

## RESPONSIVE REGULATION AND INDIAN PRACTICE

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### ABSTRACT

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*Under the leadership of Prime Minister P.V. Narasimha Rao, the government of India in 1991 launched a new economic policy that opened the doors of the Indian Economy for private as well as foreign investors. However, this policy would have become a success only if the private activities were to be regulated by independent regulators. As a result, the government of India created a lot of independent regulators like the Securities and Exchange Board of India, Telecom Regulatory Authority, etc.... In most of the cases these regulatory authorities have acted in a non-partisan manner.*

*However, it has been observed worldwide that the market can act more effectively if the regulatory authorities will take into consideration the interests of the regulatees. In the light of the above facts, the authors in this paper have studied how responsive the Indian regulators are and also how the responsiveness of the regulatory agencies can be increased.*

**Keywords-** *Independent; Regulator; Regulatees; Responsive; Regulation.*

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## RESPONSIVE REGULATION AND INDIAN PRACTICE

### *Introduction*

In the 21<sup>st</sup> century world, one cannot imagine any economic activity without regulation. Even simple economic activities are controlled by government regulations. As the transaction and value of economic activities increases, these regulations become even more complicated.

The twentieth-century world was very much dominated by socialism. But the present century is all about the free market. In the era of liberalization, privatization, and globalization the shares of government in economic activities have decreased. It is pertinent to note that not only the conservative governments but even the socialist governments are selling their assets. We have witnessed the same in Australia and U.K. wherein the Labor governments sold the government assets. Furthermore, the Congress Party in India which advocated socialism in the mid-twentieth century also switched to liberalization and privatization in the 1990s.<sup>1</sup>

However even though governments all across the world are selling their assets to private parties, they have not reduced their control over these assets. To ensure proper results and increase output the governments sold the assets to private parties. But, to ensure that the private parties don't act contrary to the public policy, the government has come up with a lot of regulations.

In the late 1980s the Australian government decided to privatize certain entities. This move of the Australian Government was surprising because the same was suggested by a Labor Government which is a beacon of socialism all around the world. However, as the Labor party privatized these entities, they came out with even stricter regulatory norms so that the private entities don't act against the public policy. In the case of Qantas (An Airline Company), many were worried that its privatization would increase the risks associated with flights. However, the Australian government strengthened the air safety regulation so that the private bodies don't act contrary to public welfare.<sup>2</sup> However, it is important that the regulators should consult the regulatees while framing

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<sup>1</sup> John Braithwaite, 'Types of responsiveness in Regulatory Theory' in Peter Drahos (ed.) *Regulatory Theory* (1<sup>st</sup> edition, ANU Press, 2017).

<sup>2</sup> *Id.*

regulation because these regulations will affect the regulatees financially. As a result, the theory of responsive regulation has been propounded.

### ***Responsive Regulation: A Conceptual Discussion***

The concept of responsive regulation is an idea proposed by the economists Ian Ayres and John Braithwaite in an imminent book “*Responsive Regulation*” which was published in the year 1992.<sup>3</sup> The term regulatory responsiveness implies that the regulatory authority should be responsive to the regulatory environment. Furthermore, the regulator should intervene only in the case wherein an intervention is necessary. If the intervention is not required then they should not intervene. It is also pertinent to note that it’s not only the regulators but even the actors of the civil society that can act responsively.<sup>4</sup>

John Braithwaite in his article titled, “*Types of Responsiveness*” argues that if an armed robber for repentance decides to work for the welfare of the community, then it’s the duty of the regulator that it does not punish the robber for his previous wrongdoings.<sup>5</sup>

As a result, some people worry that responsive regulation might result in inconsistency. Furthermore, there are contradictory views in regard to responsive regulation. Some people argue that the regulatees are responsible entities and they can be persuaded by the regulatory authorities to act in accordance with the regulation. However, the critics of responsive regulation argue that it’s only the punishment that can make regulatees act as per the regulations. Both the contentions made in favor/ against the responsive regulation are correct. So now the question arises is what should be done? What would be the best way?<sup>6</sup>

John Braithwaite has answered the same with the help of a pyramid. At the bottom of the pyramid is Persuasion. This is followed by a warning letter. Post warning letter we have the civil penalty. A civil penalty is then followed by the criminal penalty. At last, we have license revocation. John Braithwaite argues that initially, the regulators should try to persuade the regulatees to act in

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<sup>3</sup> Ian Ayres & John Braithwaite, ‘*Responsive Regulation*’ 22 (1<sup>st</sup> edition, Oxford University Press, 1992).

