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REGULATION

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Regulation of Broadcast Media
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Contents

Introduction by Director i

Regulatory Independence in Indian Context 1
T.C.A. Srinivasa-Raghavan

A Super Regulator for Financial Services? 11
Manas Chakravarty

Regulation in the Insurance Sector 24
Ajit Ranade & Rajeev Ahuja

Regulation of Aviation Services 40
Tulsi Kesharwani

Regulating Natural Monopolies :
With Special Reference to Power Sector in India 57
Anup Wadhawan

Regulation in Urban Public Transport 76
O. P. Agarwal

Regulation of Broadcast Media 90
Sunetra Sen Narayan

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Asian Institute of Transport Development
Aptt. E-5, Qutab Hotel, Shaheed Jeet Singh Marg
New Delhi - 110 016
Phones : 6856117, 6856113
Telefax : +91 (11) 6856113
E-mail : aitd@vsnl.com; aitd@bol.net.in

Regulation

Any human endeavour that pits the weak against the strong requires balancing mechanisms. Economic activity is no different. When the case for markets, which has been made with such ardour during the last two decades, is taken to its logical conclusion, the results can often be not just economically perverse, but also socially divisive. Both these consequences have been shown to be the outcome of unequal competition between the weak and the strong. Unequal competition can be between strong producers and weak consumers or between strong and weak producers. The results in both the cases are the same: perverse and iniquitous.

These negative effects of market-centred economic activity have been chronicled in heart-rending detail by authors like Charles Dickens in the 19th century. It was to mitigate these impacts that governments the world over gradually realised the need for market regulation. Indeed, had there not been a gradual displacement of authoritarian political structures by democratic ones, this realisation may not have dawned. Had not the people acquired the right to change their rulers, it is unlikely that the rulers, even when they were elected democratically, would have responded to the perversities and iniquities of the market by regulating it. In that sense, regulation is as much a political need as an economic one. This fact, however, is usually not accorded the importance it deserves.

Indians are no strangers either to a pre-eminently unregulated economy like the one that obtained before Independence or to a highly regulated one that emerged after it. In a large measure, what happened in the 40 years after Independence was a response to the perceived and actual iniquities of the pre-Independence period. There was, of course, a strong economic reason for the excessive regulation to which the Indian economy was subjected. But it would be imprudent to overlook the political imperative.

Thus, driven by politics and constrained by economics, by 1991, the Indian economy mutated into a sort of curiosity. Some sectors, notably those that had relatively low intensities of capital, were kept completely outside the purview of regulation. Others, especially those with large amounts of capital employed, were subjected to an excessive amount of regulation. The result was an industrial sector that was denied even the normal degree of freedom and flexibility required for orderly and rapid growth. As a consequence, Indians lagged behind in the race for industrial development.

Since 1991, however, India has been pursuing a less regimented approach towards the industrial sector and superfluous controls and regulations have gradually been lifted. Overall, the objective has been to build a dynamic market-oriented industrial sector that nevertheless conforms to the internationally accepted norms of regulation. However, the preceding 40 years have resulted in a slow emaciation of experience both in building up a market economy and also in regulating it. So it is not surprising that for the last ten years the country has been trying to learn how to regulate markets for a variety of goods and services, in a manner that would lead to outcomes that are acceptable economically, socially and politically.

Consistent with the AITD's current policy of devoting each issue of The Asian Journal to a chosen theme, the present one is dedicated to regulation. The Institute has been actively engaged in research relating to infrastructure and during the numerous internal discussions and seminars, the one theme that has consistently dominated the proceedings has been the realisation that there was an insufficient understanding both of the logic of regulating markets and the means to do so. It is hoped that this issue of the Journal will go some way towards addressing these two problems.

Articles in this issue deal with some of the vital aspects of regulation. TCA Srinivasa Raghavan explores the meaning and consequence of the notion of independent regulators with a view to ascertaining what such independence really means and how it can be actually achieved. Manas Chakravarty discusses the need for unifying the multiple regulatory structures that now oversee the financial sector. He examines the advantages of having such a super regulator and looks at the arguments against it as well.

Ajit Ranade and Rajiv Ahuja take up the emerging issues in the newly deregulated insurance sector and look at some of the issues that the newly devised regulatory agency, the Insurance Regulation and Development Authority, will have to contend with. Tulsi Kesharwani discusses the regulation of aviation services. He concludes that given the highly capital intensive nature of the business, regulators of aviation have to deal with some special issues that may, on the face of it, appear to go against the grain of the logic inherent in market forces, namely, unbridled competition.

Anup Wadhawan takes up the special case of regulating natural monopolies and focuses on the power sector that the government has been trying to deregulate for the last decade or so. He concludes that optimising the needs of producers and consumers in situations of natural monopoly can be amongst the hardest tasks

that can be entrusted to a regulator. O.P. Agarwal deals with the regulation of urban public transport and comes to a more or less similar conclusion. Both these papers point to the difficulties of achieving a balance between equity and efficiency.

Sunetra Sen Narayan looks at the regulation of broadcast media in India and attempts to outline the important milestones achieved in this area in the recent past. She also delineates the related current policy issues that the regulators are trying to address.

In conclusion, I would like to thank Dr. Badri Narayan of the Indian Railways who was the Guest Editor for this issue. His intellectual contribution in conceptualising the issues has been invaluable.

K. L. Thapar
Director

REGULATORY INDEPENDENCE IN INDIAN CONTEXT

T.C.A. Srinivasa-Raghavan*

The setting up of independent regulators has been the most important development in the field of economic governance in the last two decades. In many ways, the independent regulators have been placed on par with other major institutions of democracy. It is, therefore, relevant to ask what precisely is the meaning of the term "independent regulators" and who precisely are these regulators independent of. If, for purposes of good governance, there cannot be more than one source of unimpeachable authority and legislation, where does the independent regulator fit in? What if the independent regulator begins to function at cross-purposes with overall social objectives?

This paper examines some of these issues in an attempt to sound some warnings regarding what might lie ahead for India which has only recently begun to move towards the market. It postulates that in the democratic framework of developing countries, especially where socio-political issues are still in the process of being resolved, governments need to retain reserve powers of intervention in the markets. As such, in the present conditions, it may not be advisable to invest regulatory authorities with excessive independence as it could result in severe conflicts between the accountable political leadership and the unaccountable independent regulator. Further, the issue of independence of regulatory authorities has to be viewed not just in the context of efficient markets to which they are said to be conducive but also the inherent political consequences.

