



Eight principles for better regulators

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India has setup numerous regulators. The 25 years of experience with regulators is a story of skirmishes between departments of government and the regulators they created. These problems are caused by faulty structuring of the regulators. Eight simple principles will draw the lines properly. If all parties will use these principles, they will yield a harmonious relationship and high performance.

When India started retreating from socialism in the early 1990s, many regulators were setup. It was thought that this was a way of moving away from central planning. There are now over a dozen regulators in the central government, and every state government has created a few.

Every regulator is grounded in a law and has a parent department of government. As an example, Parliament enacted the Telecom Regulatory Authority of India (Trai) Act, 1997. Parliament, represented by the Department of Telecommunications, is the principal and Trai is the agent. The law, in this case the Trai Act, is the contract that defines the relationship between the principal and the agent.

A good contract should induce a good relationship. Both sides of a well-structured contract should work as a smooth machine. Most of the time, this has not come about with Indian regulators. The leadership of departments has myriad complaints about what regulators are doing, and vice versa. There are some good periods, but they are about personalities on both sides. Low intensity warfare is the norm, which periodically erupts into the public domain with journalists taking sides. There has long been a rough idea that the department must determine policy and the regulator must imple-

ment this policy, but this has not been translated into an operational doctrine. Creating regulators was supposed to combat central planning, but India has often failed in this regard.

Every now and then, a “Lok Pal solution” is proposed: Good people should be hired into regulators and they should be left free to do as they like. This is sold under the banner of “regulatory independence”; the media screams that every instance of interference in a regulator is a bad thing. The simple slogans, however, don’t get things done. If unelected officials are hired to run an agency, and given full freedom to do as they like, they are unaccountable and may pursue the wrong objectives. The feedback loop of elections leading to Parliament and Cabinet is a key source of accountability and performance.

Here are eight principles that will create a sound working arrangement, which will yield superior performance by the regulators:

- Regulators must fuse legislative, executive and judicial functions. The regulator must have the authority to write law, which is termed a “regulation”, within parameters clearly laid down in the Parliamentary law. Many depart-

ments are stingy about giving regulators this authority, which should change.

- All members of the board of a regulator must be appointed by the department. The board should have a majority of independent directors. The chairman of a regulator (e.g. D Subbarao at the Reserve Bank of India) should gracefully accept the recruitment decisions of the department; the board should not be the appointing authority for itself.

- The department must have one nominee member on the board. The board’s role is to push the management of the regulator towards performance. It must continuously analyse the regulator’s performance, and reshape the organisation structure, process designs and resourcing. Failures of the regulator should result in feedback to the board, which should diagnose the causes and make consequential changes. Regulatory staff should gracefully accept their accountability to the board, and the power of the board to continually reshape the organisation to improve performance.

- The staff of the regulator should not have the power to write law; this power must only vest with the board. This means that the department must develop a point of view on all regulations. The appropriate forum for expressing these views is board meetings. When faulty regulations come out, this is the fault of the board.

- The board must not be involved in executive and judicial activities. The department, or any external board member, should have no say in any individual transaction with issues such as licensing, investigation or orders. Phone calls should not be made by the department to the management asking for favours on transactions. This is the narrow space where the word “regulatory independence” comes in.

- When private persons are unhappy about an order written by a regulator – e.g. rejecting an application for a license – the appropriate port of call is an appellate tribunal. At present, unhappy private persons informally complain to the department.

- The department is the principal. It must constantly ask itself whether the contract (the law) is appropriate. It must regularly change the law in order to refine the principal-agent relationship, and to modify the work allocation to the agent. The regulator must respectfully stay out of questions of its turf or the drafting of the law. The department must regularly modify the agency architecture, of what work is done by what agencies, in the quest for performance.

- The department thus has four functions: Making appointments, regulation, observing performance and continuously refining the organisation design of the agent, and, continuous refinement of the contract between the principal and the agent. It must create capacity for discharging these functions. This includes internal skills, connections with research institutions, and a stream of conversations with practitioners.

Left to itself, every organisation veers towards laziness and corruption. Accountability mechanisms and feedback loops are essential for achieving performance. The board is the centre piece of this process with regulators, as it is with large corporations. A board with a majority of independent directors, which wields the power of organisation design and resource allocation, will push the management team to perform. At the same time, regulatory independence is required on transactions.

These eight principles give simple and clear lines about the roles and responsibilities of the department and the regulator. They need to infuse all the laws that create India’s regulators, and they have important implications for the working of the corresponding departments.



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