OECD Regulatory Policy Working Papers No. 8

Regulatory policy in India: Moving towards regulatory governance

Lalita Som,

Faisal Naru

https://dx.doi.org/10.1787/b335b35d-en

OECD REGULATORY POLICY WORKING PAPERS

REGULATORY POLICY IN INDIA:
MOVING TOWARDS REGULATORY GOVERNANCE

By Lalita Som and Faisal Naru*

JEL Classification: A1, L5, N45, N75, D00

*¨OECD, France

OECD REGULATORY POLICY WORKING PAPERS

This series gathers together OECD working papers on the tools, governance and institutions of better regulation and their impact on policy outcomes. It includes both technical and analytical material, prepared by staff and experts in the field. Together, the papers provide valuable context and background for OECD publications on regulatory policy and governance.

OECD Working Papers should not be reported as representing the official views of the OECD or of its member countries. The opinions expressed and arguments employed are those of the authors.

Working Papers describe preliminary results or research in progress by the authors and are published to stimulate discussion on a broad range of issues on which the OECD works. Comments on Working Papers are welcomed, and may be sent to either gov.contact@oecd.org or the Public Governance and Territorial Development Directorate, OECD, 2 rue André-Pascal, 75775 Paris Cedex 16, France.

Authorised for publication by Rolf Alter, Director, Public Governance and Territorial Development Directorate.

OECD Regulatory Policy Working Papers are published on
http://www.oecd.org/gov/regulatory-policy/

REGULATORY POLICY IN INDIA:
MOVING TOWARDS REGULATORY GOVERNANCE

By Lalita Som and Faisal Naru*

ABSTRACT

This paper provides an analysis of India's existing regulatory regime and its evolution over the last 25 years, and the efforts to improve the regulatory framework as India has transitioned towards a market economy. The paper argues that while India has implemented many sector specific regulatory reforms, the absence of a government wide initiative to improve regulatory quality, or implement a whole of government regulatory policy, has prevented India from creating a consistent and coherent regulatory environment and has undermined trust and integrity in the regulatory system. As a result, outcomes of regulatory governance have so far been quite mixed. In many cases they have fallen far short of expectations. The paper therefore identifies some of the constraints that have challenged India's regulatory governance, the dominant presence of state owned enterprises, the multi-level government structures and regulatory independence of agencies and institutions. Meanwhile, effective regulatory governance has distinctly evolved in the securities market and it highlights the reasons behind the success of the securities market regulator. The positive example of the Securities Exchange Board of India is outlined to showcase the potential for implementing good regulatory practice through regulatory oversight, better governance of regulators, stakeholder engagement and regulatory impact assessments. The paper also looks at issues related to Regulatory Impact Assessments in the Indian context.

JEL Classification: A1, L5, N45, N75, D00

Key words: India, regulation, governance; regulatory impact assessment, network sectors, economic regulators

*¨OECD, France

NOTE BY THE SECRETARIAT

This paper has been authored by Lalita Som and Faisal Naru, with extensive input from an initial research paper by Arushi Malhotra. The authors would like to thank Luiz De Mello, Nick Malyshev, Filippo Cavassini and Stephen Thomsen for their comments,, and Sara Kincaid for help in the final document preparation

TABLE OF CONTENTS

Boxes

1. INTRODUCTION

Post-1991, the process of economic reform in India has been evolutionary and incremental. Unsurprisingly, progress toward India's becoming a genuine, fully-fledged market economy like most developed economies, has been slow, hesitant and uneven. There have been many delays and reversals due to the interplay of populist politics, the necessity of forming coalition governments that find it difficult to agree on the trajectory and pace of reform, and powerful vested interests – political, administrative and private. Nevertheless, five successive governments in India of different political hues since 1991 have persisted with economic reform, based on market liberalization and a larger role for private enterprise.

1.1 Economic and regulatory reforms in India

After 25 years, there is a general consensus in India that market forces and the State should exercise roles in a mixed economy that play to their comparative advantages. Private initiative and markets are now encouraged in most areas of commercial activity –in which State-owned enterprises (SoEs) continue to be prominent actors, though the State has receded in relative terms. It now plays a less direct, but more important and influential ***regulatory*** role in guiding economic activity. For example, it grants property rights in land, intellectual property and the exploitation of natural resources whether mineral or spectral. It undertakes directly, and influences indirectly, the development of infrastructure and the pricing of infrastructure services. It influences the value of public and private property, grants subsidies, provides tax benefits etc.

Apart from general industrial/manufacturing production, the sectors opened up for increased participation of the private sector include: telecoms, power, mining, hydrocarbons, banking, insurance, capital markets, airlines, etc. In all these areas, SoEs continue to be direct players; but to a lesser proportionate extent than pre-1991. *The steady displacement of public sector production by private entities in these sectors has inevitably required redefining the role of the State as regulator to ensure competition on a level playing field*. This change in role has also required the need for a different approach to regulatory governance.

The Indian State has, since 1991, set up a number of independent regulatory authorities to prevent monopolies, permit network industries in a number of real (non-financial) sectors, and govern the financial sector (banking, insurance, capital markets and derivatives). Such 'independent" authorities lubricate the functioning of a complex, modern economy while, at the same time, attempt to protect wider public interest objectives. These include wider stakeholder interests, wider health and safety standards, and ensuring the protection of public commons (like the environment including air, water quality standards). Their impartiality and objectivity is essential and is determined by their internal and external governance (OECD 2014a).

Sector 'restructuring' i.e. 'unbundling' publicly owned and managed entities, allowing the entry of private players, introducing competition among newly created entities (public and private) and setting up independent regulatory agencies – has characterised the essence of what is known as economic reform.

1.2 Reforms and their impact on growth in India

India's embrace of economic reforms in the early 1990s— particularly de-licensing, the privatization of SoEs, and liberalization of trade and foreign direct investment —contributed to an average growth rate of 6.0 percent for the next ten years -- from 1992-93 to 2001-02 (Ahluwalia, 2002). Growth accelerated again from 2002 onwards by an average rate of 6.33 percent in the next 8 years.

Sen and Kar (2014) categorise India's post-reform growth experience into three distinct periods. The first, from 1993 to 2002, was characterised by a set of predictable informal relationships ('ordered deals')[1] between political and economic elites, which were relatively open and were enhanced by the dismantling of the industrial and trade licensing system. This was reflected in the entry of new firms in manufacturing and services, especially in pharmaceuticals and IT (Alfaro and Chari 2009). At the same time, the Indian State's collusive relationship with selective elements of the business elite from the pre-reform period remained. In some cases they were accentuated (Mehta and Walton 2014). Thus, during the 1990s, closed deals co-existed with open deals and, consequently, many traditional industries were still dominated by entrenched business groups that had emerged during the "licence raj" (Alfaro and Chari 2009).

In the second period, from 2002 to 2010, deals became increasingly closed, leading to negative feedback effects from supposedly accountable institutions, the middle class and non-elites, along with structural retrogression of the economy. An increasing number of 'crony capitalist' deals were struck between political elites and economic elites in natural resource sectors at both national and regional levels. In various natural resource rich regions, influential and politically connected business elites systematically underpaid mining royalties to sub-national agencies.[2]

As the State still had the power to allocate licenses for production to private firms in the mining sector, there were clear incentives for political elites to allocate preferentially these licenses to select economic elites on terms that were not transparent. Stakeholder engagement and evidence based tools such as Regulatory Impact Assessments (RIA) could have assisted institutions in these activities. However, the existence of 'closed ordered deals' was not confined to natural resource sectors; it was also quite evident in the telecoms sector (Sen et al., 2014) where spectrum was the natural resource being licensed.

The third period, beginning in 2011, was one of an incipient growth deceleration with less than a 5 percent average growth rate. The governance of reforms were characterised by increasingly disordered deals. In the face of both popular and legal challenges, there was increasing uncertainty about the nature of such deals. The growing loss of credibility and political weakness of the ruling party at the centre resulted in its lacking the authority to commit to new deals with any longevity; they became increasingly disordered. Investor perception of the viability of contracts started falling from 2006 onwards and private players were increasingly concerned about the durability of any new deals. As investor uncertainty increased, corporate investment which rose during 2003-08, from 10% to 17% of GDP, declined to 10-12% since then (Sen and Kar, 2014). Since 2014 the new government has undertaken reforms to introduce transparency in licensing and the early outcomes of these changes are mixed.

After a quarter-century of economic liberalisation, private businesses in India remain vulnerable to discretionary government action at national and sub-national levels (Gowda and Sridharan, 2012).

1 . Following the work of Acemoglu and Robinson (2008) and other new institutional economists, the conventional economic explanation for economic growth to occur is that formal institutions—such as written contracts, laws that protect private property, and properly functioning courts—need to emerge. However, institutions in most developing countries are weak, and even if formal institutions exist, their decisions are unlikely to be enforced properly. More importantly, the existence of informal institutions in the form of personalised relationships between political and economic elites in explaining growth acceleration is an indispensable feature which Sen and Kar (2014) call the 'deals' space.

2 . In 2010, the national government constituted a commission to investigate irregularities in the extraction, trade, and transportation of iron ore and manganese ore across the country. The Commission found evidence of 'enormous and large scale multi-stage illegal mining of iron ore and manganese ore' (Shah Commission 2012). The Commission also found clear evidence of collusion between ruling politicians at the sub-national and national level and private mining firms, stating that 'the State has "gifted" property of thousands of millions in the hands of private companies/firms/individuals' (Shah Commission 2012).

Although the licensing powers of national and sub-national governments have been gradually reduced over the years, the State remains an important actor. Its decisions play an important role in determining the quantum and distribution of not only economic benefits but also the distribution of economic rents and favours of large economic value. This has been the case especially in the mining, real estate, and telecoms sectors and in very large industrial and infrastructure projects. Vested interests, such as producers with licenses and monopoly interests, and bureaucrats with 'rent seeking' capabilities, have often scuttled or delayed further market-based economic reforms (Wadhva, 2004).

An effective regulatory policy framework is important to lay the foundation for building integrity into the relationship between the State, citizens and businesses. In functional terms, regulators are intended, ideally, to regulate the residual monopoly segment, establish and enforce the rules of market functioning, and set tariffs in the lead-up to competitive markets. They are intended to excise politically motivated and therefore arbitrary decision processes, and replace them with technocratic, transparent rules and hence predictable decisions. These objective decisions are the result of good regulatory practices and governance arrangements that inculcate "culture of independence" in institutions (OECD 2016).

The continued absence of integrity and transparent rules-based decision-making in state-business relations, along with the exertion of often inexplicable discretionary government actions, suggests that the broad reform agenda undertaken since the 1990s has not yet translated into a clear role for regulation and regulatory agencies in the reform process. This may be compounded by the limited use or even non-existence of good regulatory practice mantra, with tools implemented, systemically. Therefore the change in the thought process that was required in moving away from central planning was not articulated, and intellectual leadership was lacking in this regard (Thomas, 2014).

Regulatory agencies were seen by the political elite as a necessary requirement, imposed by external funding institutions, or as a relatively costless quick fix or at worse diversionary tactic to signal seriousness about reform. The creation of regulatory agencies was, therefore, a somewhat formulaic appendage to a larger sector reform process, focused on financial restructuring, attracting private investment, and putting in place de-politicized decision structures. Regulatory agencies were the key mechanism intended to achieve the last objective, but with little critical reflection on whether and how they would do so (Dubash and Rajan 2000).

2. INDIA'S REGULATORY ENVIRONMENT: LEGACY ISSUES AND CRITICAL FACTORS

Basic regulation in India is implemented via the concerned line ministries, which may proceed to create industry-specific regulatory authorities that have varying degrees of autonomy, functions, and power. India lacks a coherent policy on regulation, or regulatory reforms.[3] There are significant variations in the structure of the governing bodies, tenure of the members, sources of finances, and interface with the government (Second Administrative Reforms Commission, 2013)[4]. This section looks at some of the reasons why the regulatory environment in India is uneven and what impedes the evolution of regulatory governance.

2.1. The conflicting objectives of optimisation and efficiency

In helping to shape the relationship between the state, citizens and businesses, an effective regulatory regime must ensure that consumers' interests are protected by way of lower prices, more choice, and better quality. At the same time, producers must remain financially viable, efficient, and innovative. Regulation must ensure that broad goals for annual business growth, satisfactory, high-quality employment generation, high-quality capital investment, competition, universal service, equity are advanced and public goods like the environment are protected.

At the heart of any State is its ability to generate revenue from taxes. Governments in most countries license private sector activities whether for regulatory purposes or to generate revenue, or both. The conflicting objectives of optimality (the maximization of the government's revenues) and efficiency (the maximization of social welfare via both consumer and producer surpluses), inherently cause friction in designing and implementing regulatory policies.

Revenue maximisation objectives of governments through licensing, addresses the vexed question of determining the optimal sharing of economic rents between the government and industry. In effect, it addresses the questions "What should be the magnitude of the total tax levied on industry?" and "How high can the total fiscal take be before it becomes a serious disincentive for industry to invest?" (Guj, 2012).

Taxes based on accounting profits or economic rents, while desirable because of their greater economic allocative efficiency, result in unstable government revenue. The alternative of achieving a higher degree of revenue stability is by relying more on fixed taxes but it prevents the government from sharing in high rents (when prices rise) and is economically inefficient. If the fixed tax is set too high, a project may prove uneconomic and new projects may not be developed. This hurts the interests of citizens as well -- as consumers and as job seekers.