HISTORICAL PERSPECTIVE

Ever since the advent of organised societies, good governance has meant, among other things, the need to strike a sustainable balance between equity and efficiency. However, until recently, these terms were not the ones used to describe one of the central dilemmas of just governance. Indeed, they were not even explicitly recognised to be such. Thus, these terms did not enter the lexicon of governance until well after the end of the Second World War. Even after they did, it was only about 15 years ago that achieving a balance became an active concern of the democratic governments. And, for the last five years, even the

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* *Economist; Consulting Editor*

so-called Washington Consensus which had steered the worldwide movement towards market economics, has begun to accept the validity of the need to actively, rather than passively, balance the rival claims of equity and efficiency.

The post-Industrial Revolution view of the changes in the types and levels of economic activity reveals an unmistakable trend, namely, the inexorable increase in the amounts of capital employed per unit of output. More than any other factor, it is this development that has shaped societies over the last 200 years. It has had monumental consequences for the forms of government, the methods of governance and the shape and nature of communities and societies.

As long as countries were ruled by non-democratic means, equity was not a major concern for the rulers. It was only after the riots in England in the year 1817 that the political establishment first recognised the need for keeping equity in view as well. However, progress was slow because of the absence of even full adult, let alone universal, franchise. Such exclusion of a vast majority of the people from the political process meant that for the next hundred years, that is, until the Communist Revolution of 1917, equity issue would remain very much in the background. But the success of the Bolshevik Revolution alerted the Western governments to the dangers of complacency in this regard. A further impetus to focus on equity came with the Great Depression of 1929-34 which left more than 70 per cent of the workforce of the industrialised economies unemployed. The result was that by the mid-1930s political parties in the democratic world had incorporated equity as a major plank in their programmes.

In the post-Second World War period, this had an important consequence i.e. an increasing trend towards excessive regulation. Acutely conscious of the need to keep the electorate happy, politicians sought to rein in industry by means of a wide range of rules and regulations designed to maintain the balance between equity and efficiency. Such, indeed, was the preoccupation with regulation that, according to one estimate, in 1980, the US government had put in place a total of 920 regulations that needed to be observed in order to make a hamburger!

The consequences of such an approach were predictable – by the mid-1970s, the pendulum had swung too much in the direction of equity and, consequent to the industrial sclerosis that this introduced, rates of economic growth in the industrialised West slowed down. By 1979, when the second oil shock hit, it had become clear that the balance would have to be restored.

The opportunity to do so came in 1979-80 with the massive politically conservative majorities, first in the House of Commons in the UK and then, a

few months later, in the presidential election in the US. These two countries set the pace in righting the balance between equity and efficiency by dismantling the more onerous laws that had tilted the balance excessively in favour of equity. Since then, economies, the world over, have moved inexorably in the same direction, namely, increasing reliance on market forces. This movement, among others, contributed to the collapse of the Soviet Union and its empire as well.

EMERGENCE OF INDEPENDENT REGULATORS

The lessons of the past had been well learnt. The most important manifestation of this learning became evident when the governments explicitly recognised that to regulate the markets directly was a wrong policy. Instead, they chose to do so through "independent" regulators. They realised that the political benefits from such a method far outweighed the losses which would be mostly in the form of forgone credit when things went right. It seemed far more important to avoid blame when things went wrong, as they had during the Great Depression and in the slowdown during the seventies.

Therefore, whichever way one looks at it, the setting up of independent regulators has been the most important development in the field of economic governance in the last two decades. This is so because the movement has introduced a hitherto unknown institution, namely, the independent regulator, on par with other major institutions of democracy. In view of the rapidity with which the world is moving towards market economies, and increasing importance of markets as the arbiters of economic decisions, it is safe to predict that the significance of independent regulators would grow during the next quarter of a century.

Since, as mentioned earlier, these regulatory bodies have emerged as the latest amongst the various institutional safeguards, it is relevant to ask: what precisely is the meaning of the term "independent regulators" and who precisely are these regulators independent of. If, for purposes of good governance, there cannot be more than one source of unimpeachable authority and legislation, where does the independent regulator fit in? What if the independent regulator begins to function at cross-purposes with overall social objectives?

This paper examines some of these issues in an attempt to sound some warnings regarding what might lie ahead for India which has only recently begun to move towards the market. Its starting point is the fact that a regulator needs to keep in mind the interests of all participants in the related market and has to act in a manner that is fair to all of them.

THE TASK

The starting point of the inquiry has to be the fact that, in any market, there are three categories of participants:

- Producers, who are the most powerful in a day-to-day sense.
- Consumers, who are the least powerful.
- Government, which lays down policy but not the rules.

This suggests that the regulators might be confronted with a multiplicity of objectives and that they will have to do the best within these constraints. Their one task would be to make the consequences of these objectives as transparent as possible. In certain cases, it might lead to decisions that hurt future generations of users while favouring the present generation.

Producers are mainly concerned with the details of the operating rules. They tend to accept the policy regime as given. Operating rules are easier to devise when a market is opened up for the first time, e.g., insurance, telecoms, etc. in India, because the regulator starts from scratch. The regulator must also ensure that the service providers earn a reasonable return on capital. The primary goal here would be to eliminate shortages. But the task is harder when order is sought to be imposed on a chaotic market such as, say, the fertiliser or the lubes industry. There is wide divergence in the interests of the producers and it becomes very hard to achieve balance as each of them has a different history of finance, management and technology.

Regulations are of two types – ground rules type and procedural and definitional type. The latter are particularly important in the context of norms relating to accounting and reporting, training, safety, etc. These are usually worked out harmoniously and the main issue in their case is that of policing and enforcement.

The consumer interest lies mainly in quality and price. Usually, fair competition ensures most of this. But it is not clear whether the regulator also needs to ensure free competition or if this should be left to some other institution. It is worth discussing this issue in relation to consumers because speedy dispute settlement hinges on this. To address certain distributional concerns, the government may impose a mix of service price requirements. This would violate the efficiency concerns, which the regulator might be focusing on. Economists would argue that there are other means to address distributional concerns, but politicians may adopt solutions that yield highest short-term payoffs.

