ILLUSTRATION BY AJAY MOHANTY

Great institutions, not great men

India must make sure that capabilities lie in institutions and not in one person

We repeatedly get excited about some individual, but the rule of men always disappoints. What matters is to build institutions that have competence, consistency and predictability, and are not vulnerable to the whims and fancies of individuals. The journey to this is grounded in fundamental redesign of laws and institutions, with an emphasis on the rule of law.

Like children, we are keen to find a hero. We believe the hero can do no wrong, and we expect the world from the hero. But as Bertolt Brecht wrote in *Life of Galileo* in 1939, "Unhappy is the land that needs a hero". A few years later, we always look back with disappointment about how little the Great Man got done. The rule of men always disappoints.

If you were accused of a crime, would you like to face one judge or a bench of five judges? Five judges are more likely to find the right answer. It is harder for the bad guys to pressure five judges. Our journey as India is about going from the machinations and arbitrary power of a khap panchayat, to a bench of judges that works within the rule of law.

We have seen judges go rogue; we have seen Reserve Bank of India governors go rogue. The solution is not to search for a next hero. We must reduce their power so that no one person matters too much, so that the consequences of one person going rogue are minimised. Capabilities should lie in the institution and not the person.

When monetary policy instruments are controlled by one person, this is risky. He could be wrong. He could pursue his own career objectives, making deals with the ruling party where the inflation objective is sacrificed in return for certain favours. It is safer to place control of monetary policy instruments with a committee.

Hence, the world over, monetary policy instruments are controlled by a Monetary Policy Committee (MPC). As an example, in Australia, the MPC gives two votes to the governor and seven to external independent experts who owe the governor nothing. In an MPC of nine people, winning requires five votes. The governor can have his way if he is able to convince at least three out of the seven external members. This seems like a reasonable amount of power for him.

SNAKES & LADDERS

AJAY SHAH

In the MPC that we are headed towards in India, there are three internal members, three external independent experts, and the governor has the casting vote. There is no MPC in the world where the governor has a casting vote. Under this design, the governor has his way even if all external members disagree with him. This is just a cosmetic improvement upon the present arrangement; it is as vulnerable to the identity of the governor as is the case today. Under this design, external members feel their voting is pointless and will devote little effort to this work.

Arbitrary power is found in opacity; accountability is found in transparency. The key ingredient which keeps every member of the MPC honest is the requirement to vote, to provide a rationale with the vote, and the public release of these documents. This is analogous to a bench of judges, where each person takes a reasoned stand in public. This transparency creates pressure to do the right thing, as opposed to trading in favours.

Thanks to this transparency, we know the names of judges who collaborated with Indira Gandhi's attack on the rule of law. Similarly, in 2011, the European Central Bank launched a pre-emptive strike on inflation. They were wrong, and they quickly backed off. The individuals who voted for that pre-emptive strike have suffered reputational and career damage.

Similar issues apply to laws that are written by regulators. Unelected officials write laws in the form of regulations. This is a troublesome concept, when the power to frame laws ordinarily only flows from the legitimacy of winning elections. This is particularly dangerous when power in a regulator is concentrated in one person, so one unelected official writes the law.

Airports Economic Regulatory Authority (Aera) and Telecom Regulatory Authority of India (Trai) have some of the best processes for regulation-making in India, flowing from their laws. The Supreme Court recently struck down a regulation by Trai on the grounds that it was inadequately argued. This order is a major milestone for India in demanding sound regulation-making processes. At present, all financial regulators merrily violate a good governance handbook that they have agreed to abide by. Individuals in financial regulators have the power to arbitrarily issue a new law on the website with no checks and balances.

Such concentration of power and lack of due process yields bad results. As an example, blunders at RBI have given us a massive banking crisis. RBI's work in banking, payments, capital controls and the bond-currency-derivatives nexus is a litany of failure. When selection of payments banks and small finance banks was done, it used an arbitrary procedure which is inconsistent with the Supreme Court's order on coal block allocation. Why were so many mistakes made? The solution lies not in hiring a Great Man, but in better drafting of the primary law, which ensures rule of law, requires a sound regulation-making process that ensures adequate checks and balances.

The Supreme Court's order on Trai's regulation-making process urges Parliament to frame a law that requires sound processes of all regulators. The draft Indian Financial Code, that was the work of B N Srikrishna's Financial Sector Legislative Reforms Commission, answers this challenge. Similarly, the process in the draft Indian Financial Code for licensing of banks is consistent with the Supreme Court's order on coal blocks.

There are severe gaps in the mainstream understanding in India of political philosophy and public administration. The media and the Facebook/Twitter mob create a hype about individuals, and are perennially in the search of great men. The essence of sophisticated state machinery, however, lies in dispersion of power, checks and balances, and the rule of law.

The writer is a professor at National Institute of Public Finance and Policy, New Delhi