On one side, there is the theoretical approach that advocates that, under perfect market conditions, government could/should appropriate a larger share of the rents. On the other side is the pragmatic approach that recognises that economic and political circumstances surrounding this issue are far from

3 . This is unlike what has been observed in many of the emerging economies, such as China, Mexico and Vietnam. The initiation of regulatory reforms in Mexico, for instance, coincided with privatisation, trade liberalisation, and the development of the economic sectors. Their Federal Law of Administrative Procedures was amended in 2000 to create an institutional framework for regulatory reforms, notably the Federal Commission for Regulatory Improvement (OECD 2014b). Vietnam, too, saw regulatory reforms in the face of WTO membership (OECD 2011).

4 . See Annex 2

perfect and that the optimal sharing of rents must consider the economic risks undertaken by businesses (Guj, 2012).

The regulatory compliance burden on both governments and businesses is another significant consideration in establishing a dynamic revenue system. Compliance costs increase with the sophistication and complexity of the tax system. Higher compliance and auditing costs for both government and industry have usually weighed heavily in governments' choices of avoiding taxes based on either rents or accounting profits.

In a country like India, when businesses often realise extraordinarily high levels of profit, it generates the perception that licenses were allocated preferentially on terms that were not transparent or the most economically competitive, in return for extra-legal monetary rewards through back-handers to bureaucrats and politicians. This issue invariably generates vigorous debate. The government and citizens are short changed as they do not receive a "fair share" of the rent and prompts political pressure for a review of the existing licensing fiscal regimes.

This section looks at: (a) how the dichotomy between the interests of governments and businesses, as well as that of citizens, has manifested itself over the years in four distinct sectors i.e. mining, hydrocarbons, power and telecoms; and its impact on regulatory governance and (b) changes, if any, that have been brought about in these sectors since 2014.

Mining

In most jurisdictions throughout the world mineral resources are, with some rare exceptions, in public rather than private ownership. In India, the mining sector remained under the State ownership till the 1990s, with restriction on private investment. It was opened to 100% FDI in 2006. The share of the public sector in the total value of mineral production has since declined from 91.19 percent in 1988-89 to 74.61 percent in the year 2004-05 (Indian Bureau of Mines, 2007).

Special taxes for the mining sector, including traditional mineral royalties, in combination with standard or mining-specific provisions for corporate income tax, are the main components of a mining fiscal regime that have been used to achieve the desired balance of a number of fundamental government objectives. They represent, therefore, different ways for governments to levy an additional share of the revenue flowing from mining operations.

The Mines and Minerals (Development and Regulation) Act 1957 empowered the national government to take control of the regulation of mines and the development of minerals. The prices, distribution and royalty of major minerals are governed and fixed by the national government while royalties are collected by sub-national governments. While sub-national governments are legal owners of all major mineral resources, their ability to profit from mining activity is restricted because they cannot set royalty rates or dead rents (charged if output is too low).

To take advantage of the increased demand for minerals originating from China in the early 2000s, mining rights were granted in an "arbitrary and opaque" manner and were determined on a "first come, first served" basis. In most cases, monitoring officials from government agencies did not conduct any kind of infield assessments before licenses were granted. As a result of these ´crony capitalist´ deals struck in ´high-rent´ natural resource sectors such as bauxite, coal, iron ore, manganese ore, the State lost significant amounts of revenue in addition to putting several regions' environment and ecology at risk.

In various ore-rich regions such as Jharkhand, Karnataka, Goa and Odisha, businesses systematically underpaid mining royalties to sub-national agencies along with extracting iron and bauxite in excess of the amounts stipulated by the leases. In Karnataka, high-ranking members of the government were found to have managed illegal mining businesses and became the subject of a Central Bureau of Investigation (CBI) inquiry in December 2009. The deep-rooted nature of illegal iron ore mining led the Supreme Court to impose a ban on iron ore exports in 2011-12. Between 2005 and 2011, the two regions of Goa and Karnataka incurred losses of Rs. 35 billion and Rs. 2.9 billion respectively. Mining has since resumed in these two regions with annual production caps.

The prevalence of illegal mining is consistent with the weak incentives offered to sub-national governments to encourage legal mining activity. Illegal mining clearly enables evasion of mining royalties, although the very low historical royalty rates served to mitigate this advantage (Eynde, 2015).

These examples of both political and business opportunism led to concerns about regulatory legitimacy in the eyes of citizens. A Commission (The Shah Commission) was set up by the Ministry of Mines in 2010 to look into the illegal mining of iron ore and manganese in the country. It noted that officials from both the national and sub-national governments colluded with the miners by exploiting the loopholes in mining regulations. The Commission recommended cancellation of leases, punishing corrupt officials and recovery of lost revenue from companies.

In order to increase investment in the mining sector and promote sustainable mining practices and to meet the requirements of industry without sacrificing environmental concerns, the government passed the Mines and Minerals (Development and Regulation) (Amendment) Bill, 2015. Aiming to improve transparency in allocation and to get a fair share of the value of minerals for the government, the new Act prescribed competitive bidding by auction for the allocation of mining leases[5].

The new bill provides greater decentralisation of power to sub-national governments for the allocation of resources. It requires establishing a non-profit body called the District Mineral Foundation[6] (DMF) to protect the interest of citizens affected by mining operations. Holders of mining leases are to pay the DMF an amount not exceeding one-third of the royalty in the case of new leases and equivalent to the royalty in case of old leases. The amendment allows sub-national governments to set the rules for the foundation and determine its composition (Narain 2015).

However, concern about the optimal sharing of economic rents remains, given the growing recognition of public policies in both enhancing and undermining the competitiveness of mining sector. Governments and investors have differing objectives. Governments prefer annual mining royalties that are stable, transparent, equitable to all parties, generate revenue in continuum, and are easy to administer. On the other hand, mining firms prefer royalties that are stable and predictable, based on their ability to pay, responsive to downturns in price cycles, do not distort production decisions such as cut-off grade or mine life and do not add to operating costs.

The dynamics of setting the mining royalty is complex; especially so in India, given the complex distribution of responsibilities between the national and sub-national governments and the past experience of revenue losses incurred by the State. The mining royalty regime in India is a complicated one. Occasional changes have created a complex system of royalty formulas that differ for each mineral.

5 . Auctioning of mining licenses under the new MMDR Act 2015 has not commenced yet. If a firm was issued a Letter of Intent by the State under the old law, mining license for that block would be directly granted by January 11, 2017.

6 . The idea behind DMR is similar to revenue equalisation fund to counteract revenue instability by resisting the temptation to overspend in periods of high mineral revenues and by adopting smoothing strategies.

Every three years, the royalty rates are revised upwards[7]. Subsequently, India has one of the highest royalty rates in the world (Chakraborty, 2014, 2015). Mining royalty has moved away from unit based[8] to value based[9] since 2012, but the rationalization of rates to internationally competitive rates has not yet materialized[10]. In addition, the rate estimation suffers from discretion in deciding the grade content of the extracted ore in arriving at royalty calculations (Chakraborty et al., 2016).

When value based royalty was introduced for iron ore in 2009, it led to an immediate increase of per unit royalty rates by a factor of five, while the royalty collections on iron ore increased by a factor of more than ten in the affected regions. This affected iron ore output which witnessed an immediate slump (Eynde, 2015). Such an onerous tax and royalty regime affects the competitiveness of mining firms more than firm level factors (Chakraborty, 2014). New levies – additional cess, incremental share of royalty for DMF in addition to the existing mining taxes, royalty paid and forest levies[11] have added to the costs of businesses[12] and affected new investments by mining companies.

In the coal sector, since 1993, governments have allocated 218 coal blocks to public and private enterprises for specified purposes, under the provisions of Coal Mines Nationalisation Act 1973. Serious public and political concerns were raised about the allocation of licences for coal blocks in 2004–2011. These licenses were issued preferentially at lower-than-market rates, instead of a competitive bidding process, according to the Comptroller and Auditor General (CAG) in its 2012 report. That report emphasised that the failure to conduct auctions led to a large revenue loss for the government and corresponding windfall gains for the license holders.

In 2014, the Supreme Court cancelled 214 of the 218 coal block allocations made since 1993, and imposed fines on the operational mines among them. Consequently, the government was forced to issue an Ordinance, which amended the 1973 Act, to introduce certain coal sector reforms – one of them being auctioning of coal mines. The Coal Mines (Special Provisions) Act, 2015 has now been implemented and aims at creating more fiscal space for the mining sector[13]. Three rounds of coal e-auctions have been

7 . The argument in favour of a royalty hike (in combination with a shift to an ad valorem system) focused on the need for "fair compensation" to sub-national governments, in the light of windfall revenues for miners who had benefited from strong demand in China was a genuine one. But the criteria by which rates are revised so frequently need re-examining (Chakraborty and Garg, 2015).

8 . In this case, a fixed monetary rate is applied to a physical rather than a financial base, for example as dollars per tonne or dollars per cubic metre (Guj, 2012).

9 . In its simplest form, value based or an ad valorem royalty consists of a uniform percentage (the rate) of the value (the base) of the mineral(s) in the products sold by the miner (Guj, 2012).

10 . The Hoda Committee 2006 (National Mineral Policy) recommended policy changes to make the mining royalty rates competitive, by benchmarking to Western Australia rates (Chakraborty et al., 2016).

11 . In addition to the levies under the MMDR Act, a mine operator is required to pay other fees and levies for the use of forest land for mining operations under the Forest Conservation Act, 1980 and the Indian Forest Act, 1927 (Chakraborty, 2014).

12 . The mining sector contributes to around 2.4% of India's GDP, the factors responsible for its low contribution are procedural delays, exorbitant royalty and taxation regime, and the infrastructural bottlenecks (Chakraborty, 2014).

13 . Prior to this Act, concerns were raised in the allocation of licences for coal deposit blocks to private firms by the national government during 2004–2011, which was done preferentially at lower-than-market rates, instead of a competitive bidding process, according to the CAG (Sen, 2015).

completed so far and the e-auction procedure has so far been transparent and fetched a significant amount of revenue for the government[14].

Coal mining royalty has moved from unit based to value based from 2012 onwards. There has been an upward revision in royalty on coal to 14 per cent ad valorem. After the introduction of a royalty regime that guaranteed substantial revenues from legal mining activity, sub-national governments were willing to act against illegal mining (Eynde, 2015). On the other hand, to counteract the high mining royalty regime and uncertainty emanating from e-auctioning, businesses have formed cartels to bid (Chakraborty, 2015, Chakraborty and Ravgotra, 2015).

Hydrocarbons

This sector is managed largely by the national government. The procedures for onshore and offshore licensing are different. The Oilfields Act of 1948 and the Petroleum and Natural Gas Rules of 1959, allow the national government to grant onshore licenses and to decide on royalty and surface rents. While the national government — through the Ministry of Petroleum and Natural Gas (MoPNG) and the Directorate General of Hydrocarbons (DGH) — monitors offshore oil and gas resources, the responsibility and ownership of onshore oil and gas reserves lies with the sub-national governments where such reserves are found.

The Petroleum and Natural Gas Rules (PNGR), provide for sub-national governments to grant licenses for exploration of onshore blocks with prior approval from the national government. The rates of royalty, however, are determined by the national government. As with mining, the license fee and royalty from production are collected by the sub-national governments. But they have no right to decide on the method of fixing the royalty or its periodic revision.

Before 1999, oil and gas exploration was almost entirely dominated by the two national oil companies, Oil and Natural Gas Corporation Limited (ONGC) and Oil India Limited (OIL). Since 1999, the New Exploration Licensing Policy[15] (NELP) regime has seen blocks awarded to state and non-state companies, foreign and domestic. Since then, about 250 production sharing contracts have been signed, US$16 billion of investments committed, and reserves of 700 million metric tonnes of oil and oil-equivalent gas accumulated under NELP. However, looking closely at *ex post* outcomes, the regime has yielded inconclusive results, both in terms of a firm indication of India's resource potential, and increased domestic production (Sen and Chakravarty, 2013).

A significant reason for this, among others[16], again point to the differing or conflicting objectives of optimality and efficiency. In addition to royalty and taxes, the PNGR provides for the national government

14 . Business Standard's analysis of government data when all auctioned coal blocks start production, in line with existing mining plans, the coal-endowed regions will make an annual Rs 62.84 billion from the auction. Over the lifetime of the mining plan for the auctioned blocks or over 30 years, whichever is lower, sub-national governments stand to earn Rs 1.77 trillion.

15 . NELP is based on a Production Sharing Contract between the national government and exploration company. The system was not front-loaded from the investor's point of view, and revenue (from the sharing of profits from production between the government and exploration company) began flowing to the government in proportion to the volume of cash flow, with profits beginning to be shared only after companies had recovered their capital costs of exploration. Royalty rates were reduced from 20% to 12.5 per cent for onshore and 10 per cent for offshore areas. Companies were allowed to claim back 100 per cent of exploration (capital) costs prior to sharing their profits from production with the national government. A seven-year tax holiday was granted from the start of production (Sen and Chakravarty, 2015).

16 . Procedural and process delays and policy uncertainty.

entering into Production Sharing Agreements with producers, through which it can receive, as non-tax revenue, a certain share of 'profit petroleum'. The relative shares of the government and the contractor vary, depending on the Investment Multiple ratio (i.e. the ratio of net revenue to investment (exploration + development costs) of the operator applied to the producer's cash flow in the previous year (Noronha and Srivastava, 2012).

Oil Industry Development cess is another national impost that has been levied since 1976 under the Oil Industry Development Act 1974 to help develop the oil industry. While the amount of cess has increased over the years, only a small amount has been used to benefit the oil industry, and the cess has become a key source of revenue for the national government (Noronha and Srivastava, 2012). These add to the costs of the producers, while there is little flexibility to adjust regulated prices in tune with new developments in technology or unforeseen geological conditions (Soni and Chatterjee, 2014).

The NELP regime raises question about the effectiveness of the national government in revenue maximisation and the pace of exploration by companies. The CAG in its audit of 22 NELP Production Sharing Contracts in August 2011 has claimed that large amounts of revenue had been potentially lost to the government due to poor *ex post* enforcement, particularly in relation to the monitoring of capital costs and profit sharing.