For the government there are two key issues. One is that policy has to be consistent with market economics and competition, for otherwise the regulatory regime will be flawed *ab initio* as it is in the case of the banking system in India. The desire to meet social obligations remains important, particularly to fulfil the needs of the poorest people, even with introduction of competition and restructuring of transport networks. This implies that one needs to reconcile private participation in the sector with some social objectives. This calls for a regulatory regime which ensures that operators have enough incentives to invest in activities that they may not have otherwise considered profitable, including delivery of services to poor people.

Alternatively, the regulatory regime could include a clear specification of universal service obligations (USO) in the scope of the service providers' responsibilities. USO is an obligation imposed on the service provider to ensure that everyone in its service area has access to an affordable minimum level of a quality service mix. A source of concern in this regard is that sometimes affordable means a price that does not cover the cost of delivering that service. In addition, the precise definition of the service to be covered under USO varies. It may address spatial or geographical differences, demographic or institutional characteristics or focus on criteria relating to low-income levels. Meeting USO is likely to put pressure on the service providers' costs and could, thus, result in compromises in quality and/or safety to reduce such costs. This suggests that an effective way of clarifying USO may be to translate these into transparent and specific targets consistent with the government's overall objectives for the sector. India has done this quite effectively in the case of banks and, more recently, in the field of telecommunications.

Advocates of regulatory programmes offer many reasons in support of them. Yet a small number of economic arguments are advanced as 'justification' for the kind of regulation. With market behaviour judged on the efficiency norm that prices equal full social costs at the margin, regulation is required to overcome one or more 'defects' that prevent corporations from operating according to the norm. The 'defects' that have most often led to policy proposals for regulation can be classified as follows.

The presence of monopoly power. When economies of firm scale in a particular market are so extensive as to create a significant cost advantage for a single enterprise, then this 'natural monopolist' can be expected to restrict output or directly set prices higher than the marginal costs without concern for entry of a competitor. Regulation of such a firm aims to provide cost-driven prices, but it cannot attain 'efficiency', since to do so would require ending up with per unit

revenues below the level necessary for firm survival (with marginal costs less than average costs, the natural monopolist cannot be expected to set prices equal to marginal costs).

A variant of the argument has been used to regulate both monopolies and competitive industries. When and where the amount of 'rents' paid to scarce resources are unusually large and is the consequence of sharp, unexpected price increase of a widely used product, regulation has been sought to keep prices down. For example, the regulation of natural gas at the wellhead in the 1960s and of petroleum products at retail in the 1970s were for this purpose, without regard for the competitiveness of the market. But where there is competition, supply will fall short of demand, then regulation has to be justified on grounds that shortage for a few does less harm than the good that comes to the rest of the consumers from keeping prices down.

To account for spillover costs. Regulation has been proposed where a product's price does not reflect important costs inherent in the production process – costs that are imposed on neighbours or others in the economy. For example, the price of electricity may not reflect the full cost of air pollution that results from using coal in power generation. If not, demand for electricity is greater than the norm of economic efficiency would dictate.

Of course, the harmful effects of pollution result both from the electricity generation process and the fact that people have moved into the area bordering the plant. In theory, electricity consumers and pollution sufferers would agree to share optimally the cost of anti-pollution devices if they could bargain efficiently among themselves. Such bargaining typically has been found by legislatures to be impractical, however, as compared with direct regulation of emissions or discharges. Environmental regulation, as a way to constrain important spillovers, has attacked the pollution generating process by setting engineering standards for equipment used in the production process – standards which are aimed at reducing discharge.

The effectiveness of such regulatory controls has been much debated. To what extent they have been successful in taking account of 'spillover' costs in setting standards and in actually reducing pollution or increasing safety have been major issues in applied research. Local controls and penalties in the form of higher insurance charges, court damage awards, etc. existed even before the federal environmental and auto safety regulation had been established. Some argue that strict engineering standards imposed through the federal regulation have not shown better results. Others agree, but at the same time opine that taxes

on pollution or unsafe cars or incentive based systems could be effective if the current methods do not work.

To compensate for inadequate information. Regulation sometimes aims at lowering the cost of obtaining information. In particular, government action is called for when (i) suppliers profit from misleading consumers whose available legal remedies, such as private court actions, are more costly than regulation; (ii) consumers cannot readily evaluate the information available, and the cost of mistakes is high, such as on potential drug effectiveness or safety of a particular airline; and (iii) the market on the supply side fails for some reason to furnish the information as is demanded (at cost-based prices). Given the first and second reasons, the government has created special commissions to license 'safe' goods and services. For the last reason, the government may seek to provide more, if not better, information or to require producers to supply the necessary information, as in the case of financial or securities disclosures. Most such approaches have been pursued without specific knowledge of markets for information or empirical studies on the 'failure' of current sources.

Other justifications. Of course, there are special interest arguments for regulation. Price and entry regulations of airlines, trucking, and ocean shipping, for example, have been justified to control 'excessive' competition that would allegedly destroy all except one or two firms that would then set non-competitive prices. This argument is advanced by the incumbent firms. However, the cost functions implicit in these depictions of behaviour are not widely found in these industries. Regulated firms have at times advanced a similar argument in an effort to extend regulation of entry to encompass the prices set by competitive, unregulated rivals.

Unequal bargaining power sometimes is used as a rationale for regulation that would protect small firms, suppliers or customers from the power of the large firms or buyers with whom they have to deal. State regulators, for example, prescribe standard forms for insurance contracts. This again is a monopoly rationale, stated from the viewpoint of the corporate purchaser of goods and services. The operationality of these arguments determines the worth of regulation. There has to be a direct relationship between rationale and results so as to establish a foundation for regulatory policy. Thus, which is the 'true' rationale for a particular programme can be determined by examining regulatory methods and results.

This short discussion of the tasks that the regulator has to perform brings into sharp focus the nature of the interface between the regulator, the government,

the producers and the consumers. The issue of independence becomes important precisely in this context because if every major group in society is an interested party, the need for a neutral arbitrator between competing claims is self-evident. The earlier method of the government taking on the role of regulator was highly unsatisfactory because governments and legislatures are both driven by electoral considerations and are thus unable to be neutral while balancing claims. India provides an excellent example of such a situation.