<sup>4</sup> John Braithwaite, ‘*Types of responsiveness in Regulatory Theory*’ in Peter Drahos (ed.) *Regulatory Theory* (1<sup>st</sup> edition, ANU Press, 2017).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

accordance with the regulations. Since the regulatees are responsible entities so the regulators can easily persuade the regulatees. However, if the persuasion fails then the regulators should issue a warning to the regulatees. In case the warning does not work then the regulators can impose a civil penalty. Even if the civil penalty does not deter the regulatees then the regulator should impose a criminal penalty. However, if the criminal penalty also fails to deter the regulatee. Then at last the regulator should revoke the license of the regulatee.<sup>7</sup>

The concept of responsive regulation has influenced the whole world. Countries and regulators all over the world have switched to responsive regulation. Since most of the business entities are responsible entities, the problem is solved at the persuasion stage itself. It's only in exceptional cases wherein the regulators have gone up to the extent of revocation of license.<sup>8</sup>

### ***Limitations of Responsive Regulation***

Though Responsive Regulation is the need of the hour, we cannot deny the fact that there are certain limitations of responsive regulation. The first major limitation of responsive regulation is that in certain cases step by step escalation up the pyramid might not be suitable. For example: In cases wherein, the companies are involved in the business of something in which a lot of risks are involved. Then in those cases, it will not be correct for the regulatory authorities to move step by step up the pyramid. In a business wherein public safety is at stake than the regulatory authorities need to take the harshest of steps very early.<sup>9</sup>

Secondly, in certain cases, it is necessary that the regulatory agency moves down the pyramid and decrease its punitive approach towards the stakeholders. Ayres and Braithwaite in their book argue that once the regulatory authority punishes a stakeholder then the relation between the two worsens. So, it will be difficult to ensure that no prejudice exists between the regulators and the regulatees even after a sanction has been imposed.<sup>10</sup>

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<sup>7</sup> Ayres and J. Braithwaite, *Responsive Regulation* 25 (1<sup>st</sup> edition Oxford University Press, 1992).

<sup>8</sup> John Braithwaite, 'Types of responsiveness in Regulatory Theory' in Peter Drahos (ed.) *Regulatory Theory* (ANU Press, 2017).

<sup>9</sup> Robert Baldwin, Martin Cave & Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* 260 (1<sup>st</sup> edition, Oxford University Press, 2012).

<sup>10</sup> *Id.*

Furthermore, the regulators presume that it's their pressure and sanctions which affect the conduct of the regulatees. But it's the culture prevailing in a particular sector that plays a major role. Lastly, it is presumed that responsive regulation is most effective when a binary relation exists between the regulators and the regulatees. There is a clear understanding between the regulators and the regulatees and both of them can predict each other's behavior. However, the critics argue that even in the case of binary relationships such coordination can't be developed. There will be certain kinds of interference which will come up between the two.<sup>11</sup>

### *A Case Study of Responsive Regulation in India*

In the year 1991, the government of India came out with a new economic policy of liberalization, privatization, and globalization. The new economic policy of the government increased the share of private entities in the market. However, this policy of the government could have become successful only if there were independent regulators to regulate the conduct of the private bodies. As a result, the government of India created an independent regulator in every sector.<sup>12</sup>

But the unfortunate part is that there is no common administrative law framework that regulates the conduct of every regulatory institution. Every regulatory institution is governed by its statute. As a result, there is a lack of common behavior among all the regulatory institutions. Furthermore, it is pertinent to note that the members of these regulators are not democratically elected. Therefore, it is necessary that these regulators must follow the policy of responsive regulation.<sup>13</sup>