The report also criticized the DGH for not stringently enforcing relinquishment rules, which may have slowed the pace of exploration (CAG, 2011). These concerns are partially attributable to enforcement issues. But, it can also be argued that the original NELP resolution does not clearly state the objectives of the government in terms of the relative importance between optimality and efficiency (Sen and Chakravarty, 2013). Hydrocarbon Exploration & Licensing Policy has now replaced NELP that has been in existence for 18 years. The new policy aims to reduce the discretion in the hands of the government, reduce administrative delays and therefore disputes. It will not be necessary for the government to verify the costs incurred by the contractor and the policy also provides for pricing freedom.

Power

In 1991, the Ministry of Power swept away four decades of public monopoly in the generation of power. The Electricity Laws (Amendment) Act of 1991 allowed private entities to establish, operate, and maintain electricity generation plants as Independent Power Producers (IPPs) and to enter long-term power purchase agreements with State Electricity Boards (SEBs). However, little actual investment materialized. A decade later, the IPP policy was broadly viewed as a flawed and half-hearted approach to power sector reform.

A key reason for IPP's failure was the opportunity it created for graft and malfeasance. Projects were not typically selected through competitive bids, and power purchase agreements were kept secret even though they contained contracts involving public financial obligations (Dubash and Rajan, 2001).

The Electricity Act 2003 replaced all existing legislation in the sector. It required sub-national governments to unbundle their SEBs, establish independent regulatory commissions, facilitate open access to transmission (wholesale competition), and meter all electricity supply. The Act provided the sub-national governments some flexibility on how to organize ownership of the unbundled sector. Following the Enron debacle, the national government has accepted that electricity provision is a purely commercial enterprise, but has reinserted social and economic development goals as legitimate concerns within a broad framework of fiscal accountability.

In the years since the passage of the Electricity Act 2003, India has been unable to introduce any meaningful competition in the sector. The central government has sought to implement a limited form of competition – open access, largely dictated by political constraints. The idea is to allow independent power generators "open access" to public transmission wires on payment of a fee for use of those wires and a surcharge to compensate the public utility. This would enable them to contract directly with large electricity consumers, creating competition in at least a segment of the market. These consumers are likely be more creditworthy than cash-strapped sub-national utilities, thereby encouraging the entry of more generators to bridge the supply gap. Regulators drafted the implementing regulations to make this approach work.

To implement this idea effectively, regulators had to take into account political choices. If, because of open access, large electricity consumers were to shift their power purchases to independent private generators, the finances of public power generators would become unsustainable, leading to a declining quality of supply to poor, but politically important, constituencies. Large industrial electricity buyers who could exit keep the system afloat by cross-subsidising other users such as farmers and households.

The political impact of open access was, therefore, directly linked to a regulatory decision on the size of the cross-subsidy surcharge paid by large users. If it was set too low, the public utility became dysfunctional and open access became a non-starter. Most regulators have chosen the latter, or have chosen to stall on implementation of open access (Dubash, 2011).

The current government plans to amend the Electricity Act by segregating the distribution and supply businesses in order to bring competition by having multiple distribution licences in an area, giving consumers freedom to choose their supplier.

Box 1. The primary regulatory actors in the electricity sector

Central Electricity Authority (CEA): The CEA was created under the Electricity (Supply) Act, 1948 (which was replaced by the Electricity Act, 2003), and it is responsible for the technical coordination, and supervision of programmes. The CEA is also tasked with formulating the National Electricity Plan in accordance with the National Electricity Policy (NEP), and notify such plan once in 5 years. Section 73 of the Electricity, 2003, empowers the Authority to perform some of the following functions:

- specify the technical standards for construction of electrical plants, electric lines and connectivity to the grid;
- specify the safety requirements for construction, operation and maintenance of electrical plants and electric lines;
- specify the Grid Standards for operation and maintenance of transmission lines;
- specify the conditions for installation of meters for transmission and supply of electricity.

Central Electricity Regulatory Commission (CERC): CERC is a statutory body constituted under the repealed Electricity Regulatory Commissions Act, 1998 and continued under Electricity Act, 2003. Its main functions as described in the Electricity Act 2003 are:

- to regulate the tariff of generating companies owned or controlled by the Central Government;
- to regulate the tariff of generating companies, not owned or controlled by the Central Government, if such generating companies enter or otherwise have a composite scheme for generation and sale of electricity in more than one State;
- composite scheme for generation and sale of electricity in more than one State;

– composite scheme for generation and sale of electricity in more than one State;

– to advise the Central Government in formulation of National Electricity Policy and Tariff Policy.

State Electricity Regulatory Commission: The Electricity Act, 2003, holds that every state government must constitute a SERC, whose main function is to determine tariffs. Some of its important regulatory functions have been listed below:

– determine the tariff for generation, supply, transmission and wheeling of electricity, wholesale, bulk or retail within the State: If open access has been permitted to a category of consumers under section 42, the State Commission shall determine only the wheeling charges and surcharge thereon, if any, for the said category of consumers;

– regulate electricity purchase and procurement process of distribution licensees including the price at which electricity shall be procured from the generating companies or licensees or from other sources through 46 agreements for purchase of power for distribution and supply within the State;

– issue licences to persons seeking to act as transmission licensees, distribution licensees and electricity traders with respect to their operations within the State;

– adjudicate upon the disputes between the licensees, and generating companies and to refer any dispute for arbitration.

Telecoms

Before 1991, telecommunications services and products were provided by a State-owned monopoly that was a division of the Department of Telecommunications (DoT), of the Ministry of Communications. When the sector was opened to private players including foreign investors, the Telecommunications Regulatory Authority of India (TRAI) was established in 1997. The TRAI Act granted the TRAI regulatory powers while the licensing continued to remain with the DoT.

Telecom licences were first auctioned in 1995 for basic and cellular services by the DoT. Private operators bid large sums for licenses but defaulted on their payments to the government. The National Telecom Policy 1999 allowed the operators to pay their license fees by sharing part of their revenues over a 20-year period. Since then the sector has witnessed impressive growth.

In 2008, under the aegis of the Ministry of Telecommunications (MOT), the Department of Telecommunications (DoT) decided to allocate second generation (2G) spectrum licences to mobile phone operators on a first-come-first-served (FCFS) basis at a price significantly below the market price. The period 2008-2012 saw another explosive growth episode, when the number of wireless subscribers increased from 261 million to 919 million (TRAI Annual Report 2012). This growth has been attributed to the initial mode of cellular licensing in India, 2G spectrum was bundled with the license resulting in low initial investment for companies.

Although the CAG[17] estimated the loss to the Indian exchequer due to the under-pricing of 2G licences at over Rs 1.76 billion (Sen et al., 2015), mobile services in various parts of the country were offered at very competitive tariffs. The rate per minute (Call Charges per Minute, in USD) in India was 0.01 while Malaysia and Australia report 0.07 and 0.06 per minute respectively. While low tariffs and high usage reflect high consumer surplus, it highlights the difficulties businesses face in generating profits (Ravi and West, 2015).

---

17 . Later investigation by the CAG found clear evidence of insider information being passed to selected private firms on the timing of the FCFS announcement, as well as the very short time given to submit the applications (Guha Thakurta and Kaushal 2010).

The Supreme Court of India in 2012 ordered cancellation of those licenses citing irregularities in their allotment. This resulted in an increase in the cost of spectrum acquisition from around US$370 million for 2G spectrum in 2008 to around US$ 3.5 billion after 2012. Analysts have documented that "spectrum cost in India is now one of the highest in the world." Its spectrum pricing runs around "25 times costlier than the countries such as U.S., France, Singapore, Germany, Spain and Sweden." By having licenses that run just for 20 years, government policies force firms into expensive infrastructure investments without sufficient time to reap the financial rewards of those costs.

In a highly competitive environment such as India, it has been challenging to balance the need for operators to realize a profit and the government's interest in boosting revenues. Operators have limited their investment capital. In addition to license fees, taxes and levies amount to 30 percent of revenues in the sector, which is significantly higher than most other emerging countries. The impact of these high costs explains, in part, the decline in service quality as measured by increased incidence of call drops and interruptions. The last spectrum auction held in 2014 and 2015 led to national revenues of Rs.61.2 billion and Rs.110 billion respectively. But wireless operators complained that the government auction raised prices to unreasonable levels and forced them to take on high debt levels (Ravi and West, 2015). The high reserve price for 2016 auction ended with 60% of the total bandwidth on offer left unsold.

Box 2. The Telecom Regulatory Authority of India (TRAI)

TRAI was established in 1997 through an Act of the Parliament – the Telecom Regulatory Authority of India Act, 1997 to regulate the telecom sector. TRAI is responsible for regulating telecom services. Its functions include

- Ensure compliance with licenses (which are issued by the Department of Telecommunications, not TRAI);
- Lay down the standards of quality of service to be provided by the service providers and ensure the quality of service and conduct the periodical survey of such service provided by the service providers so as to protect interest of the consumers of telecommunication services;
- Levy fees and other charges at such rates and in respect of such services as may be determined by regulations

The need for establishing an independent telecom regulator emerged after the Indian economy began opening up in 1991, and the telecom sector was being reformed, with the entry of private players (TRAI website). Further, The TRAI Act was amended by an ordinance, effective from 24 January 2000, establishing a Telecommunications Dispute Settlement and Appellate Tribunal (TDSAT) to take over the adjudicatory and disputes functions from TRAI. TDSAT was set up to adjudicate any dispute between a licensor and a licensee, between two or more service providers, between a service provider and a group of consumers, and to hear and dispose of appeals against any direction, decision or order of TRAI (DoT Website).

This section has outlined that some of the objectives of regulation – i.e. to create viable, competitive industries in every sector, comprising a network of firms (whether private or public) that are nationally and globally competitive, innovative, capable of growth, employment generation, and swift, successful adaptation to new technological possibilities in their domains – are invariably obscured in India, if not subordinated to the more limited goal of maximising revenue generation for government at national and sub-national levels. That confusion of regulatory aims and objectives compromises effective regulation. However, the more active use of regulatory policy, e.g. Regulatory Impact Assessment (RIA) and stakeholder consultation, can inform the government on the cost of some of these trade-offs. Furthermore the explicit adoption of institutional arrangements that characterise a modern regulatory eco-system, such as oversight functions and independent arm's length bodies, can nurture regulatory governance.

2.2. Conflict of interest and the dominant presence of SOEs

Economic reforms of the 1990s allowed for private entry but did not entail privatization of the incumbent erstwhile monopoly service providers in many sectors. The government continues to be the policy maker and auctioneer of operating licenses while it also owns some of the largest companies in those sectors.

A noticeable feature of many of the regulators is that they are charged with the promotion and development as well as the regulation of a certain industry. That can result in the regulator thinking of the interests of the industry rather than the users of the industry. The inadequate institutional distance between regulators and state-owned firms, especially when there are no firewalls between them, has meant that the regulators have not promoted enough competition. Role clarity is one the key aspects in the governance of regulators where conflicts of interest are either avoided or the capabilities to manage them are provided (OECD 2014a).

In economies with large SOEs as in the case of India, the State is obliged, to a greater or lesser degree, to play a dual role: i.e. that of market regulator when it is also the owner of commercial SOEs, particularly in newly deregulated, often partially privatised industries. Whenever this happens, the State is inevitably conflicted in its opposing interests as: first, a major market player/firm owner in its own right, and second, as an arbitrator in the (supposedly) neutral, impartial, dispassionate role of regulator.

This conflict of interest is difficult to resolve or reconcile, especially when it comes to: (a) the State dictating the content of general corporate laws, in its own favour as shareholder, to the detriment of competitors in industries where private firms are competing with SOEs; (b) enforcing those laws and associated rules and regulations; (c) outside investor protection; and (d) ensuring competitive market efficiency. Yet, identifying and resolving conflict-of-interest situations is crucial to good governance and maintaining trust in public institutions.

Conflicts of interest arise when the State has enterprise ownership interests which improperly influence the performance of its primary legitimate statutory duties and responsibilities. A conflict of interest involves a conflict between the public duty and the private commercial interest of the State, in which the State's private-capacity interest could improperly influence and compromise the basic functions of good governance.

As a result of regulatory preferences extended to SOEs, such as being allowed to operate as monopolies and given exemptions from antitrust enforcement, SOEs entrench their monopoly/oligopoly status. That enables them to exercise a strong influence in home markets. These privileges and immunities distort competition in the market between SOEs and private enterprises. Needless to say, the Indian regulatory system suffers from various conflicts of interest.

In the financial sector, in particular for the Reserve Bank of India (RBI), where conflicts of interest arise between (a) monetary policy and investment banking; (b) monetary policy and banking regulation; and (c) the RBI as regulator versus the RBI as player (Herd et al., 2011).

In the Petroleum sector, the DGH which was established in 1993 is responsible for the holistic development of the upstream oil and gas sector and to be its technical regulatory body. But, since it falls under the administrative control of MoPNG, concerns have been raised regarding the composition and independence of the members of the DGH. That is because they are mostly appointed on deputation from public sector oil companies whose activities fall under the regulatory purview of the DGH. This leads to a conflict of interest between the DGH's objectives and the oil companies (Soni and Chatterjee, 2014).

The dominant presence of SOEs in some cases like coal has prevented the entry of private producers in the generation of electricity as preference is given to public generating companies (Nathan, 2013). The

State-owned Coal India Limited (CIL) produces around 80% of the coal in the country. The Ordinance to amend the Coal Nationalisation Act 1973 introduced in 2014, allowed auctioning of coal blocks but permitted the government to continue with direct allocation of coal mines to public sector enterprises. It also allows the government to reserve a fourth of the mines for users of coal in the cement, steel and power sectors to bid, while CIL retains preferential allocation of mines (Rai and Shah, 2014).

