearances is equally important. Clearances, approvals etc are intended to achieve certain objectives. However, there is a need to ensure that the enforcement of regulations and associated licenses does not unnecessarily hamper the smooth operation of business, and thereby enhance the transaction costs of doing business without providing an offsetting benefit. Thus, all licenses (existing legislations and regulations that affect starting as well as smooth running of a business) need a review in regard to their utility for the smooth functioning of business.

Identification and elimination of redundant licenses and licensing practices is of paramount importance in improving the business environment in the country. Once such bottlenecks have been identified, the government could take decisive steps to develop a decisive and integrated action plan to enhance transparency, simplify bureaucratic procedures and modify or scrap licenses.

9.3 Window system

For starting a business, a number of business approvals/clearances are required from different authorities such as Pollution Control Board, Inspector of Factories, Electricity Boards, Municipal Corporations etc. Possible ways to obtain approvals/clearances can be classified into multiple window and single window systems. Under a multiple window system an entrepreneur has to approach each and every authority separately which is time consuming. The single window system provides a convenient single point of contact to investors for completing all regulatory procedures, resulting in savings of time and money.

[25]. Licences in India can be categorised into three categories;

- General licenses, which are applicable to all businesses nation wide
- Sector business licenses, which are applicable to businesses operating in a specific sector
- District/municipal licenses which are applicable to businesses/operating activities

In India, most state governments have set up single window services. These are supposed to help the investor in information collection, identification of project sites, arranging for feasibility studies, obtaining clearance of projects from financial institutions etc. However, implementation is poor due to poor political commitment and bureaucratic inefficiency and corruption. Lack of quick decision making at the local level often acts as a hurdle in obtaining various regulatory approvals and getting land and access to necessary infrastructure. Local authorities take an ad hoc approach and often apply inconsistent and overly complex rules

10. Mechanisms for Ensuring Regulatory Coherence

A robust overarching regulatory philosophy/ framework is need for coordinated development of the economy and its constituent sectors. However, the evolution of regulatory institutions in India is not guided by a common philosophy. Political constraints and government preferences seem to have dominated the reform agenda. The next steps for regulatory reform should ideally focus on developing a common institutional framework for regulatory bodies, their role and functions, their relationship with the executive and legislature, and their interface with markets and people.

Some mechanisms for ensuring regulatory coherence have already been implemented while others are being contemplated. To ensure fair competition in the market and hence promote sustainable growth of business, the Government of India has taken several steps such as enacting a competition law and setting up of the Competition Commission. Competition policy and law is one component of the regulatory structure that binds functioning of the different sectors of the economy. In addition, the Planning Commission, Government of India has developed an approach paper on ensuring regulatory coherence and consistency among different sectors of the economy which would serve as an important guide for regulatory reform.

More than fifteen years of independent regulation in India have been characterised by the government's inability to create and follow a cogent and coherent approach to independent regulation. "Quite often, the policy objectives that the government wishes to achieve through the regulatory regime are not spelt out clearly in the legislation. At times, the regulatory mandate falls short of what is required for achieving the stated policy objectives. A multi-stakeholder approach is nearly missing in most of the sectors and given ambiguous regulatory mandate as well as limited regulatory capacity, this evolving form of governance is falling short of expectations so far." [26]

At the State level, Bureau of Industrial Promotion (BIP) works as a nodal agency to provide regulatory coherence i.e. it is the nodal agency for expediting clearance of private sector projects. Being a nodal agency it interacts with all the regulatory bodies at the state level and tries to ensure coherence among them. But in practice it has not been very effective.

Overall regulatory coherence may be improved by making the following institutional arrangements:

- Regulatory legislations need to be clear and coherent. "The framework offered by the Electricity Act 2003 could be used as the starting point.