THE INDEPENDENCE ISSUE

The previous section has briefly described the sort of things that regulators are expected to do. By and large, this does not pose any major difficulties. But, problems do arise when the manner in which a regulatory institution interprets its charter is at variance with the manner in which the government wants it to be interpreted or the legislature intended it to be interpreted. Two examples that illustrate this point are given below – one is drawn from India; the other from New Zealand.

The Indian example pertains to the newly set up regulatory body for the insurance industry, namely, the Insurance Regulation and Development Authority (IRDA). A major concern of the government and parliament was that the process of liberalisation of the insurance business should not result in the exclusion of the rural poor. The government and parliament were not particularly concerned about the fact that the poor may not be able to afford the premia required for an insurance policy. So, throughout the period that preceded the issuance of licences, a major debate focussed on how to take care of the rural problem. Various suggestions were put forward and eventually the one that was accepted was possibly the worst because it simply said that a certain portion of the insurance company's business would have to originate in the rural areas. Had the regulatory authority been truly independent, it would not have inserted this clause. Instead, it would have left the rural business to the commercial sense of the insurance companies. By giving in to political pressure, however, the authority has served neither the interest of the rural poor nor of a fully efficient insurance industry, because insistence on rural business is bound to lead to an unacceptably high degree of cross-subsidisation of premia.

The second example is from New Zealand. The central bank of that country has been made fully independent of the government and has been given a one-point programme: to ensure that inflation rate does not go beyond two per cent per annum. While pursuing this objective, the central bank is completely free to adopt such monetary policies as it thinks appropriate. So far, this experiment has

worked well, in part due to the ten year long expansion in the US economy. However, now that there are clear recessionary trends visible in the world economy, it will be interesting to see what sort of conflicts develop between the objectives of the central bank and those of the government which might be obliged to pursue an expansionary fiscal policy. Should it so happen that political circumstances arising out of high level of unemployment require the government to run up large fiscal deficits, but the central bank follows a monetary policy which makes this prohibitively expensive, a conflict is likely to develop. It is in such a situation that the independence of the central bank will be truly tested. One possible indication of what might happen comes from Finland where central bank follows a highly independent course. When Finland got into an economic downturn in the early 1990s, the central bank, instead of loosening monetary policy, tightened it and made the recession even worse. The politicians had to pay the price.

The message that emerges is that genuinely independent regulatory authorities are possible only if the political establishment is willing to accept the blame for their mistakes. (The inaction of the Delhi government to take action against pollution until forced to do so by the Supreme Court, which could be made to take the blame, illustrates this point). While this would certainly exert enormous pressure on the political establishment to ensure that competent people man regulatory authorities, it will still not completely take care of the moral hazard problem. This is because, as long as the regulatory authority knows that the consequences of its acts of omission and commission will be borne by someone else, it could continue to act in a highly inappropriate manner. There can be no better example of this than the actions of the Securities and Exchange Board of India (Sebi) during the 1990s.

Twice in ten years, Sebi's policy has resulted in an enormous loss of wealth and value as represented by market capitalisation at the Bombay Stock Exchange. The first was the Harshad Mehta case and the second is the Ketan Parekh case. On both occasions, Sebi was found wanting, not just in detecting the irregularities when they started showing but also afterwards, when corrective action had to be taken. The resulting public anger has been directed towards the government, which on both occasions has responded by setting up a Joint Parliamentary Committee to investigate the matter. It is arguable that we are still in the process of learning.

It is also noteworthy that in both the cases the banking system has also been an accomplice. And, just as in the case of Sebi being first negligent and then incompetent, the Reserve Bank of India (RBI) has also acted in an identical

manner – first negligent and then incompetent. And just as in the case of Sebi, the consequences of the acts of omission and commission by RBI will be faced not by the central bank but by the government and the Parliament.

Had India's democracy and economy been more mature, in which the different institutions could have found a mutually equilibrating balance, it would have been possible to predict the quick emergence of genuinely independent regulatory authorities. But, neither is Indian democracy fully mature, nor is the Indian economy anywhere near adjusting to the pulls and pressures of market economics. This suggests that for the foreseeable future at least, regulatory authorities in India will be independent only in name inasmuch as their ability to follow policies that may have an adverse impact on the electoral fortunes of incumbent governments will continue to be highly circumscribed. Purists will bemoan this, but it is worth bearing in mind that until sufficient regulatory expertise has been developed, it may not be advisable to invest regulatory authorities with excessive independence as it could result in severe conflicts between the accountable political leadership and the unaccountable independent regulator.

To sum up, the issue of independence of regulatory authorities has to be viewed not just in the context of efficient markets to which they are said to be conducive but also the inherent political consequences. Independence cannot be viewed in isolation of the larger social, economic and political reality, especially when other institutions in the country are still in the process of developing into full maturity.

A SUPER REGULATOR FOR FINANCIAL SERVICES ?

Manas Chakravarty*

This paper discusses the need for a super regulator for India's increasingly mature financial services institutions and markets. The walls separating the various segments of the financial system are breaking down, and there is much overlap in the activities of banks, mutual funds, housing finance companies, securities dealers, etc. As a result, markets are being interwoven into a seamless web. The present system of financial regulation with different regulators for different markets, is unable to cope with these developments.

The paper looks at the advantages of having a super regulator as also the arguments against having one, and considers the reasons for the worldwide trend towards having a super regulator for financial services, with particular reference to the work done by the UK's Financial Services Authority.

The paper concludes that a super regulator is best able to tackle the issues of cross-sectoral regulatory innovation, on the one hand, and of taking a holistic view of the entire financial system, on the other.

THE BACKDROP

The growth and maturity of the Indian financial system is breaking down the barriers between the different segments of the financial market. The market had for long been rigidly compartmentalised, with the financing of the stock market, for instance, having hardly any linkages with the banking system. To take another example, investors in the money markets are still largely confined to the banks, and there is very little retail participation.