In telecoms, incumbent State-owned operators like MTNL and BSNL have posed legal challenges to the regulator's powers. BSNL has managed to extend its reach into mobile and internet service provision riding on its dominance in fixed line telephones outside the two major metros (Delhi and Mumbai) covered by MTNL – its other public sector rival. As government operators neither BSNL nor MTNL have to pay license fees. They enjoy rights of way, automatically, for laying cables and building towers (Gupta, 2011) which gives them an unfair advantage.

In the insurance sector, the state-owned Life Insurance Corporation of India (LIC) does not fall under the scope of the Insurance Regulatory and Development Authority (IRDA).

In this context independent arm's length entities from the government and industry are even more critical as the market referees. And their governance structures of paramount importance to ensure they can carry out the necessary function with impartiality.

2.3. Regulatory independence and effectiveness

Regulators are expected to behave and act objectively, impartially, and consistently, without conflict of interest, bias or undue influence -- in other words, independently. Independence is also about finding the right balance between the appropriate due and inappropriate undue influence that can be exercised through the regulators' daily interactions with ministries, regulated industries and end-users. Regulatory independence is a means toward ensuring effective and efficient public service delivery by market players (OECD, 2016).

Regulation is supplied in response to the demands of interest groups struggling among themselves to maximize the income/welfare of their members (Posner 1974). Under these circumstances, the challenge of independence is to avoid capture by interest groups who stand to benefit from regulation. When the government is not institutionally endowed, and when it plays an important role in regulating economic activity, such state regulation creates enormous opportunities for granting favours to selected business groups who in turn develop a vested interest in such regulation and are prepared to devote resources towards that end—resulting in what is called 'regulatory capture'; the subservience of the legal, regulatory and policy environment to the interests of those vested interest groups.

Most studies of regulatory capture focus on capture by firms. However, the nature and motivation of regulatory capture in India is quite different from the classic articulations of the capture theory. This regulatory capture or "undue influence" can be structurally institutionalised or activated at a particular moment in time to make the regulator do something it would not have done by itself (OECD 2016). Regulatory capture by local politicians, with their own vested interests in securing large economic rents in perpetuity is a common feature of Indian political life. It has large economic consequences. Politicians may indulge in inefficient redistribution or inefficient dynamic allocation of resources for political or private gains (Acemoglu and Robinson, 2001).

Regulatory capture by politicians, government or the executive can be used as a lever to operationalize such inefficient redistribution or allocation. Groundwater in India is an important setting for examining regulatory capture by politicians. MPs (Members of Parliament) do not have formal authority over groundwater provision to the farm sector, but they can facilitate access in a number of ways. The most important way is by influencing electricity provision to farmers. Regulated entities in the power sector are mainly state owned enterprises, with either an attenuated or only emergent profit motive and instinct.

Publicly owned and operated electricity boards have historically managed electricity to farmers at tariffs determined at the sub-national level. The nature of the regulatory capture threat manifests in the way local political regimes influence both pricing and regularity of supply (duration and frequency of power cuts). Local distribution of electricity is frequently documented to be captured by politicians (Nagavarapu and Sekhri, 2014).

Specialised, statutory regulatory bodies are often assumed to operate through administrative means to support the goal of economic efficiency. More generally, the notion of the regulatory state connotes greater reliance on institutions operating at arms-length from government, insulated from daily political pressures and embedding their decisions in technical expertise (Dubash, 2005). But continued interference by local politicians through the issuance of opportunistic "policy" directives has resulted in legitimately mandated regulatory functions being routinely compromised affecting the effectiveness and independence of regulatory institutions. Recommendations of regulatory bodies and the Competition Commission India (CCI)[18] authority are not binding on ministries, allowing ministries to continue with their directives.

The judiciary has had to intervene in a significant way in regulation in recent years, because the objective of regulation to deepen the role of technical and sector-specific expertise in the regulatory process has not been fulfilled effectively in the country. The Indian Administrative Service (IAS) – the elite governmental bureaucracy -- has a ubiquitous presence in regulatory bodies. Regulatory independence from the executive is difficult to administer if regulators themselves come from a career directing political decisions, and potential still with political links. This strain is exacerbated when regulators are appointed directly from senior governmental positions, requiring them to shift, from administering and defending government positions, to acting as an impartial referee. This has curtailed the emergence of a new and distinct regulatory culture (Dubash, 2008).

In the power sector, regulators have struggled to maintain a façade of apolitical decision making based on technocratic criteria, even while finding themselves constrained in various ways, explicit and subtle. Regulators have created the appearance of de-politicization while allowing for active consideration of political stakes in the decision-making process especially on key issues such as tariff-setting. Instead, a process of accommodation between the executive and the regulator, through explicit and implicit understanding, has been established.

Far from depoliticizing the sector, regulators have actively internalized political sentiments in its decision-making (Dubash, 2012). As a result, competition has not been introduced effectively in the sector and governments have been unable to deal with historically entrenched electricity pricing and subsidy patterns.

Regulatory effectiveness is affected adversely, when regulatory authorities are not granted statutory standing. In the upstream segment of the petroleum and natural gas sector, the DGH is responsible for

18 . The Competition Act, 2002, which established the Competition Commission in 2003, which became functional only in 2009. The commission aims to eliminate practices having an adverse effect on competition, promote and sustain competition, protect the interests of consumer, and ensure freedom trade in the markets of India. Before the CCI became operational, the Competition (Amendment) Act, 2006 was passed in order to create the Competition Appellate Tribunal, a quasi-judicial body. The Commission can look into the abuse of dominant position by an enterprise or a group, or inquire into agreements that have adverse impact on the competition. It can also inquire into mergers and acquisitions, based on information or its own knowledge, if such a combination will affect the competition in India (but within one year of a combination).

overseeing the development of the upstream oil and gas sector and to evolve as the technical regulatory body. DGH falls under the administrative control of MoPNG. Various expert groups and committees including the Chawla Committee of 2011 have recommended for the creation of an independent upstream regulator.

However, the assessment of MoPNG, that establishing an independent regulator is irrational, has prevailed over this debate. Continued involvement of the government in the appointment of the regulatory bodies has affected the independence of regulation in the downstream as well (Soni and Chatterjee, 2014). The board continues to attract professionals from state–owned oil and gas enterprises as its members, affecting the independence of the regulatory authority. The terms and manner of the leadership within the regulatory agency sets the tone for the overall culture of the organisation, especially in relation to independence (OECD 2016). In addition to these, the relation between the MoPNG and PNGRB has also affected the pace of development of the sector (Standing Committee on Petroleum and Natural Gas, 2012).

In other cases, regulatory ineffectiveness is due to legislative ambiguity and the lack of clarity provided in terms of jurisdictional powers vested in the CCI as well as sector regulatory bodies. In the case of an overlapping jurisdictional conflict, which regulator has the over-riding jurisdiction is not clear from the relevant enactments.

Some regulatory bodies are statutorily empowered to look into competition issues in their respective sectors, allowing them to override the provisions of the CCI[19]. When these bodies do not coordinate their decisions and processes, and when there is no overarching hierarchy of regulatory precedence, it creates significant regulatory risk for investors and increase compliance costs, harming consumer interests by rising prices.

Regulators in India are not free to make discretionary decisions in the interest of their respective sectors. Although all regulators are *de jure* autonomous bodies, they depend on government funding. Institutional stability might therefore be presumed to be high; but enforcement capacity is invariably low. Regulatory bodies simply go through the motions of following rules and process, in an effort to garner legitimacy for regulatory actions. Yet there has been limited discussion on the expected role of regulators, institutional design and capacity issues, questions of accountability, and mechanisms to safeguard independence. In other word the *de facto* behaviour of the independent regulatory agencies and ultimately whether or not their outcomes are optimal for the purpose of their existence.

2.4. Relationship between national and sub-national (state) governments

Multilevel regulatory governance – considering the rule-making and rule-enforcement activities of all the different levels of government, and not just at the national level – is one of the core elements of effective regulatory management. Any regulatory reform agenda depends crucially on a close co-operation between different levels of government. The distribution of regulatory responsibilities across national and sub-national levels has implications in terms of competition and market openness.

Regulatory overlap and inconsistencies in the application of rules/regulations prevent a country from reaping the full benefit of an integrated national market. For India’s federal structure, the Constitution has

19 . The objective of CCI is clearly stated to play an overarching role as a market regulator across all sectors with the focus on anti-competitive behaviour of companies. Sector regulations are framed ex ante (laying down performance criterion) after consultation with industry and consumers, and reviewed from time to time for correction, whereas the market regulator, CCI, performs mostly ex post functions only to curb concentration in the market. The Chairperson of CCI believes that there is a misconception in the presence of sector regulators, there is no need for a market regulator like the CCI (Sanghi, 2014).

clearly assigned responsibilities between the national and sub-national governments through the Union list, State List and the Concurrent List. Governments at different vertical levels accordingly have exclusive or concurrent jurisdictions to make laws. Licensing is a key activity at the sub-national level in many sectors. Although the sub-national budgets benefit from royalties, their rates are set by the national government.

Economic liberalisation, coming on the heels of political federalization, has transformed federal –state relations unleashing unintended and unplanned decentralisation (Sinha, 2004). As state level representation, has increased in national governments since 1996, sub-national governments have experienced considerable political and economic autonomy over the years. But they face intense fiscal pressures on their fragile economies.

India faces two fiscal imbalances: (a) vertical imbalance[20] and (b) horizontal imbalance[21]. Sub-national governments levy taxes on income from land, sales of goods and on property, while the national (or central) government has the power to tax corporate income, personal income, foreign trade, manufacturing and services sector as well as major mineral resources.

Sub-national governments' expenditures have grown over the years because of employment-intensive public services such as public health, education, and other responsibilities like agriculture, water supply, urban development etc. This increase has not matched with an increase in sub-national governments' resources, resulting in further dependence on the national government. Sub-national governments have always been critical of the uneven financial position.

The ratio of recurrent expenditure by sub-national governments to total recurrent expenditure (national and sub-national governments) has remained at about 57-58 per cent over the last 60 years while the share of the revenues collected by the sub-national governments in the total revenues has been around 40 percent. Vertical imbalance has increased because of the growing share of services sector in the Indian economy which only the national government can tax (Kelkar, 2010).

In the early 1950s, only 10 to 12 per cent of the national tax revenue was shared with the sub-national governments. That share rose to around 30 per cent from the 1990s onwards. The 14th Finance Commission[22] (2015-2020) has increased the sub-national governments' share to 42% and has conferred them more fiscal autonomy. Along with this, the expected introduction of GST (Goods and Services Tax)[23] in 2017, will allow sub-national governments to tax the services sector and correct a large part of the vertical imbalance.

Despite these renewed constitutional arrangements, federal-state relations have been affected significantly with the rise of multi- party coalition governments and alliance politics in the 1990s. Coalition and alliance partners from states have become progressively more powerful at the national level and more capable of bargaining with the national government. That political reality has added

---

20 . Vertical imbalance refers to the imbalance faced by the different levels of the government in their relative ability to raise revenues against their expenditure.

21 . There are major differences in the ability of different sub-national governments' fiscal capacities to supply essential public goods or services. The ratio of highest per capita income and the lowest per capita income amongst the regions in India is 8:1 (Kelkar, 2010).

22 . The Finance Commission is an independent constitutional body, appointed every five years. It reports to the President of India. Each Finance Commission works out its own approach, to devise a formula for sharing of the taxes, i.e. for vertical sharing and horizontal distribution.

23 . The GST will subsume many national level taxes like excise duty, service taxes, customs duty and sub-national level taxes like sales tax, other surcharges related to the supply of goods.

considerable complexity to the environmental and social dimensions of economic decision-making which need the cooperation, and an explicit ethos for regulatory governance, of both national and state governments. The need for multi-level policy coordination has been felt making way for the creation of technical and regulatory agencies at various levels, at times adding to the complexity of policy processes, at others to the bypassing of traditional forms of accountability at all levels (Arora, 2014).

The example of the warehousing sector in India highlights the need for multi-level policy making and coordination, and the issues which arise when policy exclusively belongs to a specific level. The warehousing sector had, until recently, been dominated by State-owned enterprises (SoEs) such as the Central Warehousing Corporation (CWC) and State Warehousing Corporations (SWC). In the past decade, private firms have been permitted to provide warehousing services (warehouse service providers or "WSPs").

A large number of small, sub-national level companies now dominate the private warehousing sector. Under the current constitutional framework, sub-national governments make legislation for the licensing of warehouses. Sub-national governments across the country have different licensing norms; with different standards. As a result, WSPs have been unable to expand across the country and create an integrated national market for their services. In 2006, the government passed the Warehousing Development Regulation Act, and established the Warehousing Development and Regulatory Authority (WDRA) as a national regulator. It regulates the functioning of the WSPs.

The warehousing sector suffers from uneven regulation and the absence of national standards. Stakeholders have complained that registration requirements with WDRA do not provide them any relevant information about the credibility of the WSPs. The costs of registration with the WDRA outweigh the benefits. This will ultimately affect the growth of the warehousing market, with high-quality warehousing services withdrawing from the market (Burman and Damle, 2015).

The financial market regulator, SEBI has launched a stakeholder consultation process in 2016 to review warehousing norms in order to strengthen warehousing facilities for the commodity futures market to ensure integrity and transparency in delivery and settlement mechanisms. But with SEBI as a stakeholder in the warehousing market, there may be positive developments in store for the sector in the coming years.

2.5. The evolution of the Securities Exchange Board of India (SEBI) as a credible regulator

Despite the critique of SEBI's record on its stakeholder consultation process, the annual assessment of the implementation of the Principles for Financial Market Infrastructure (PFMIs) finds that the financial market regulators -- Reserve Bank of India (RBI) and the SEBI -- have all regulatory measures "fully in force"[24].