[26] "Regulatory Framework for Infrastructure sector in India", CUTS C-CIER

Box 2. Regulatory framework for power sector

The role of determining the specific direction to be given to the reform process within the overall framework of Electricity Act 2003 primarily lies with the Central government (and to a lesser extent the State governments) as the policy maker, and with regulatory bodies- the CERC and SERCs. The Central government prepares the national electricity policy and tariff policy in consultation with State governments and regulatory authorities.

- Sector specific apex bodies need to be established at the centre. These bodies should be complemented by a well endowed economy wide regulatory and competition authority in each state.

- An appellate tribunal for all appeals against sector regulators needs to be established. If the workload increases in any one sector, these can be hived off.

- Interface between regulators and the competition commission needs to be formalised in legal terms so that there is no conflict between them and impugned parties do not take advantage of the same.

- Multi-stakeholder participation should be the way forward, which can effectively take care of several concerns with regard to regulatory efficacy and accountability. Consumer organisations need to be strengthened with resources so that they can be effective advocates."[27]

11. Gap between Promulgation and Implementation of Regulation and Underlying Institutional Weaknesses

The Government of India has undertaken various steps to implement regulatory reforms in the country. This includes the removal of controls and simplification of rules and procedures so that the government becomes a facilitator instead of a 'regulator'. Some important initiatives in this regard have been:

- Compulsory licensing limited to a few industries; only a few items remain reserved for SSIs

- Registration procedure simplified

- Tariffs cut to liberalise trade

- Tax structure streamlined and rationalised

- Foreign investors given national treatment and private players, both domestic and foreign, allowed in almost all the sectors

- Public grievance redressal system strengthened

However, as mentioned, implementation of regulatory reforms, especially at the state level, remains poor. There are a few islands of achievement. For example, in the telecom sector, a directive is in place which forces service providers to provide interconnection facilities at rates fixed by the regulator, TRAI. However, TRAI has not been able to force BSNL, the public sector company, to allow private operators to

[27]. *Ibid.*

roam on its network. Another case of conflict is illustrated by the controversy relating to the 'principle of calling party pays'. This principle, which effectively reduced tariff collections for BSNL, came only after a bruising court battle and a very public and head-on collision between private mobile phone players and the government.[28] This regulatory intervention led to very low telephony rates.

Like telecom, in the power sector also, there have been some significant regulatory successes -- for example, introduction of the concept of *Availability-Based Tariffs* and discipline imposed on the overdrawing of power from the electricity grid. However, after the early years of reform there has been a slowdown in momentum. Progress has been poor in critical parameters such as open access due to inability to resist political pressure.

There seem to be inadequacies in regulatory implementation in the power sector. Power scarcity has been sought to be overcome through reform comprising of unbundling of the power supply set up and suitable introduction of competition into the separated elements. However, flouting of open access principles, continuation of exclusive power purchase agreements, lack of competitive neutrality and legal violations by state governments have deterred private entry and hampered competition.[29]

The case of the power sector implies that regulations that seem good on paper often do not have the expected impact because of poor implementation.

11.1 Institutional causes

Successful implementation of regulation requires financial and functional autonomy of the regulator (which, in turn, depends on security of tenure of members, a mature political system as revealed by an arm's length distance between the line ministry and the regulator, earmarked sources of funds for the regulator etc.) as well as effective coordination and delineation of functions among sector regulators and competition agencies. Though regulators in India are supposed to be independent of the government, in practice they are often seen as functioning as government agents. The regulators, such as ERCs, themselves have contributed to this tendency by not making use of the powers granted by the respective Acts to exercise financial autonomy. The government also always finds ways and means to conveniently distort the nature and extent of functional independence.

There is a need to implement regulatory reforms that adopt best practices and thus enable the economy to attract large investments in infrastructure and promote consumer satisfaction to the maximum extent possible. Predictability of the regulatory framework is an essential pre-requisite for attracting investment. To ensure regulatory independence, delineation of the regulator's and line ministry's respective powers is necessary.