Slowly but surely, however, the walls separating these compartments are being breached. Banks have expanded into areas far beyond commercial banking. They have set up subsidiaries for undertaking various activities, such as investment banking, factoring, primary dealership, mutual funds, credit card business, housing finance, securities trading and custodial services et al. In some sectors, such as credit cards or housing, some banks are dealing with the new business in-house,

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* *Financial Editor, Business Standard.*

i.e. not through subsidiaries. Recently, some banks have set up affiliates for the insurance business.

At the same time, there is no bar on investment banking houses starting banks, and one house has already floated a bank, while another is in the process of doing so. Development financial institutions, whose activities used to be confined to the provision of long-term finance to industry, have now diversified into providing short-term working capital as well, besides floating banking affiliates, housing finance companies, venture capital companies, and have even ventured into securities trading. So much so that one ex-development financial institution, ICICI Ltd, now calls itself, together with its subsidiaries, "a virtual universal bank." This move towards universal banking has sparked a debate on the kind of supervision that is needed for the new, interdependent, financial market.

The recent financial scandals have exposed the lack of coordination between regulators. Bank funds are often used to ramp up prices in the stock markets, and coordination between the Reserve Bank of India, and the stock market regulator, the Securities and Exchange Board of India, is needed to trace the source of funds. Similarly, the cooperative banking system is currently under two regulators: the RBI, and the state registrar of cooperative societies. The lack of consultation between the two has led to the cooperative banking system becoming a very weak link in the financial system.

AD HOC APPROACH TO FINANCIAL REGULATION

It is, however, not only a question of plugging the loopholes in the system. The entire approach to financial regulation in India (perhaps with the exception of the commercial banks) has so far been ad hoc, and has been more a response to crises, rather than the result of a well-thought-out blueprint or philosophy of regulation. During the 1992 securities scandal, funds from the commercial banks found their way into the stock markets, thanks to a weak settlement system in the securities markets. The response was to tighten regulation for the commercial banks and put in place a proper settlement system. A few years later, after the manner of making Initial Public Offerings (IPO) was found to be susceptible to fraud, and the response was to tighten the IPO regime. Then, after non-banking financial companies (NBFCs) were found to have taken depositors for a ride, both the RBI and Sebi sought to avoid responsibility for the regulation of NBFCs. The response to that crisis was to place NBFCs firmly under the RBI's control. The point is that our approach to financial regulation has been piecemeal, attempting to fix problems as they occur, rather than take a pro-active stance and anticipate where the next problem could crop up and take steps accordingly.

This ad hoc approach is not limited to the Indian regulatory system. Howard Davies, chairman of the UK's super regulator, the Financial Services Authority (FSA), aptly summed up the state of affairs in the UK by pointing out that financial regulation had in the past been influenced by the "dangerous dog" phenomenon, whereby extensions in regulation had been imposed in response to individual crises and scandals.

But for a regulator to take a holistic view of the financial system, there needs to be some agency which feels that the entire financial system is its responsibility. That is one reason why we need a super regulator. It will be the job of a super regulator to view the entire financial system as an interconnected whole, which is the first step towards devising a pro-active policy of regulation.

That is why the Khan committee report had called for a super regulator that would oversee universal banking in the country. The committee had recommended the "establishment of a super regulator to supervise and co-ordinate the activities of multiple regulators in order to ensure uniformity in regulatory treatment". Unfortunately, the RBI has ruled out the possibility of a super regulator for universal banking. To be sure, in its report on the "Trend and Progress in Banking", RBI has pointed out that "any conglomerate, in which a bank is present, should be subject to a consolidated approach to supervision and regulation," but the apex bank has declined to take the issue to its logical conclusion and discuss the need for a super regulator.

THE GLOBAL TREND TOWARDS A SUPER REGULATOR

The world is moving towards a unified regulatory authority for financial services. A trend towards national integrated regulators or 'super regulators', covering deposit-taking and other financial activities such as insurance, pensions and stock market entities like securities dealers and stockbrokers, is emerging. Canada, the United Kingdom, Sweden, Norway, Denmark, Australia, Mexico, and Hungary have adopted the super regulator concept, and it has also been considered for such diverse countries as Korea, Singapore, and Latvia. There are cogent reasons for the move towards a super regulator, but in some instances this movement has been brought about or hastened because of recent crises in national and international financial markets. Even the United States, where financial services have traditionally been notoriously fragmented, has moved in the direction of consolidated supervision, but less aggressively. Under the new financial modernisation legislation, the Federal Reserve has been given the equivalent of backstop consolidated regulatory authority, but not frontline responsibility for regulating and supervising non-banking affiliates of banks.

NEED FOR A NEW APPROACH

The traditional method of regulating financial services is the 'entity' approach, in which the regulator regulates everything that the 'entity' does. Under this approach, you have one regulator for banks, one for insurance companies, one for stockbrokers, and so on. This approach works well in a world where the various entities stick to their sectors. The trouble is, this fragmented structure of regulation of financial services, based on sectoral divisions, has become increasingly outdated. Banks, for instance, have moved into insurance, in what is known as the bancassurance model. Many of them have their own asset management subsidiaries or associates. Many have set up affiliates for venturing into stock market operations.

The entity approach to regulation will, under these circumstances, result in overlapping of regulatory functions. If a stockmarket entity decides to move into deposit-taking, then the stockmarket regulator will have to start regulating a function usually reserved for the central bank. Conversely, if a bank starts an asset management subsidiary, the central bank will have to start regulating the stock market operations of the banking group. Under such circumstances, there are increasing costs to companies as a consequence of the need to deal with multiple and overlapping regulators imposing different regimes. Consumers, too, face a confusing array of regulators and dispute resolution mechanisms. And the respective regulatory authorities do not have either the expertise or the experience in the new fields in which they have to venture. Clearly, the entity approach is unsuited to a world where the barriers between financial services are being dismantled.

Listed below are reasons why the old methods of regulation no longer apply:

First, the expansion of the securities business and tighter linkages among financial sub-sectors have posed additional challenges for systemic stability. Banks have increasingly shifted from traditional lending to 'off-balance-sheet' business, while securities houses have started offering products that compete directly with those of banks. Hybrid products, such as annuities and derivatives, cut across the old categories.