The evolution of SEBI as a credible regulator partly stems from the fact that the financial sector falls under the Union List and only the national government has exclusive jurisdiction to make laws. This allows SEBI in its rule-making and rule-enforcement activities to function without having to coordinate with multi-levels of government. This has been a necessary but not a sufficient condition for its emergence

24 . PFMIs are global standards for securities market regulators as set by the International Organisation of Securities Commissions (IOSCO) and the Bank for International Settlements (BIS). The IOSCO Principles of Securities Regulation sets out 38 Principles of securities regulation, which are based on investor protection, fair, efficient and transparent markets and reduced systemic risk. There are five other jurisdictions - Australia, Brazil, Hong Kong, Japan and Singapore where all regulatory measures are 'fully in force'.

as a key financial sector regulator. This section looks at the various features of the regulator which has contributed to its emergence as a credible regulator.

SEBI has been set up under the Securities and Exchange Board of India Act, 1992 (SEBI Act), with a mandate to protect the interest of investors, to regulate and to promote the development of the securities market. The responsibilities of SEBI have been stated by law, and they stem from various statutes, in particular (i) the SEBI Act; (ii) the Securities Contract (Regulation) Act, 1956 (SC(R) Act); (iii) the Depositories Act,1996; and (iv) and the companies Act, 1956 in respect of listed companies. It shares certain responsibilities in the regulation and supervision of securities markets with the Ministry of Corporate Affairs (MCA) and the RBI.

There are committees between SEBI and the RBI, and between SEBI and MCA to foster coordination. Inability to prevent cases of financial fraud in the 1990s was blamed on ambiguities/gaps/overlaps in jurisdiction and regulatory arbitrage. SEBI has broad licensing, supervision, investigation, and enforcement powers and its responsibilities are clearly established by law. Based on its strong legal framework SEBI has developed robust regulations for different types of market participants, including issuers, collective investment schemes (CIS), brokers, portfolio managers, underwriters, and recognized stock exchanges (RSEs). Its robust market surveillance system and separate investigation department have effectively acted against unfair trading practices, such as market manipulation, and insider trading (IMF, 2013). SEBI orders can be challenged in the Securities Appellate Tribunal (SAT).

In terms of its structure, SEBI was created as an independent regulator with a clear and sole focus on regulation of securities markets. This was a significant departure from the Indian economic policy thinking. It marked a sharp contrast with the prevalent style of the regulatory functions at the central bank, where a wide range of functions merged together, affecting both the independence and outcomes of each function.

SEBI was the first constituent of India's financial architecture that was modern in the approach to focus on one function. The creation of a new and independent regulator led to focussed reforms of the equity markets (Thomas, 2006). The first and foremost challenge for the fledgling regulator was to create a regulatory and supervisory framework for the market, a job that proved formidable, because vested interests resisted every new step through strikes (Bajpai, 2006). Such intransigence persuaded policy makers that incremental reform of the incumbent exchanges was not feasible. The initial policy predisposition of reforming existing institutions was cast off in favour of building new ones.

Policy makers therefore opted for more fundamental reform to not only create a new exchange (the National Stock Exchange (NSE)) that would compete with the BSE but also a fundamental transformation of the equity market. NSE started trading in 1994. The success of the NSE gave confidence to policy makers and eased the way for further reforms and inspired greater policy activism in the securities markets (Thomas, 2006). Significant reforms included the introduction of a clearing and settlement system, formation of a centralised counterparty for transactions, establishment of a modern depository system for stocks, and a move from a carry-forward (*badla*) system to the introduction of exchange traded derivatives (futures/options contracts) to minimise credit, liquidity, solvency and operational risks (Bhagwati et al., 2016).

The fundamental and structural changes brought about in the market's design and operation since 1992 have resulted in broader investment choices (Bajpai, 2006). The equity market (both spot and derivatives) has evolved into becoming India's most sophisticated and most liquid market. The cost of transaction and the risk of settlement have been minimized, making Indian stock exchanges one of the safest and the lowest cost securities markets in the world (Sabarinathan, 2010). Efficiency, transparency, and safety have also increased integration with the global markets. SEBI has led the effort in improving standards of corporate governance in India in listed companies. The emphasis on internal control, board oversight, independent directors in the new Companies Act (2013) and SEBI Regulations have raised the bar for Indian companies significantly. But the conflicting interests of the dominant shareholders versus the minority shareholders and related party transactions remain the challenges of corporate governance in India.

In the larger setting of Indian finance, the equity market has been the first place where modern finance and financial regulation have taken root. The institutional capabilities and experience associated with these reforms have transformed other components of the financial system. For example, in 2008, they served to establish a currency futures market (Herd et al, 2011). However, the scope of reforms in the banking sector and insurance sector has been slow partly due to the extent of public sector presence in the sector and regulation of public sector banks (PSBs) by the RBI. This has profound effect in the way capital markets, derivatives, bond markets and the insurance market are run as well. But this is obviously beyond SEBI's powers to change radically.

Other characteristics which aided SEBI in becoming a credible regulator included; the legal foundations of SEBI were relatively new and did not suffer from any legacy constraints, the legal provisions were amended apace—in response to the requirements of the equity market, creation of a comprehensive regulatory system tailored to the needs of Indian markets, regulators' understanding of how their markets function, the leadership role played by chairpersons of SEBI in the first 10 years of its existence.

While data provide a quantitative measure of the impact SEBI's regulation has had on the securities market, they do not measure its impact on the efficiency of the market. That exercise is complicated by the quick pace at which many of the reforms have been implemented as well as the number of other factors that affect the efficiency of the securities markets. Another important aspect to measure SEBI's effect on efficiency, is the cost of regulation to issuers. The regulatory activity of SEBI imposes a cost on issuers. However, in the absence of an analysis that measures the impact of the regulation on the efficiency of the market, it is not possible to assess whether the cost incurred is justified by the benefits (Sabarinathan, 2010). Regulatory Impact Analysis (RIA), the global practice to evaluate the costs and benefits of a proposed/existing regulation would allow SEBI to judge the efficiency of its regulatory framework. Although SEBI has initiated a process of introducing RIA in 2007, it has since been carried out in a limited scope in a few situations (FINSEC, 2013).

3. SHIFTING REGULATORY GEARS – FROM MORE REFORMS TO BETTER GOVERNANCE

A *whole of government* policy towards "regulating" would provide the connectivity of different reform efforts and help the concerted effort towards regulatory governance instead of disconnected regulatory reforms. This may include a combination of creating or enabling institutions to embed good regulatory principles into their functioning i.e. their living and breathing. And it may also include the systemic implementation of good regulatory practices such as regulatory impact assessments, public consultation and administrative simplification in priority sectors. This will also allow in reaching a consensus on some key strategic and foundational principles, or even philosophy, that should be agreed upon and implemented when "regulating". These are some of the critical of a quality regulatory management system.

3.1. Institutional infrastructure for regulatory policy

A regulatory regime relies upon institutions to be the viceroys of the system and ensure the effective functioning of markets. However there are some critical institutions that are required to not only be in place but also be enabled to fulfil their part or function in a quality regulatory management system. Regulatory agencies of markets are one of these key institutions (OECD 2012). While India has created many of these, the effectiveness of such agencies and crucially their ability to act and behave independently has come under scrutiny time and again.

The credibility of the SEBI can be seen through the lens of it adhering to some key good governance principles as detailed by the OECD's Best Practice Principles for the Governance of Regulators (OECD 2014a). To a greater extent than other regulators, its role is well defined in statute and so is the role of the executive, reducing opportunities for overlap and confusion. Where coordination is required this is managed through specific bodies. And the adoption of corporate governance arrangements such as on board appointments and terms have all assisted.

Regulatory agencies, commissions and other such bodies in India, both at the national ad state level, should also follow similar institutional structures to create greater levels of trust and integrity in the objectivity of their operations. This is not only important for the regulated market at hand, but for the entire regulatory state and system. Therefore protecting from undue influence in all regulatory institutions is critically important given the some of the legacy issues of the different stages of reforms (OECD 2016).

Despite the number of bodies in India that are involved or responsible for regulatory reform, there is one function that seems to be missing and that is of a central oversight function. Most countries have an explicit whole of government regulatory policy and an oversight body, sometimes more than one, that is responsible for embedding some of the systemic tools across different parts of the government machinery (OECD 2015a). India has focussed on targeted reforms in specific sectors, but this effort to change the machinery of government has not begun.

The regulatory oversight function is an important institutional element in a regulatory quality system. Often it is centrally located at the national or federal level and plays the role of firstly disseminating best practices and driving consistency in the regulatory process. It also often plays a role in quality checking new regulatory proposals to ensure they are fit for purpose and do not impose any more burdens on citizens and business than are necessary. This often includes supporting stakeholder engagement practices and regulatory impact assessments. They often take stock of the regulatory system through annual reports so that the government machinery has clear sight over its extent and quality of regulation making. This would enhance India's regulatory state.

3.2. Stakeholder engagement

Stakeholder engagement is a central and fundamental pillar of regulatory policy. The central objective of regulatory policy – ensuring that regulations are designed and implemented in the public interest – can only be achieved with help from those subject to regulations i.e. citizens, businesses, etc. (OECD, 2015a). Regulations issued by regulators have the full status of law. But regulations are drafted by unelected officials. To reconcile this contradiction, a sound regulation-making process is needed to ensure unelected officials do not have arbitrary law-making power and are obliged to articulate the reasons clearly by following *due process*. For this, decision makers need access to the best advice and evidence available. All regulatory actions result in both costs and benefits for regulated entities and the market. Only those are expected to be implemented where the benefits clearly exceed the costs. This requires regulators to conduct formal cost-benefit analyses and engage with stakeholders through a consultation process (Pattanaik and Sharma, 2015).

Despite the fact that regulators in India actively consider the political implications of their decisions and accommodate local political regimes, regulators have enshrined the principles of transparency, participation and recourse in their administrative law procedures. In the power sector, some sub-national regulators have established a procedural framework enabling access to information about the sector, a process of public hearings in particular for tariff orders, and a mechanism for filing petitions and pleadings, power purchase agreements, new investment.

Regulatory procedures on information and participation have been expanded to include labour groups, political parties, consumer groups, individual consumers, industry associations, farmers, and other public bodies. The public engagement has resulted in re-shaping regulatory policy by deepening the procedural rules. Earlier hesitation and confusion to disclose information was partly due to staffing by individuals in the regulatory bodies who bring paternalistic attitudes characterized by former monopoly state utilities (Dubash, 2008). There is little doubt, however, that the institutional space for regulatory policy is slowly but certainly becoming more open. The broadening of regulatory space to include stakeholders is the most far reaching change brought about by independent regulation.

The Airports Economic Regulatory Act, 2008 mandates the airports regulator, AERA (Airports Economic Regulatory Authority), to 'ensure transparency in exercising its powers and discharging its functions' by holding consultations with stakeholders, allowing them to provide their feedback, comments and suggestions and documenting and expounding the decisions taken by it. The existence of the principle of transparency in the primary law has led to the AERA being a relatively responsive regulator (Zaveri, 2016).

However, the regulatory process displayed at AERA in terms of transparency and organisation is not seen in the case of country's financial sector regulators. Financial sector regulators have been endowed with a surprising mix of powers by the Parliament. Often, regulatory actions enjoy protection from judicial review as they are deemed to be "actions taken in good faith". But the regulatory process followed by them is not considered to be transparent. Regulations are issued as unilateral pronouncements. Scant information is disclosed about the problem being solved or the reason for the regulatory action. Often, there is a real risk of a ban on products, participants, retroactive changes in tax policy, and changes in investment norms being introduced without any warning or rationale (Pattanaik and Sharma, 2015).

The Report of the Standing Council on International Competitiveness of the Indian Financial Sector highlights regulation and regulatory uncertainty as important factors that impede further financial market development in the country. The regulatory track record of seeking public comments is poor. Public comments were sought only on 2.4% of RBI's circulars. SEBI sought public comments on 44.4% of its regulations and on 17.4% of its circulars. In some cases, the contents of the public consultation documents do not clearly lay out the objective of the proposed regulation, the problem being addressed, or the cost benefit analysis and propose limited solutions (Pattanaik and Sharma, 2015).

To achieve better regulatory governance in the Indian financial sector, the Financial Sector Legislative Reforms Commission (FSLRC) has proposed the Indian Financial Code (IFC), a consolidated draft law for the sector. Non-legislative elements of the draft Code are included in the Handbook on adoption of governance enhancing and non-legislative elements of the draft IFC (Handbook). The Handbook lays down international best practices on regulatory governance and lists the procedures that regulators need to follow to achieve greater transparency in regulation making (Pattanaik and Sharma, 2015). The government will introduce the IFC in Parliament after completing the public consultation process.

Experience with regulatory governance in the last two decades has resulted in the Regulatory Reform Bill 2013 (See Annex 3) which intends to legislate an overarching regulatory law to introduce further regulatory reforms and standardise some basic institutional features and processes across all regulatory bodies. Its mandate includes the constitution, powers, functioning and accountability of the regulatory bodies for public utilities and introducing of reforms towards transparency, determination of tariffs, enforcement of performance standards, promoting investment and competition.

Currently, there are not only divergent approaches to regulation but also differences in the structure of regulatory agencies (in terms of their statutory standing, mandates, tenure, qualification and selection process, appellate tribunals) across various sectors[25]. Overall, regulators lack a consistent and a coherent approach partly because of the regulatory framework in various sectors evolved at different points of time — when they were opened up to private participation. The Regulatory Reform Bill 2013 anticipates to bring a common approach and philosophy in the regulatory arrangements prevalent in different sectors. The current government has drafted a new version of the bill and NITI Aayog has launched a public consultation on the re-drafted bill.