Financial autonomy may be ensured through the following measures:[30]

1. Regulatory agencies should be allowed to generate resources on their own through a fee, cess, etc. wherever possible, and be allowed to spend it;

2. 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 regulator's budget should ideally be a charged expenditure on the Consolidated Fund; and

[28]. Sunil Jain, "Regulatory Roulette" 2008.

[29]. "Competition and Regulation in India 2007" ed. Pradeep S Mehta, CUTS International, 2007.

[30]. *Ibid.*

3. Regulators should be given the liberty to hire required staff on contract and appoint consultants in a transparent manner.

Along with independence, all regulators could be made accountable by making provisions for an appellate tribunal, wherever it does not exist, where the orders of the concerned regulator may be challenged. Further, setting up a Parliamentary Committee on regulatory bodies can also enhance accountability.

The current requirement for regulators to submit annual reports to the legislature is not sufficient to make them accountable in an effective manner. Having appropriate provisions on an ex-ante basis is also important. The following measures can enhance accountability[31]:

1. "Make the Parliamentary Committee on Regulation & Competition the reporting authority for regulatory agencies: The Committee needs to have its own staff with suitable experience so that it does not depend on other agencies." The proposed Committee should be able to call regulators for an explanation only regarding systemic issues.

2. "Create a Consumer Advocacy Fund to build the capacity of consumer/civil society groups to raise consumer concerns more effectively and facilitate review of the regulator's performance by an important stakeholder group";

3. Provide for evaluation of the regulator's performance through a peer/external review system against the given mandate

4. Political parties and the government should consider giving their feedback as stakeholders to the regulator whenever it is sought. Besides, they need to participate in the open discussions/hearings conducted by the regulator.

5. The regulatory process needs to be made transparent – by making hearings open to the media and television broadcast, for instance.

11.2 A review of available instruments to assess regulatory quality

Quality of regulation depends on overall policy and working environment in the country which includes a sound approach to competition policy, effective legal and judicial system, political buy in, culture (the way people think and act) and absence of corruption.

The assessment of quality of regulation becomes important as many regulations which are good on paper never realise their potential because of poor institutional machinery. It is important to assess whether the regulator is independent of government and sectional lobbies, is consistent and timely in its pronouncements, has well qualified staff etc.

12. Government's Plans for the Future[32]

The Government realises that the sector approach to independent regulation in India has been associated with the evolution of a haphazard and uneven regulatory environment. There is no regulator in some sectors, partial regulators in others and relatively comprehensive regulators in yet others.

[31]. *Ibid.*

[32]. "Eleventh Five Year Plan (2007-2012)" Volume I, Inclusive Growth, Planning Commission, Government of India.

The government is planning to articulate the objectives of regulating the infrastructure sector so that divergent mandates for sector regulators can be eliminated. The objective is that in the infrastructure sectors suited to competition, regulation should be light handed and tariff setting could be left to competitive markets. On the other hand, those characterised by a significant incidence of the classic causes of market failure (natural monopoly, information asymmetries and externalities) should be subjected to close regulation including tariff setting or determination. In all cases, performance standards should be regulated to ensure quality of service.

The government is also planning to reform the institutional framework of regulatory commissions, their role, functions and relationship with the executive and legislature, their interface with markets and people, and processes and methods of regulation including rule making and dispute resolution as follows:

- Empowering all regulators to make and enforce regulations, issue licenses and impose punitive measures including suspension or cancellation of licenses; and set performance standards and determine tariffs.

- Ensuring independence of regulatory bodies: the government is planning to make the selection process transparent and shorn of interference. To ensure this, the chairpersons and members of regulatory bodies may be appointed by the President of India on the recommendation of the Prime Minster. The Prime Minster can choose these names from a panel of two or three names empanelled by a committee comprising the Chairperson of the Union Public Service Commission (UPSC), Cabinet Secretary and Chairperson of the respective regulatory body. Similar arrangements are planned at the State level.