Second, technology is an important factor that must be taken into account. For instance, traditionally, stock market regulation has usually been exerted through self-regulatory organisations, such as stock exchanges. Regulators, being resource-constrained, have relied on such gateway institutions for grassroots supervision,

by successfully leveraging the resources of the self-regulating organisations to meet regulatory goals. With new technology, however, new trading platforms have developed that can bypass exchanges altogether. Platforms, such as Reuters' Instinet proudly advertise that they 'allow nothing to come between the customer and the best price'. Who is to regulate these new platforms? What if these are used to sell products that take advantage of the ignorance of the consumers?

Third, unquestionably the most important advance in technology in recent years has been the Internet. Intermediaries, which have traditionally served as the regulatory agents, are those which are most at risk in the internet environment. That's not all. The Internet space has allowed financial products to be offered by software firms, telecom companies, retail chains, etc. The question is, who regulates these new entities? And how do we regulate: do we regulate merely that part of the business that may give rise to systemic risk?

Fourth, the Internet is also unique in that it transcends all geographical barriers. Traditionally, financial regulation has been either national or regional. The globalisation of financial services has thrown a challenge to that comfortable paradigm, and the Internet is likely, in due course of time, to deliver the *coup de grace* to purely national regulation. The Internet is no respecter of national frontiers. Often it is very difficult to know where a website, or the company owning a website, is actually located. It is similarly difficult to know at whom its offerings are targeted. Increasing coordination among national regulators is, therefore, a necessity today.

Fifth, the increasing complexity of financial entities and activities is complicating financial supervision. The near failure of Long-Term Capital Management, a highly leveraged hedge fund, underscores this development. The consolidation of financial services adds further complications. It won't do, for example, for the central bank to merely regulate commercial banks in the fond belief that they are the only sources of systemic risk. Some institutions may now have become so large as to be 'too big to fail' or, more precisely, too big for regulators to risk letting creditors take a loss for fear of sparking a run on many institutions of similar, or smaller, size.

Sixth, product complexity currently well exceeds the ability of unsophisticated investors to understand the risks of the products they are investing in. On the one hand, we have more and more individuals bypassing exchanges and other intermediaries in their quest for "the best price". Also, more and more people are investing in more risky instruments, wanting to take advantage of the more exciting returns available in equity-related products, rather than putting

their money in a bank fixed deposit. Yet, on the other hand, their financial understanding is not equal to the task of finding their way through a maze of competing products, often of great complexity.

FUNCTIONAL REGULATION

All the above developments in the landscape of financial services are reasons why we need a change in the system of regulation. One suggestion is to have functional regulation, where different regulatory agencies would be in charge of regulating different functions. If a bank ventures into selling mutual funds, for example, it will be the securities market regulator that will be responsible for overseeing the mutual funds part of the group's business, while the central bank continues to supervise the group's banking business. Although called functional regulation, the approach essentially involves having different regulators for different financial products and services.

Functional regulation would further investor protection in a number of ways. It would subject all securities activities to a single set of standards, consistently applied by one expert regulator. This is in marked contrast to the fragmented system currently in place. Under the functional approach, banks, broker-dealers, fund managers, insurance companies would all be subject to the same requirements with respect to training, supervision, sales practices, and financial responsibility. Banks that advise investment companies, like all other registered investment advisers, would be subject to oversight and other requirements designed to guard against conflicts of interest.

Functional regulation would also eliminate duplicative regulation. Under existing US law, for example, bank-affiliated securities firms and investment companies must comply with overlapping and potentially inconsistent regulatory requirements. This duplication imposes unnecessary costs, impairs industry competitiveness, and wastes scarce government resources.

Replacement of the existing regulatory regime with a system of functional regulation should relieve financial services providers from many of the burdens of duplicative regulation. Of course, at the same time, with financial services reform and the expansion of bank securities activities, there will be an ever greater need for cooperation among regulators.

ADVANTAGES OF HAVING A SUPER REGULATOR

It may, however, he pointed out that even functional regulation will not be able to address the problem of regulating new financial products, or new

technology. It will not solve the problem of globalisation of business as there will still be a need for effective coordination between different functional regulators. And most importantly, it will not create an agency that could undertake regulation of new products, nor will it tackle in a pro-active manner the challenges posed by new technologies that effectively bypass regulated modes of doing business in financial services. It is to take care of all these problems that a super regulator is required.

To take one example, the demutualisation of stock exchanges and their replacement by profit-seeking corporate structures could result in conflicts of interest between the need for profitability and the regulatory functions of stock exchanges. In London, for instance, the super regulator or the Financial Services Authority (FSA) has reached the conclusion that one exchange, which is competing with other exchanges, should not be the national listing authority. That function was accordingly transferred to the FSA from May last year. The Chairman of the FSA has confessed that he felt more comfortable with that responsibility in-house, particularly when there are considerable pressures to relax listing standards to take account of the particular circumstances of new economy stocks. As a matter of fact, the London Stock Exchange itself reached the same conclusion.

Streamlined oversight by a super regulator is viewed as a mechanism to deliver improved supervision at a lower cost. It may better align supervisory bodies with financial and economic realities.

A super regulator can vastly improve the quality of supervision by enhancing its effectiveness and efficiency. This can occur in a number of ways. For instance, a single regulatory body would provide diversified financial groups with better coordinated, more consistent supervision. That is because a super regulator is set up and functions on the basis of a single, rationally constructed set of principles and rules. Under a fragmented regulatory system, the rules are usually developed ad hoc, and are not really grounded in any overarching philosophy of regulation. Sometimes, the rules developed by different sectoral regulators can be overlapping and duplicative, and even conflicting.

A super regulator would be in a better position to uphold the principle of equal treatment. The magnitude of penalties levied by different regulators, for example, is often very different. The development and application of a single set of rules would result in equal treatment for financial intermediaries with similar risk characteristics and product lines, operating in similar markets. That doesn't mean, of course, that the super regulator is precluded from supplementing the common rules, whenever necessary, with more specialised ones for particular markets.

And finally, a single regulator can also operate more efficiently because it can take advantage of certain economies of scale; maximise scarce resources, such as staff with specialised skills; centralise some functions, such as support services like personnel, recruiting, information technology, and accounting/finance; and avoid duplication of other services or initiatives.