3.3 Evidence based regulatory regime – regulatory impact assessment

The erstwhile Planning Commission's 12th five-year plan (2012-2017) recommended the employment of RIA for both existing and future regulations that affect the business environment in India. It proposed that a National Business Development and Regulation Bill should be brought to the Parliament that would enable mandatory implementation of RIA by the national and sub-national governments before a regulation is passed (ex-ante analysis) and will include periodic reviews of regulation (ex-post analysis). The ex-ante analysis will enable the government to take an informed decision from the different options available for regulation to be able to select the one which imposes minimum burden on businesses and consumers. Ex-Post analysis will ensure that the government is able to analyse the effectiveness of enforcement of regulations and lift regulation when it becomes unnecessary in a given market (invoking the sunset clause).

RIA systems provide a standardised and consistent methodology for assessing the impacts of new regulatory proposals across government. In some instances the introduction of the principles of RIA has many benefits in itself from simply scrutinising whether government intervention is necessary (Adelle et al 2015). More sophisticated adoptions of RIA include greater quantification with ultimately governments being able to know the level of burdens and benefits of regulation annually. This adds an important tool for having regulatory governance. Malaysia has recently set up the institutional infrastructure for RIA

25 . The second Administrative Reforms Commission set up in 2005 recognised these lacunae in India's regulatory structure and highlighted the lack of a legal framework which could direct the interface between the regulators and the government.

leveraging stemming from the recognition to have a national policy and process for new regulatory proposals (OECD 2015b). The need for RIA in India was also highlighted by the Committee for Reforming the Regulatory Environment for Doing Business in India that submitted its report in 2013. It proposed that every regulatory authority, national or sub-national government, ministries or departments should have a Regulation Review Authority within itself tasked to undertake the RIA of all regulations proposed by the respective body (Bharti, 2014). The Financial Sector Legislative Reforms Commission has also recommended the implementation of RIA for the financial sector. The IFC provides the necessary guidance to design the required regulatory architecture for RIA.

The Pre-Legislative Consultation Policy of the national government, introduced in 2014, also requires government departments to conduct partial RIA of proposed legislations. However, lack of political will, capacity constraints and limited awareness amongst other stakeholders are impeding its application.

The regulatory regime in India has not successfully extricated from the command and control mind-set that existed before the 1990s. Regulations are therefore drafted with that approach with objectives not defined clearly, without the cognisance of the inherent costs and benefits and without the serious implementation of the stakeholder consultation process. The narrow division between regulation and interventionism, makes the development, review, and reform of regulation, a sub-optimal exercise in India. Businesses in India have remained highly vulnerable to discretionary government action and limited analysis and assessment is conducted before utilising the discretion. RIA is therefore important in the Indian context and such an analysis would aid policymakers to question the arbitrariness.

There is a broad understanding though that the regulatory mindset - ‘the State can do no wrong’ is archaic in the context of increasing policy complexity and regulators need robust evidence-based policy mechanisms while developing and enforcing regulations. The CCI has voluntarily piloted a Competition Impact Assessment system, to assess the impact of its regulations on competition. Experts believe that India has encountered a regulatory plateau after 25 years of economic reforms, and RIA could bring about the required quality in policy debate and policy coherence. Regulatory bodies conduct a rigorous cost benefit analysis internally, but rarely engage in open public consultation and publish results of their internal processes. Therefore, the momentum for RIA could be built in India from this as the starting point and scale it up to formally integrate in the governance process.

4. CONCLUDING REMARKS

In the last two and half decades, has India moved close to becoming a regulatory state as in Majone’s (1994) characterization of the shift from public ownership, planning and centralized administration to regulation through structuring of incentives and signals? There is no doubt that the country has taken some genuine steps to evolve itself into a regulatory state, but outcomes have been mixed so far.

The ‘regulatory state’ in India has functioned in quite different ways contrary to the accepted template – of making technocratic decisions in the interests of all stakeholders without political interference. India’s experience with licensing has often revealed that the focus of the government has been over-whelmingly on short run revenue maximization. Licenses and contracts were also awarded in an opaque way. In sectors such as aviation and telecommunications, cronyism and entrepreneurship went hand in hand. Competition has been so robust in these two sectors that millions of consumers have benefited. But in other sectors like, mining and property, where businesses operated in collusion with government officials led to a large revenue loss for the government and corresponding windfall gains for the license holders. The government's focus on optimisation has affected businesses in realising a profit.

Many regulators fall under the administrative control of their parent ministry, efforts to create independent regulators have been resisted. Regulators have in other cases actively internalized political sentiments in their decision-making. Regulatory capture by local politicians is common and as a consequence undue influence exists. Even within this limited operating space for regulatory bodies, they have provided an increased range of accountability and participatory possibilities through the processes of the regulatory design.

Regulatory agencies emerged in isolation without an overarching framework guiding the development of the regulators. Several studies and committees have emphasised the need for India to formulate a regulatory framework. The Regulatory Reform Bill is an important step in this direction, however these reforms are more focussed on the establishment of commissions and bodies without examining and tackling the existing regulatory environment first. Nor does the establishment of these regulatory institutions look at their foundational governance that may be critical to them achieving the outcomes they were set up to achieve.

Notwithstanding India's checkered experience with regulatory bodies, SEBI has evolved into a credible regulator of international repute. During its inception, SEBI faced daunting challenges when vested interests resisted new reforms. Implementing radical reforms was its response to overcome the initial challenges. Other significant characteristics which have contributed to SEBI's success are that its responsibilities are clearly established by law and faced no legacy constraints and although it shares some of its responsibilities with MCA and RBI, coordination is facilitated through bilateral committees.

The regulatory bias towards SOEs, and the failure of regulators mandated with introducing more competition in their respective sectors, have distorted competition in the market between SOEs and private enterprises. the State has been obliged to play a dual role, that of a market regulator when it is also the owner of commercial SOEs and it is conflicted in its opposing interests.

Given the significant challenges in India's progression towards becoming a regulatory state, there is a compelling need for better federal-regional coordination and an adjustment in the fiscal regime related to natural resources to better reflect the interests of the sub-national governments. Multi-level regulatory governance and policy coordination has added to the complexity of policy processes in India. Although the Constitution has clearly ensured the roles and responsibilities of national and sub-national governments, the federal-regional relations have been affected significantly with the rise of multi- party coalition governments and alliance politics in the 1990s, making coalition and alliance partners more powerful and capable of bargaining with the national government.

The importance of co-ordination across levels of government has been recognised and during its short existence the NITI Aayog which replaced the Planning Commission has played the role as the main arbitrator of federal-regional relations and policy coordination. But it needs to create further mechanisms to facilitate dialogue, collaboration, develop common regulatory principles, political negotiation, sharing information and best practices. This may also involve finding incentives, including competition, between sub-national governments to implement good regulatory practice. The UK's Primary Authority system is a good example of creating business friendly conditions at the local level and creating a market for "better regulation" among local authorities.

Following the recommendations by the 14th Finance Commission, the government has increased the states' fiscal autonomy and is implementing a framework of co-operative and competitive federalism. In the spirit of co-operative federalism, India needs to revise its current profit sharing methodology related to natural resources.

Regulation and its wider public interest objectives, and the fact that regulations are drafted by unelected officials, a sound regulation-making process is needed to facilitate engagement with stakeholders through a consultation process. Despite regulators in India actively considering the political implications of their decisions and accommodating local political regimes, regulators have effectively enshrined the principles of transparency, participation and recourse in their administrative law procedures.

As SoEs continue in existence in India in many significant sectors, the country needs to clearly state the rationale for state ownership, the legal and regulatory framework for SOEs to ensure a level playing field and strong agencies to enforce fair competition.

The regulatory framework in India can be best described as uneven, without an overarching framework guiding the development of regulators. To overcome the lack a consistent and a coherent approach to the regulatory framework in the country, a *whole of government* policy towards regulatory governance is necessary instead of disconnected regulatory reforms. This must be coupled with appropriately resourced, empowered and enabled institutions to guide the whole of government policy and hold those involved to account.

The institutional infrastructure should support the systemic implementation of good regulatory practices, such as public consultation and administrative simplification in priority sectors. The Regulatory Reform Bill 2013 is an important step in this direction, and the OECD would welcome the opportunity to engage with the NITI Aayog during the redrafting process of this bill.

There exists a certain consensus on the importance of RIA and half-hearted efforts have been made so far to implement it. NITI Aayog should encourage regulatory bodies to actively implement RIA, while the CCI should lead this endeavour by example.

Perhaps also lessons can be learnt from Australia and New Zealand's Productivity Commission, which shows, most importantly, that the regulatory environment needs to be constantly evaluated to make sure it is keeping pace with the changing technology, business environment, and consumer needs and demands[26] (OECD 2010).

India could learn from the examples of those countries that adopted market reforms around the same time as India. Malaysia has undertaken large market reforms which have also led to initiatives for greater regulatory coherence. The National Policy for the Development and Implentation of Regulation (NPDIR 2012) has been the base for an explicit whole of government regulatory policy. This includes the adoption of regulatory impact assessments, standards for public consultation and initiatives to reduce regulatory burdens in key sectors (OECD 2015b). Through the work of the Malaysia Productivity Commission, there was a 52% reduction in licenses that equated to compliance costs savings of over 700 million Malaysia Ringgits (approx. 175 million USD) as part of the Modernising Business Regulation agenda. Singapore's efforts on regulatory reform are long standing and based around public-private partnership to identify and address regulatory issues through the Pro-Enterprise Panel. In both instances the involvement of the highest ranking level officials in the process and oversight is a key success factor.

In mature regulatory policy countries such as Australia, Korea and United Kingdom, the implementation of good regulatory practices has been ongoing for a number of decades. This has led to

26 . The report can be found here - http://www.productivity.govt.nz/sites/default/files/regulatory-institutions-and-practices-final-report.pdf

some of the traditional tools such as regulatory impact assessments and administrative burden reduction programmes evolving into regulatory management systems where for each new burden created there must be an equivalent burden taken out of the system. These "one in one out" systems have even translated to "one in two out or three out" mechanisms and demonstrate the systemic nature of modern regulatory governance with the appropriate institutional infrastructure. The United Kingdom's Regulatory Policy Committee is an independent body that provides opinions and scrutiny over the quality of analysis by government departments and are engaged in setting "regulatory guidance" across the government. Korea's Regulatory Reform Committee and the Ministerial meetings which is chaired by the President drive forward the regulatory reform agenda (OECD 2015a)

Even countries such as Viet Nam, for instance, adopted a new plan of public administrative reform for the period of 2006-10, and one of the main components of the reform was Project 30 – the Master Plan to Simplify Administrative Procedures in the Fields of State Governance (OECD 2011). Between 2007 - 10, a comprehensive inventory of administrative procedures was developed on an online database, along with a review of the necessity, legality, and user-friendliness of the procedures, and two sets of simplification measures (OECD 2011). Project 30 was needed to reduce the administrative burdens on businesses and citizens, which were reducing the benefits of the markets reforms that the country had introduced. The high administration costs and red tape were promoting corruption and informality (OECD 2011). The project's goal was to simplify procedures and reduce administrative costs by at least 30%. A similar approach to take stock of India's administrative procedures, along with their assessment at the same time, while making the information easily available, will accomplish several key objectives – reducing corruption, increasing transparency, and identifying administrative procedures that are redundant and unnecessary. The current national government is committed to the idea of administrative simplification to increase India's competitiveness but has yet to enact it in a regulatory policy.

For a quality regulatory management system, a review of existing institutions responsible for regulatory delivery in particular its regulatory agencies and the compliance regimes for laws and regulations would provide an initial first step towards mapping the organisational set up to effectuate a joined-up regulatory reform effort. Typically this requires a central capacity at the centre of government to coordinate and drive the collective endeavour for better policies for better outcomes. A central regulatory oversight function that may have a high-level body to monitor and set the agenda and a technical support institution to provide the secretariat function and operationalise the agenda on a daily basis.

Finally, while government often sets the policies, it is the duty of regulatory agencies to deliver the policy outcomes and achieve the goals of a more competitive, market-friendly, sustainable environment that protects consumers and the environment. The establishment and good governance of these regulators is vital to ensure the policy objectives are achieved and that the integrity and trust in the regulatory environment is built and maintained. More specifically the way laws and regulations are implemented through effective and targeted enforcement regimes and compliance strategies will determine the up-keep of the rule-of-law and help provide the certainty that is a prerequisite for investment and job creation.

In 2014, the Government of India announced a number of labour reforms[27] including simplification of labour regulations and greater transparency in inspections which is an example of the vigour with which the regulatory reforms are being introduced. A move towards an overarching regulatory governance

27 . Speech of Prime Minister, Government of India Press Information Bureau (http://pib.nic.in/newsite/PrintRelease.aspx?relid=110602)

approach would assist to propel and maintain these efforts in the future in a sustainable and systemic fashion. Perhaps this could lead towards India replacing its' "License Raj[28]" title to "Market Taj".

28 . License Raj was the system of central controls introduced in 1951 to regulate entry and production activity in the registered manufacturing sector. Industrial and investment licensing was adopted to allocate private investments according to national priorities. Under the Industries (Development and Regulation) Act of 1951, an industrial license was required to establish a new factory, significantly expand capacity, start a new product line, or change location (Agion, Burgess, Redding and Zilibotti, 2008, and Bhagwati and Panagariya, 2013). This term has been used to describe the overall approach to regulatory policy by India.

REFERENCES

Acemoglu, Daron and James Robinson (2008), 'The Role of Institutions in Growth and Development', Working Paper No. 10, Commission for Growth and Development, Washington D.C.