To understand the degree of responsiveness followed by our regulatory authorities Anirudh Burman and Bhargavi Zaveri conducted a study of 4 regulators- Telecom Regulatory Authority of India (TRAI), Airports Economic Regulatory Authority (AERA), Security Exchange Board of India (SEBI) and Reserve Bank of India (RBI). In this paper, the authors have done an empirical study to measure the responsiveness of the Indian regulators.<sup>14</sup>

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<sup>11</sup> *Id.*

<sup>12</sup> Anirudh Burman & Bhargavi Zaveri, 'How Responsive Are India's Regulators?', Bloomberg Quint (Nov. 21, 2022, 7:00 p.m.), <https://www.bloombergquint.com/law-and-policy/how-responsive-are-indias-regulators>.

<sup>13</sup> Anirudh Burman & Bhargavi Zaveri, "Regulatory responsiveness in India: A normative and empirical framework for assessment," Indira Gandhi Institute of Development Research, Mumbai Working Papers 2016-025 9 (2016).

<sup>14</sup> Anirudh Burman & Bhargavi Zaveri, 'How Responsive Are India's Regulators?', Bloomberg Quint (Nov. 21, 2022, 7:00 p.m.), <https://www.bloombergquint.com/law-and-policy/how-responsive-are-indias-regulators>.

The benchmark which these researchers used to measure the responsiveness of a regulator is as follows-

*“(i) Whether the regulator publishes any explanatory document? (ii) Did the regulator interact with the stakeholders before framing any regulation? (iii) Do the regulatory agencies publish comments received before they issue the final regulation? (iv) Does the agency provide time for counter comment? (v) Does the agency respond to the comments received? (vi) Does the agency provide for more than one method of receiving feedback from the stakeholders? (vii) Does the agency publish a statement of when the decisions will be made based on the consultative process? (viii) Does the agency publish the name of the individual in charge of the consultative process? (ix) Does the Agency publish the source of the legal power to issue the proposed regulation? (x) Does the Agency give adequate time for responding to the draft proposed by it?”<sup>15</sup>*

To get the answers to their questions the researchers went to the website of every regulator. The final score revealed that in very few cases the regulators publish explanatory documents before issuing a regulation. While Telecom Regulatory Authority of India (TRAI) and Airports Economic Regulatory Authority (AERA) do so for about half of their regulations, Security Exchange Board of India (SEBI) and Reserve Bank of India (RBI) fare extremely poorly. Only TRAI and AERA published comments received by them during this period, while SEBI and RBI rarely do so. And only TRAI publishes its responses to comments.<sup>16</sup> The final results are quite disappointing because it indicates that the Indian regulators are least responsive.

The current scorecard reveals that there is an urgent need to improve the responsiveness of regulators. The government needs to come out with a strong legislative reform. The degree of responsiveness of regulators in a country has a direct correlation to how well the rule of law is observed in a country. The interaction with the stakeholders is important because it's the stakeholders who will be most affected by the regulations of the regulatory authorities.<sup>17</sup>

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<sup>15</sup> *Id.*

<sup>16</sup> Anirudh Burman & Bhargavi Zaveri, 'How Responsive Are India's Regulators?', Bloomberg Quint (Nov. 21, 2022, 7:00 p.m.), <https://www.bloomberquint.com/law-and-policy/how-responsive-are-indias-regulators>.

<sup>17</sup> Anirudh Burman & Bhargavi Zaveri, "Regulatory responsiveness in India: A normative and empirical framework for assessment," Indira Gandhi Institute of Development Research, Mumbai Working Papers 2016-025 9 (2016).