CHALLENGES FACING A SUPER REGULATOR

This doesn't mean, however, that a super regulator will start functioning superbly right on the day it is appointed. One of its many challenges lies in the realm of politics. Existing regulators have, over time, built up their own vested interests, their perks of office, and their jealously guarded "turf". All of them can be expected, therefore, to oppose tooth and nail the concept of a super regulator. This is especially true where regulation has so far been carried out by self-regulatory organisations (SROs) like the stock exchanges. These SROs are rightly apprehensive of over-bureaucratisation, on the one hand, and the usurpation of their powers by government-appointed regulators, on the other. There is thus a major challenge of bringing together existing supervisory agencies, in terms of both organisational structure and human resources.

In most countries, initial staff for the super regulator is transferred from a combination of its regulatory predecessors. The staff bring with them considerable experience in their fields. However, there are also traditional biases that need to be overcome in the new environment. Problems of "cultural" conflict may also develop, especially because the different regulators can be expected to have vastly different regulatory styles. In India, for instance, most of the banks are in the public sector, and the relationship between the RBI and these banks has traditionally been one of command-and-control. On the other hand, the supervisors coming from the capital markets' regulatory ambit are likely to have a far lighter touch. Accordingly, the creation of a new organisational culture is needed for the staff to integrate properly and promptly.

Funding is another issue that needs to be tackled. Traditionally, some regulators, such as stock market regulators, get their funding by levying fees on the market participants. The central bank, the regulator of the banking system, often levies no such fees. So a super regulator will have to think of a funding system that is consistent across all categories, in the sense that it does not discriminate against some players in the financial marketplace by levying fees on them while letting others go scot-free. Establishing a single assessment or fee structure merits careful consideration to ensure that no supervised group is unduly affected.

Differences in existing methodologies of reporting and disclosure by financial entities also pose a problem which needs to be addressed. The lack of common reporting within all industries on items, such as investment valuation, performance presentation standards, bad debt provisioning and income recognition can create incompatibilities in information across functions.

Finally, in most countries, changes to the regulatory structure require legislative action and extended time-frames. There may be other legal barriers, such as privacy laws and jurisdiction, created by law or convention, that need to be addressed before a newly appointed super regulator can be fully effective.

ARGUMENTS AGAINST HAVING A SUPER REGULATOR

There are, however, many arguments against having a super regulator. As a matter of fact, several arguments in favour of fragmentation of regulatory agencies have been put forward. One argument is that fragmentation promotes regulatory innovation through a process of 'regulatory competition'. Regulatory competition can take place between regulators in different countries, in different sectors of the same country or even within a sector. Proponents of regulatory competition argue that bureaucratisation and inflexibility will be reduced and only best practices will survive and develop.

But the regulatory competition theory is unlikely to be of much use in practice. There cannot, for instance, be multiple regulators in the same functional area – that would be a recipe for anarchy. And learning from cross-sectoral regulation is often ruled out, for the simple reason that the businesses being regulated are vastly different, requiring very different approaches. And so far as cross-border competition between regulatory authorities is concerned, that can occur even under a super regulator.

The regulatory competition thesis makes sense only where concurrent regulatory regimes exist, such as in the case of US banking, where different states have different regulatory structures. It may also, to some extent, be developing now in Europe. Any bank registered and supervised in one member state of the European Union (EU) may branch out to other member countries and a certain regulatory competition is likely to develop.

More serious opposition comes from those who point out that, for all their interlinkages, financial service is a catch-all term for different types of businesses. For instance, a hedge fund is likely to have different regulatory need from a staid main street commercial bank. Regulators need to understand the market for their

supervision to be effective, and it is impossible for a single super regulator to develop expertise about the whole financial market.

As a matter of fact, the move towards universal banking is by no means as universal as it is presumed to be. For instance, the big four UK clearing banks at the time of the Big Bang in 1986, made an attempt to develop an investment bank alongside their commercial, small business and retail banking. But all of them have since pulled back. Each one of them has some capital market operations, but has no pretensions to compete with the bulge-bracket US firms. It is often pointed out that the reason why the US has the world's most powerful investment banks as well as some of the best commercial banks is that the Glass-Steagall Act for decades expressly forbade them to trespass on each other's territory. This enabled the banks to specialise which in turn helped them to concentrate their energies on innovation and expertise in their respective fields. And if the market favours specialised entities, how can their regulator not be specialised?

There is also the possibility that, in our enthusiasm for holistic regulation and all-embracing laws, discretion could well be a casualty. And yet, it is virtually impossible to draw up rules governing every aspect of financial activity. Having one's ear to the ground and knowing the market is a must, and for effective regulation, market intelligence must be combined with discretion to apply the rules.

Yet another criticism of the super regulator concept arises when the regulators it replaces are in the nature of self-regulatory organisations. In that case, there is a legitimate fear that elected office-bearers will be replaced by supervisors appointed by the government. In India, for instance, the market regulators have been drawn, for the most part, from among the income-tax officials. These people have little understanding of how stock markets work.

For all these reasons, not all countries have either the political will or the desire to create a super regulator and, therefore, have instead taken other steps to obtain its advantages. The most important step, of course, is to work on improving cooperation between regulators. Periodic meetings are a must, but these often degenerate into a mere formality, devoid of any real content. Periodic sharing of information is an absolute necessity, and the meetings must be occasions to deliberate on risks which may cross over regulatory boundaries. There needs to be a shared use of information about financial conglomerates so that an effective strategy for supervising all of their financial activities can be developed.

A regulatory framework that allows for information sharing must be in place to support the necessary high level of cooperation between regulators.

Likewise, reporting and disclosure requirements must be uniform so that information can be easily shared and analysed. But coordination is by no means all that is required. As mentioned earlier, there is need for an agency that is constantly scanning the financial services universe for new products, and identifying possible weak spots. Such an agency has necessarily to be independent of any sectoral regulator. In countries that do not have a super regulator, this function can only be performed at the government or ministry of finance level.