Adelle C, Macrae D, Marusic A & Naru F (2015), *New development: Regulatory impact assessment in developing countries—tales from the road to good governance*, Public Money & Management, 35:3, 233-238, DOI: http://dx.doi.org/10.1080/09540962.2015.1027500

Ahluwalia, Montek S. (2002). 'Economic Reforms in India since 1991: Has Gradualism Worked'? Journal of Economic Perspectives.

Alfaro, L. and Chari, A. (2009). 'India transformed? Insights from the firm level 1988- 2005'. NBER Working Papers 15448, National Bureau of Economic Research, Inc.

Arora, Dolly (2014). 'Trends in Centre-State relations,' Indian Institute of Public Administration, New Delhi. http://www.iipa.org.in/upload/Theme_Paper_Dolly_Arora_2014(_for_website-9-1-15.pdf

Bajpai, G.N. (2006). 'Developments of capital market in India.' Speech delivered at the London School of Economics and Political Science.

Bhagwati, Jaimini, M. Shuheb Khan and R. K. Reddy Bogathi (2016). 'Financial Sector Legislative Reforms Commission and Financial sector regulation in India.' Indian Council for Research on International Economic Relations Working Paper 324.

Bhagwati, J. and Panagariya, A (2013), *Why Growth Matters: How Economic growth in India reduced Poverty and the Lessons for Other Developing Countries*, Public Affairs, New York

Bharti, Aparajita (2014). 'Regulatory Impact Analysis: Hopefully, a prelude to 'Make in India'. https://policyblog.oxfordindiasociety.org.uk/2014/09/25/regulatory-impact-analysis-hopefully-a-prelude-to-make-in-india/

Burman, Anirudh and Iravati Damle (2015). 'New moves in regulating warehouses.' https://ajayshahblog.blogspot.fr

Chakraborty, Lekha (2014). 'Revival of Mining Sector in India: Analysing Legislations and Royalty regime.' Working Paper 129, National Institute of Public Finance and Policy, New Delhi.

Chakraborty, Lekha 2015. "Macroeconomic Policy for Mining Sector", Interim Report, National Institute of Public Finance and Policy, New Delhi.

Chakraborty, Lekha, Shatakshi Garg, Gurpreet Singh (2016). 'Cashing in on Mining: The Political Economy of Mining Regulations and Fiscal Policy Practices in India.' Working Paper 161, National Institute of Public Finance and Policy, New Delhi.

Chakraborty, Lekha and Shatakshi Garg (2015). 'The Political Economy of Mining regulations 2015: Spatial Inequality and Resource Curse in Two New States, India.' MPRA Paper No. 67428, National Institute of Public Finance and Policy, New Delhi.

Chakraborty, Lekha and Sahil Ravgotra (2015). 'Macroeconomic Policy Revival in Mining and Environmental Federalism: Glimpses from Modi Budget 2015- 16.' Yojana, Government of India.

Conway and Herd (2009), "How Competitive is Product Market Regulation in India? An International and Cross-State Comparison", *OECD Journal: Economic Studies*, OECD Publishing, Paris

CUTS (2013), *National Competition Policy and Economic Growth in India: Electricity Sector*, CUTS International (http://www.nathaninc.com/sites/default/files/Pub%20PDFs/Nathan_India_Electricity_Sector_Study.pdf)

Dubash, Navroz (2005). 'The New Regulatory Politics of Electricity in India: Independent, Embedded or Transcendent?' Paper presented at a workshop on the Politics of Necessity, Oxford.

Dubash, Navroz (2008). 'Institutional Transplant as Political Opportunity: e Practice and Politics of Indian Electricity Regulation.' Comparative Research in Law & Political Economy Research Paper No. 31/2008.

Dubash, Navroz (2011). 'Should electricity regulators promote competition?' The Business Standard.

Dubash, Navroz (2012). 'Regulation through the back door: Understanding the implications of institutional transplant.'Jerusalem Papers in Regulation and Governance. Working Paper No. 42.

Dubash, Navroz and Sudhir Chella Rajan (2001). 'Power politics: Process of power sector reform in India.' Economic and Political Weekly, Vol. 36, No. 35.

Eynde, Oliver Vanden (2015). 'Mining Royalties and Incentives for Security Operations: Evidence from India's Red Corridor.' Paris School of Economics Working Paper no. 2015-42.

FINSEC Law Advisors (2013). 'Regulatory Impact Assessment: Is it getting its due?'

Gowda, M. V. R. and E. Sridharan (2012). 'Reforming India's Party financing and election expenditure laws', *Election Law Journal*, Vol. 11, No. 2.

GuhaThakurta, P. and A. Kaushal (2010), 'Underbelly of the Great Indian Telecom Revolution', *Economic and Political Weekly*, Vol. XLV, No. 49.

Guj, Pietro (2012). 'Mineral royalties and other mining-specific taxes.' International Mining for Development Centre - Mining for Development: Guide to Australian Practice.

Gupta, Anshul (2012). 'Cellular Mobile in India: Competition and Policy.' Pacific Affairs: Volume 85, No. 3.

Herd, Richard, Vincent Koen, Ila Patnaik, Ajay Shah (2011). 'Financial Sector Reform in India: Time for a Second Wave?' OECD Economics Department Working Paper No. 841.

IMF (2013). 'India: Financial Sector Assessment Program—Detailed Assessments Report on IOSCO Objectives and Principles of Securities Regulation.' IMF Country Report No. 13/266.

Kelkar, Vijay (2010). ‘The Recent Evolution of Indian Federalism.’ Address to the International Development Research Centre.

Mehta, P. B. and Walton, M. (2014). 'Ideas, interests and the politics of development change in India'. Effective States and Inclusive Development Working Paper No. 36.

Nagavarapu, Sriniketh, and Sheetal Sekhri. “Less Is More? Implications of Regulatory Capture for Natural Resource Depletion.” Working Paper, 2014.

Nathan Economic Consulting India Private Limited (2013). ‘National competition policy and economic growth in India – Electricity sector study.’

Narain, S. (2015). ‘The Making of Mining Policy.’ The Business Standard.

Noronha L and N Srivastava (2012). ‘India’, In G Anderson, Oil and Gas in Federal Systems. Ontario: Oxford University Press.

OECD (2009), *OECD Reviews of Regulatory Reform: China*, OECD Publishing, Paris

OECD (2010). ‘Review of Regulatory Reform: Australia’, OECD Publishing, Paris.

OECD (2011), *Administrative Simplification in Viet Nam: Supporting the Competitiveness of the Vietnamese Economy*, OECD Publishing, Paris

OECD (2012), *OECD “Better Policies” Series – India: Sustaining High and Inclusive Growth*, OECD Publishing, Paris

OECD (2013) *OECD Best Practice Principles for Regulatory Enforcement and Inspection*, OECD Publishing, Paris.

OECD (2014a), *OECD Best Practice Principles for Regulatory Policy: The Governance of Regulators*, OECD Publishing, Paris

OECD (2014b), *OECD Reviews of Regulatory Reform: Regulatory Policy in Mexico*, OECD Publishing, Paris

OECD (2015a). ‘Regulatory Policy Outlook’, OECD Publishing, Paris.

OECD (2015b), ‘Implementing Good Regulatory Practice in Malaysia’, OECD Publishing, Paris

OECD (2016). ‘The Governance of Regulators – Being an Independent Regulator’, OECD Publishinh, Paris.

Pattanaik, Arpita and Anjali Sharma (2015). ‘Regulatory governance problems in the legislative function at RBI and SEBI.’ https://ajayshahblog.blogspot.fr

Posner, Richard A. (1974). ‘Theories of Economic Regulation.’ The Bell Journal of Economics and Management Science Vol. 5 No. 2.

Rai, Suyash and Ajay Shah (2014). ‘Rethinking the policy framework in coal’. https://ajayshahblog.blogspot.fr

Ravi, Shamika and Darrell West (2015). ‘Spectrum policy in India’. Center for Technology Innovation at Brookings.

Sabarinathan, G. (2010). ‘SEBI’s Regulation of the Indian Securities Market: A Critical Review of the Major Developments.’ Vikalpa, Vol. 35, No. 4.

Sanghi, Anupam (2014). ‘The significance of the Competition Commission of India.’ Livemint. http://www.livemint.com/Opinion/nKY6PoaDeUi9NP2aOhECYL/The-significance-of-the-Competition-Commission-of-India.html

Sen, Anupama and Tirthankar Chakravarty (2013). ‘Auctions for Oil and Gas: Exploration leases in India.’ The Oxford Institute of Energy Studies Paper SP 30.

Sen, Kunal and Sabyasachi Kar (2014). ‘Boom and Bust? A political economy reading of India’s growth experience, 1993-2013’. Institute of Economic Growth Working Paper 342.

Sen, Kunal, Sabyasachi Kar and Jagadish Prasad Sahu (2014). ‘The political economy of economic growth in India, 1993-2013.’ Effective States and Inclusive Development Working Paper No. 44.

Shah Commission (2012), Final Report on Illegal Mining in the State of Goa, Government of India.

Sinha, Aseema (2004). ‘The Changing Political Economy of Federalism in India: A Historical Institutionalist Approach.’ India Review, Vol. 3, No.1.

Soni, Anmol and Anomitro Chatterjee (2014). ‘Governance of the Petroleum and Natural Gas sector in India: A Status note.’ The Energy and Resources Institute Working Paper Series No. 15.

Standing Committee on Petroleum and Natural Gas (2012). City Gas Distribution Projects.

Thomas, Susan (2006). ‘How the financial sector in India was reformed?’ http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.460.3394&rep=rep1&type=pdf

Thomas, Susan (2014). ‘Regulatory reform in India: Improving regulatory quality.’ Finance Research Group, Indira Gandhi Institute of Development Research.

TRAI. TRAI Annual Report 2012.

Wadhva, Charan D. (2004). ‘India trying to Liberalize: Economic Reforms since 1991’. http://apcss.org/Publications/Edited%20Volumes/RegionalFinal%20chapters/Chapter16Wadhva.pdf

Zaveri, Bhargavi (2016). ‘Participatory governance in regulation making: How to make it work?’ https://ajayshahblog.blogspot.fr

ANNEX 1

GOVERNMENT OF INDIA – REGULATION MAKING POWERS

India is a Union of States with a parliamentary system of government governed in terms of the Constitution of India which was adopted by the Constituent Assembly on 26th November 1949 and came into force on 26th January 1950. The three branches of the union government are the *executive branch* consisting of the president, vice president, and a Council of Ministers (or cabinet), led by the prime minister. The *legislative branch* is bicameral with two houses of parliament. The *judicial branch* is the Supreme Court.

The executive branch or government of India is a federal entity, with the Central Government and 29 state governments for each of the states in the Indian Republic, along with 7 union territories, which are administered by the Central Government (except for Delhi and Puducherry as they have their own legislative assemblies, and have been granted partial statehood). Each level of the government derives its subjects to make laws from the Constitution of India, which divides subjects between central and state governments. A third list – the concurrent list – consists of those items on which both the governments can legislate, but in case of a conflict the central law prevails. However, those state laws, which have provisions that are contrary to the provisions of an earlier or an existing law made by the Parliament can be kept for consideration by the President, and following his assent, they will prevail in the state as long as the clauses do not interfere with the Parliament's ability to enact any other law. The concurrent list contains 52 items, including subjects like bankruptcy and insolvency, commercial and industrial monopolies, combines and trusts, trade unions; industrial and labour disputes, price control, and electricity.

Box 3. Federalism in India

Federalism in India is governed by Part XI of the Indian Constitution, which describes the relation between the Union and the States. Article 245 states that the Parliament may make laws for the whole or any part of the country, while state assemblies may make laws for the whole or any part of the state. Article 246 of the Constitution of India and the Seventh Schedule therein lists the various items on the Union, the State and the Concurrent lists. The Parliament, further, has the Residuary Powers (Article 248), which allows it to make laws on subjects not listed in the State or the Concurrent Lists.

List I, the Union list, contains the items over which the Central government has authority to legislate. Some of these items include Reserve Bank of India, stock exchanges and futures markets, insurance, taxes on income other than agricultural income, corporation tax, industries that the Parliament declares by law to be necessary for the purpose of defence, railways, national highways, and trade and commerce with foreign countries.

List II, on the other hand, includes items, like taxes on agricultural income, taxes on land and buildings, taxes on luxuries (including taxes on entertainments, amusements, betting and gambling), capitation taxes, industries that have not been deemed as necessary for defence or public interest, and trade and commerce within the state.

List III is the Concurrent List, and contains subjects like criminal law, transfer of property other than agricultural land, Contracts, including partnership, agency, contracts of carriage, and other special forms of contracts, but not including contracts relating to agricultural land, bankruptcy and insolvency, trusts and trustees, economic and social planning, commercial and industrial monopolies, combines and trusts, trade unions, industrial and labour disputes, social security and social insurance, employment and unemployment, welfare of labour (including labour conditions, pensions, and maternity benefits), price control, factories, electricity, and acquisition and requisitioning of property.

In terms of power in the Parliament, the states are represented by the Rajya Sabha – the Upper House of the Parliament (also known as the Council of States). Its membership is limited to 250 members, with 12 members nominated by the President of India for their contributions to art, literature, science, and social services. The rest of the members - the representatives of each State in the Council of States – are to be elected by the elected members of the Legislative Assembly of the State in accordance with the system of proportional representation by means of the single transferable vote (Article 80). This, however, can skew the house in favour of the more populous states. For instance, Uttar Pradesh has 31 members, while some states like Arunachal Pradesh, Goa, Manipur, and Tripura have only one member.

This imbalance of power is visible in the Lok Sabha as well, where each Parliamentarian represents a constituency, which are carved on the basis of population of the states. As a result, highly populated states, like Uttar Pradesh (80 seats), Maharashtra (48 seats), and Bihar (40 seats) tend to have greater sway in the Lok Sabha. The number of Lok Sabha members from sparsely populated states of Mizoram, Nagaland, and Sikkim is one each, like the Union Territories, which are areas administered by the Union Government.