- Fixing the tenure of members: The government is considering stipulation of a uniform tenure of four years for members of all regulatory bodies. Further, to attract quality personnel and enrich the functioning of the regulatory body, remuneration would be enhanced and a provision for having a non-governmental representative, such as an academician or a lawyer, as a member would be included

- Reforming the process/criteria underlying removal of chairpersons and members of regulatory bodies: The removal has to be approved by an enquiry conducted by a sitting judge of the Supreme Court or the High Court and approval by the President of India or the government as the case may be.

- Restricting reappointment of members. Members once appointed will not be considered for reappointment and will be barred for a period of two years from acquiring and holding, directly or indirectly, any office, employment, consultancy or business with any entity or its associate dealing in matters under the jurisdiction of the body.

- Reducing the overlap of jurisdiction between the CCI and regulators; government is planning to define a workable division of labour and increase the interface between the two which at present is minimal.

- Introducing multi-sector regulators. The government is contemplating the establishment of multi-sector regulators for (i) communications; (ii) transport; and (iii) electricity, fuels and gas. This would eliminate proliferation of regulatory commissions, help build capacity and expertise, promote consistency of approach and save on costs. At the State level, a single regulatory commission for all infrastructure sectors may be more productive and cost effective. States should be encouraged to consider this approach and the scope of their existing electricity regulators could be extended to other sectors.

- Constituting appellate tribunals on the lines of telecom and electricity appellate tribunals: Another approach under consideration is the constitution of a single appellate tribunal with regional benches for all regulatory commissions

13. Gaps in Literature on Regulation

The important gaps in literature on regulation can be identified as follows:

13.1 Perceptions of stakeholders are inadequately captured

In India, continuous changes are taking place in the business and economic environment of the country. Changes are also continually being made in the economic governance system. These include changes in government policies/measures; amendment of existing legislations or enactment of new ones such as the new competition law; establishment of sector regulatory bodies in utility sector such as electricity, petroleum and natural gas. All such measures are designed to ensure that markets function well in the new economic policy regime and yield desired results.

But serious efforts have not been made to take into account the perceptions of stakeholders on these matters.

13.2 Lack of data on compliance and enforcement

For the assessment of regulatory quality we need to examine a mapping between desirable inputs and desirable outcomes. This provides us a framework to study the performance of regulatory regimes in a country. But India lacks data on these parameters which constrains assessment.

For example, Regulatory Impact Analysis has not been used in the Indian context because of lack of data on costs and benefits of regulations. Exhaustive primary surveys are needed to collect credible data on these variables. Such cost-benefit analyses are necessary for scientific choice among candidate regulations or for passing judgement on existing ones.

Similarly, the thrust of economic reforms has been to allow for more competition resulting in better quality, lower prices and greater availability of products to the consumer. The assessment of welfare impacts can be made through Consumer Impact Assessment (CIA). Such assessment will help in enhancing the accountability of regulators and government departments towards consumers and force them to be more consistent and transparent in their decision-making.

However, even the application of CIA requires data which may not be available in the Indian context.

Conclusion

Regulatory reforms in India have been initiated as these have become essential in the light of changing macroeconomic policies. At the level of the central government, the progress is quite satisfactory but State governments need to supplement it by taking similar initiatives.

At the sector level, many sectors remain unexplored from a regulatory point of view. Coal sector promises to be an important sector because of the importance of coal in the Indian context. Other sectors which deserve attention are the social (health and education) and retail sectors. Both play a significant role in the Indian economy from the point of view of human capital formation and demand generation respectively.

Another competition issue that needs to be given priority is simulation of competition in natural monopolies through public-private partnerships (PPPs). This is particularly relevant in the case of sectors such as railways and highways. Of particular importance are the negotiation and renegotiation of contracts underlying PPPs which should be tailored to maximise social welfare. Finally, creating independent regulators in the true sense is equally important.