The first step which the government needs to take is that there should be a common administrative framework for every regulatory agency. It is high time that the Central Government gives serious consideration to the report of The Financial Sector Legislative Reforms Commission (FSLRC). The Financial Sector Legislative Reforms Commission gave the following proposals-

*“(i) Review and if necessary, rewrite the legislations which adversely affect financial markets in India. (ii). Evolve a common set of principles for the governance of financial sector regulatory institutions. (iii). Remove inconsistencies and uncertainties in legislation and make legislations consistent with each other. (iv). Streamline the regulatory architecture of financial markets.<sup>18</sup>”*

If the same is implemented then it will become easier for the regulatees to abide regulation. In case of inconsistencies, it becomes quite difficult for the regulatees to follow regulation and when they don't follow regulations then they are punished by the regulators. So, the implementation of FSLRC will make it easier for the regulatees. Apart from that the Indian Regulators need to understand that the private entities are sensible bodies. It is not necessary that they punish them strictly in order to ensure that there is a proper compliance of regulation.

As stated earlier the regulatees are responsible entities so the regulators can easily persuade the regulatees. However, if the persuasion fails then the regulators should issue a warning to the regulatees. In case the warning does not work then the regulators can impose a civil penalty. Even if the civil penalty does not deter the regulatees then the regulator should impose a criminal penalty. However, if the criminal penalty also fails to deter the regulatee. Then at last the regulator should revoke the license of the regulatees.<sup>19</sup>

### ***Conclusion and Suggestions***

In the era of privatization and globalization the role of private entities has increased. Today the private parties play a major role in our economy. Even in the 2021 budget, the Union Government has shown an inclination towards disinvestment wherein they have decided to sell certain assets to the private parties. However, we need to keep in mind that when privatization will increase,

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<sup>18</sup> ‘The Financial Sector Legislative Reforms Commission’, PRS India (Nov. 23, 2022, 7:30 p.m.), <https://www.prsindia.org/report-summaries/financial-sector-legislative-reforms-commission>

<sup>19</sup> Ayres and J. Braithwaite, *Responsive Regulation* 25 (Oxford University Press, 1992).

regulations are bound to increase. We have a case of Australia wherein with the increase of privatization there has been an increase in the number of regulations. This is because the government cannot let the private parties act as per their own whims and fancies. Furthermore, the modern state is a welfare state so the private entities are supposed to abide by public policy.

However, it is important that we have a responsive regulation making process. It is because these regulations are mostly made by the regulatory bodies which are not democratically elected. Thus, these regulatory authorities are not accountable to the public in large. These regulatory bodies do submit regulation before the Parliament for the purpose of review. However, the Parliament hardly reviews it in a proper manner. A PRS study reveals that most of the regulations are not even reviewed by the Parliament. As a result, it is necessary that we need to have responsive regulation. It will make the process more democratic because the stakeholders will be able to voice their concerns before the regulatory authorities. The views of the stakeholders should be taken into account because the regulations will affect the working of the regulatees.<sup>20</sup>

Apart from that the regulations made by these regulatory authorities are supposed to be followed by the private entities. Sometimes these regulations also impose economic cost over the entities thereby affecting their business decisions. If the views of the stakeholders are taken into consideration and there is a responsive regulation making process then the predictability will increase which would improve business and also ensure better law compliance.<sup>21</sup>

At last, the authors will suggest following measures to improve the current situation-

- (i) The regulators should publish more explanatory documents.
- (ii) The regulators should interact with regulatees before framing regulations.
- (iii) The regulators should publish comments received by the regulatees before they publish final regulation. Furthermore, the regulators should also respond to the comments received.
- (iv) The Regulators need to give time for counter comment

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<sup>20</sup> Anirudh Burman & Bhargavi Zaveri, 'How Responsive Are India's Regulators?', Bloomberg Quint (Nov. 21, 2022, 7:00 p.m.), <https://www.bloombergquint.com/law-and-policy/how-responsive-are-indias-regulators>

<sup>21</sup> *Id.*



(v) The Regulatory bodies should provide more than one method of receiving feedback from the regulatees.

(vi) Lastly the Regulators should give adequate time to the regulatees for giving response to the proposed draft.<sup>22</sup>

More the regulators involved regulatees in regulation-making better would be the compliance.

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<sup>22</sup> *Id.*