In terms of power, the lower house has more authority than the upper house. All financial bills, like the budget, must be introduced in the lower house. Further, the Council of States must return the bill to the lower house with or without recommendations within 14 days from the date of the receipt of the bill. If it fails to do so, the bill is deemed to have been passed by the upper house. Even if the bill is returned without recommendations, it is deemed to have been passed. In case the Rajya Sabha does send the bill back with the recommendations, the Lok Sabha may or may not accept them, and the bill will pass as the Lok Sabha wants it to (Article 109).

Source : Constitution of India

Many of the essential regulation related items happen to be on the Concurrent list, which can lead to different laws in different laws in different states. This leads to differences across the states with respect to the business environment, regulatory governance, and the role of the public sector. Though the overall business environment of India is generally seen as highly restrictive, Conway and Herd (2009), found notable differences in the extent to which state government policies are conducive to competition. The product market regulation indicators revealed that the regulatory environment in some of the southern and north-eastern states was relatively more supportive of competition in contrast to states in the east and west of the country, which have regulatory frameworks that are relatively restrictive of competition. These kind of discrepancies across states can harm expansion of firms as moving across states would require adapting to different regulations.

The Parliament of India is responsible for the legislation process at the federal level, and as a bicameral legislative entity, the proposed law needs to pass both the houses – the Lower Chamber (Lok Sabha, or the House of the People), and the Upper House (Rajya Sabha, or the House of the States), which then requires the assent of the President of India. The procedure is the same in the states with a bicameral legislative assembly. States with one chamber only need to pass the bill in the one chamber, followed by the State Governor's assent.

Box 4. State Legislative Assemblies in India

The formal legislative set-up in most states consists of a Governor, and a State Legislative Assembly – a unicameral legislative assembly. However, some states have two houses, and the second house is known as the Legislative Council.

The states with two houses, currently, are; Andhra Pradesh, Bihar, Madhya Pradesh, Maharashtra, Karnataka, Tamil Nadu, and Uttar Pradesh.

The Parliament may create Legislative Councils in a state if the majority of the state's Legislative Assembly passes a resolution in favour of its creation also.

The Legislative Councils' membership cannot exceed one-third of the membership of the legislative assemblies, but it cannot be less than 40 members. Rules regarding the Money Bills are the same as in the Parliament, thus, giving the Legislative Assemblies more authority than the Legislative Councils.

Source : Constitution of India

As such, the legislative assemblies are the primary source of and authority over legislation in India. However, secondary legislation in India can be made by the Executive to support the primary legislations, or they can be made by the delegated body to ensure compliance with the law. Such directions are usually made within the specific law, which grants power to specific bodies or the Executive to issue notices, orders, or notifications. Further, the President of India may promulgate ordinances when the Parliament is not in session, if he/she feels that immediate action needs to be taken on certain issues. Ordinances have the status of laws passed by the Parliament. Ordinances are valid until 6 weeks after the Parliament is in session, or if before the expiration of that period resolutions disapproving it are passed by both Houses, upon the passing of the second of those resolutions (Article 123 of the Constitution).

ANNEX 2

SECOND ADMINISTRATIVE REFORMS COMMISSION ON REGULATORY REFORMS

The 2nd Administrative Reforms Commission (ARC) was constituted in 2005 in order to make recommendations to restructure the administrative institutes and services in India. Since then, it has come out with 15 reports, which cover a variety of issues related to the administrative structure and the governance of the country – ranging from Ethics in Governance, and Public Order to Local Governance, and State and District Administration.

The Commission was also tasked with suggesting "a framework for possible areas where there is need for governmental regulation (regulators) and those where it should be reduced". Chapter 6 of the 13th report, which focuses on the structure of the government of India, brings the regulatory structure of India into focus and makes recommendations to reform the same. Similar to the Approach to Regulations report by the Planning Commission[29] (Box 4), the ARC report recognises the main issues within the regulatory environment in India:

- Inconsistency with respect to powers and functions of the regulators;
- Independence of the regulatory agencies;
- Lack of uniformity in terms of appointment, tenure and removal of regulatory authorities;
- Lack of a legal framework which can direct the interface between the regulators and the government.

The Central Government, on its part, has accepted all the 10 recommendations made by the ARC (see Box 5 for the list of recommendations). It remains to be seen to what extent and how these recommendations will be implemented. Interestingly, some of these recommendations mirror the OECD's Recommendation of the Council on Regulatory Policy and Governance (2012). There is an emphasis on consistency, impact assessment, review of the stock of existing regulations, and evaluation of the regulator in both the recommendations.

Box 5. Second Administrative Reforms Commission: 13th Report – Organisational Structure of the Government of India

The following are the recommendations made by the commission in its 13th report on creating an effective regulatory framework:

1. Setting up of a Regulator should be preceded by a detailed review to decide whether the policy regime in the concerned sector is such that a Regulator would be better placed to deliver the policy objectives of the department concerned;

29. The report can be found here - http://planningcommission.nic.in/reports/genrep/infra_reglawl.pdf

2. In addition to the statutory framework which underpins the interface between the government and the regulator, each Ministry/Department should evolve a 'Management Statement' outlining the objectives and roles of each regulator and the guidelines governing their interaction with the government. This would guide both the government department and the Regulator;

3. There is need for greater uniformity in the terms of appointment, tenure and removal of various regulatory authorities considering these have been set up with broadly similar objectives and functions and should enjoy the same degree of autonomy. The initial process of appointment of Chairman and Board Members should be transparent, credible and fair;

4. The appointment of the Chairman and Board Members for all such regulatory authorities should be done by the Union/State Governments after an initial screening and recommendation of a panel of names by a Selection Committee. The composition of the Selection Committee should be defined in the respective Acts and may broadly follow the pattern laid down in the Electricity Regulatory Commission Act;

5. The tenure of the Chairmen and Board Members could also be made uniform preferably three years or 65 years of age whichever is earlier;

6. Legal provisions regarding removal of Board Members should be made uniform while at the same time ensuring sufficient safeguards against arbitrary removal. This could be achieved by allowing removal by the Union Government only on fulfilment of certain conditions as laid down in Section 6 of the IRDA Act with the additional safeguard that a removal for abuse of power shall be preceded by an enquiry and consultation with UPSC;

7. Parliamentary oversight of regulators should be ensured through the respective Departmentally Related Standing Parliamentary Committees;

8. A body of reputed outside experts should propose guidelines for periodic evaluation of the independent Regulators. Based on these guidelines, government in consultation with respective departmentally related Standing Committee of the Parliament should fix the principles on which the Regulators should be evaluated. The annual reports of the regulators should include a report on their performance in the context of these principles. This report should be referred to the respective Parliamentary Committee for discussion;

9. Each statute creating a Regulator should include a provision for an impact assessment periodically by an external agency. Once the objective of creating a level playing field is achieved, the intervention of the regulators could be reduced in a phased manner ultimately leading either to their abolition or to convergence with other Regulators;

10. There is need to achieve greater uniformity in the structure of Regulators. The existing coordination mechanisms such as the Committee of Secretaries/Cabinet Committees, assisted by Secretary (Coordination) could easily ensure that the institutional framework for all Regulators follow, by and large, the a uniform pattern.

Source : Commission Reports

ANNEX 3

REGULATORY REFORM BILL 2013

The Planning Commission of India drafted the Regulatory Reform Bill of 2013, and it aims to "govern the constitution, powers and functioning of the regulatory commissions for public utilities and generally for taking measures conducive to development of public utility industries, determination of tariffs, enforcement of performance standards, promoting investment and competition"[30]. Currently, the draft bill has not been introduced in either of the houses of the Parliament, and has been placed in the public domain for comments by the various stakeholders.

The proposed bill aims to supplement the existing sector-specific laws. Further, the bill includes the infrastructure sectors – electricity, oil, gas and coal, telecommunications and internet, broadcasting and cable T.V., posts, airports, ports and inland waterways, railways, mass rapid transportation systems, highways, water supply and sanitation (preface of the Bill). Several of these areas, like coal, electricity, and railways, continue to suffer from government monopoly.

The Bill allows the government to constitute regulatory commissions and appellate tribunals subject to the provisions of the Act. The draft specifies the procedure for the selection and appointment of the chairperson and the members of the commission and the tribunal, which will be done through a selection committee as described in the draft (Article 4). It also provides guidelines for the qualifications for the members of the commissions, along with terms of office and conditions. The chairperson and members can only hold office for a term of 4 years, and are not eligible for reappointment. Further, members are not allowed to acquire, hold, or maintain directly, or indirectly, any office, employment or consultancy arrangement or business with any entity or its associates dealing in matters under the jurisdiction of the regulatory commission, or represent any person before the regulatory commission of which he/she was member (Article 6).

The draft, also, confers certain powers on the commissions, which they will have, irrespective of the powers assigned to it under the applicable law that allow the commissions to -

- Issue licenses in all cases where such licenses are required to be issued under the applicable law
- Regulate tariffs and other charges in accordance with the applicable law
- Enforce compliance with the provisions of the rules, regulations, licenses, and other instruments issued under the applicable laws
- Collect, analyse, and disseminate information and statistics concerning the relevant public utility industry and in particular matters affecting consumer interest

30. Regulatory Reform Bill - http://www.prsindia.org/uploads/media//draft/Draft%20Regulatory%20Reform%20Bill.pdf

The terms and conditions of tariff determination are also listed in Part VI of the draft. The commission may apply the ones listed in the draft or the ones listed in the applicable law. Tariff determination must be guided by the following principles -

- Commercial principles that would promote investment and competition
- Safeguarding of consumers' interest
- Determination of recoverable rate of system losses, which takes into account all relevant considerations
- Cross subsidisation among different classes of consumers is reduced progressively
- Rural areas have access to the public utility industry at an equitable tariff
- Economically weaker persons have access to the public utility industry at an equitable tariff.

  However, the draft does give the government leeway to direct the commission to not determine the tariffs if the government is satisfied that the prevailing market conditions and competition are sufficient to determine the tariff.

The draft, further, has a part dedicated to competition, under which the commission is allowed to prohibit, prevent, or restrict any agreement, action, practice, or procedure that affect the competition in the specific public utility industry, such as directly, or indirectly, fixing pricing or market shares, or abusing market power or monopoly situations. However, the regulatory commission may refer any competition-related matter to the Competition Commission, where necessary, for opinions, investigations, or adjudication of disputes.

Comparing the points for the governance of the regulatory commissions with the OECD's Best Practice Principles for the Governance of Regulators, there is little similarity. The draft provides for role clarity of the regulator along with the architecture of the governing body, but it leaves quite a bit of room for specific legislations to fill in the gaps. While the specific commissions will be governed by the applicable law that will set-up the commission, the draft bill provides a strong framework that outlines the objectives and the functions of the commissions. The draft bill, however, does not establish a sector specific or a multi-sector regulator. It merely provides the skeleton for one. However, a significant principle missing from this skeleton is performance evaluation. The agencies have the power to collect information from the regulated entities (Article 14), but this is not for the purpose to evaluating its own performance.

The draft provides for engagement through a National Advisory Committee, which is to be established by the regulatory commission. The Committee shall consist of not more than 21 members, who will represent various interests – consumers, commerce, industry, agriculture, transport, labour, NGOs, and academic and research bodies. This committee is to advise the commission on issues, like policy questions, protection of consumer interests, and matters related to quality, continuity, and extent of service provided by the licensees. However, a legislative compulsion to establish such a body may be unnecessarily rigid or prescriptive (OECD 2014).

The future of the bill is unclear. It had been drafted by the Planning Commission, and had been approved by the Government of India in December, 2013. Since its approval, it has been placed in the public domain for consultation with various stakeholders, and for eliciting comments and views on the nature of the bill. The winding-up of the Commission by the new government in August 2014 leaves the bill in an uncertain state despite the new government's continue signals of the importance of regulatory reforms.

Box 6. Approach to Regulation: Issues and Options

Approach to Regulation was a consultation prepared by the Planning Commission in August 2008, which analysed the "state of regulatory law and policy in India" and proposed "a broad policy approach to guide the next stage of regulatory reform". The Regulatory Reform Bill had been prepared in response to the recommendations made by the consultation paper.

The paper focuses on the uneven approach to regulation across the country, which has, often, led to unnecessary, inadequate, and expensive reform. The paper points out that regulatory agencies in India have emerged on a sectoral basis, where each line Ministry or State Government, often prompted by a multilateral funding agency, has constituted a regulator for a particular sector of the economy, which has resulted in an uneven regulatory environment. Such an approach, is bound to be expensive in terms of economic growth and welfare. The paper, further, compares the development of a regulatory framework in the US, the UK, Australia, and Sri Lanka.

Finally, the paper puts forth the key issues that need to be addressed while developing the approach towards regulatory reforms in India -

- The objective of the proposed approach should be to establish an overarching regulatory framework to eliminate different mandates currently set out for the sectoral regulators;
- Regulations should aim at removing barriers to competition, and it should be recognized that competition is the best safeguard for consumer interests;
- All regulatory institutions should normally be empowered to make regulation, issue licenses, set performance standards, and determine tariffs, along with the power to enforce these functions;
- The paper emphasizes that regulatory institutions be independent and autonomous. Selection, appointment, and removal of chairpersons and members should fair and transparent. The qualifications for the same should be precise, along with their tenure. Financial autonomy can be ensured by allowing the regulator to present a budget to the parliament.
- It is also necessary that the regulator be accountable through various other institutions and processes.

Source : Planning Commission of India and Approach to Regulation
((http://planningcommission.nic.in/reports/genrep/infra_reglawl.pdf)