UK FINANCIAL SERVICES AUTHORITY (FSA)

How the super regulator approach will work will be known only in the future, particularly when we have a track record of the functioning of the UK's super regulator, the FSA. The FSA, at the moment, is still a work in progress, and it will become the single regulator for financial services in the UK in the second half of 2001, when the Financial Services and Markets Act 2000 (FSMA) is implemented. So far, the FSA is still in the process of setting itself up. In a recent paper on the work that it has done so far, the FSA has said that it has identified a set of 15 key risks to its statutory objectives and elaborated from these a common risk model – based on assessing the impact and probability of risks occurring to the FSA's statutory objectives – for use across the 10,000 firms it regulates; begun work on extending the model to non-firm-specific risks that have a potential impact across the industry as a whole, and on markets and consumers; and taken forward the identification and analysis of key regulatory themes – such as e-commerce and the implications of a low inflation environment – which cut across different industry sectors and have wide-ranging implications for consumers.

CONCLUSION

To sum up, the rapid changes in the financial services market in India, including technological change, have created financial conglomerates, spanning different product segments. Under these circumstances, the old 'entity' or institutional approach to regulation no longer applies. Functional regulation is, therefore, a *sine qua non*. As the Khan committee put it, "A function-specific regulatory framework must develop that targets activities and is institution-neutral with regard to the regulatory treatment of identical services rendered by any participant in the financial system."

At bottom, however, the issue boils down to whether we should have different functional regulators, with periodic meetings between them for coordination, or whether we should have one super regulator. The key factor here

is how well the different regulators communicate *inter se*, how much information they are willing to share, and the level of understanding they have between themselves. After all, there is not much use having a super regulator if the different departments of the regulator do not communicate with each other. In other words, having a super regulator will be of no avail if the culture does not change.

It also goes without saying that a regulator, whether a sectoral one or a super regulator, must have the necessary expertise and market intelligence. In other words, a regulator's learning systems must be as complex as the external world in which it operates. To take one example, the UK's Financial Services Authority is experimenting with something it calls "the group approach" under which specific teams supervise specific conglomerate groups. Such regulatory innovations, however, are more easily carried out when there is a super regulator.

And finally, the clinching argument for a super regulator is its ability to plan for the future. By seeing the financial system as a whole, it is able to identify weaknesses, spot potential threats and take steps to rectify them. This is a function that no amount of coordination committees of sectoral regulators will have any incentive to perform.

On balance, therefore, having regard to the two key features of inter-sectoral regulatory innovation and a holistic view of the entire financial system, a super regulator would be the right solution for India's increasingly mature financial system.

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REGULATION IN THE INSURANCE SECTOR

Ajit Ranade & Rajeev Ahuja*

INTRODUCTION

At the heart of insurance business is the principle of risk-pooling. Individuals or businesses get covered for financially costly contingencies by paying an insurance company now, in exchange for an insurance cover later, by signing an insurance contract. The primary job of regulators of insurance is to make sure that such contracts are honoured and executed in the most satisfactory manner. Some key features of this contract are the verifiability of the contingency (since damage payments are made only if the contingency arises), and the continued assurance of the financial soundness of the insurer, at the time of the contingency.

Insurance regulation is also concerned with the question of market structure. By pooling the risks of various consumers, an insurance company is able to provide a cover for a small price, due to the law of large numbers. Typically, larger the pool (of uncorrelated risks), lower the price. Thus, the most efficient risk-pooling would imply that one insurance company pools all the risk, and thus becomes a monopoly, while quality of service would require that insurance be provided by many competing firms. Since insurance business, in general, cannot sustain a large number of viable competitors serving a finite market, there will be monopolistic tendencies.

The risks that can be covered are manifold. These are longevity-related, health-related, fire, theft, sabotage, accidents, earthquakes and even the risk of being exposed to uncertain sovereign policies. Increasingly, many non-insurable risks are falling into the category of insurable risks. The price of coverage depends on risk (probability) estimates, overhead costs, and returns on investible funds of the insurance companies. Competition leads to better risk categorisation, lowering of transaction costs, and better and more active management of investment funds. Competition in insurance market is expected to lead to better pricing of risk and possibly lowering of premiums. But more than lowering of premiums, competition is expected to lead to wider spread of insurance coverage.

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* *Indian Council for Research on International Economic Relations (ICRIER), New Delhi.*

A competitive insurance market encourages risk-taking and thereby promotes investment and growth.

Regulation may be considered redundant when the government has a monopoly in the market, since presumably the government would do what a (government appointed) regulator would wish it to do. But regulation is an imperative at the commencement of competition, especially in the insurance sector which is vulnerable to market failure. The basic objective of insurance supervision and regulation is to ensure that insurers will have financial resources required to pay all claims as they become due, and will also treat consumers in an equitable manner in all financial dealings. This is accomplished, firstly, by ensuring that policyholders and beneficiaries are given a fair treatment by insurance firms and insurance agents, and, secondly, by ensuring the financial soundness of the insurance firms themselves - their capital, reserves and investments.

However, as we discuss in this article, in most countries with a longer tradition of a competitive insurance industry, the primary objective of regulation has been protection of consumer interest[1]. Consumer protection has two aspects – protection against losses arising from the insolvency of institutions and protection against losses caused by fraudulent practices and other market conduct abuses. In a sense, apart from the protection of consumer interest, in the Indian context, the regulator's main brief would be to conduct a fair competition, but not let it become "cutthroat" that results in multiple bankruptcies and market implosion. Of course, the current competition between the four subsidiaries of the present General Insurance Corporation (GIC) is only notional, since there is not much pricing and strategic autonomy. In this article, we discuss the main issues related to regulation of the insurance business, and particularly focus issues pertinent to the insurance sector liberalisation in India.

The Indian insurance sector will soon have new private entrants into life and non-life business who will coexist with the state-owned Life Insurance Corporation (LIC) and General Insurance Corporation (GIC). The insurance business is presently estimated to be roughly Rs.400 billion per year and is growing at the rate of over 20 percent per annum, leaving aside the relatively undeveloped sectors of health insurance, pensions and annuities. The life fund of the LIC is currently more than Rs.1,00,000 crore. The entry of private players is expected to tap the underdeveloped market in some specific lines of business, such as household property insurance, health insurance, term life and annuities. In fact, the potential for the growth and spread of life insurance is high in India, as in many other Asian countries, due to higher economic growth, rapid

ageing of populations and a weak social security and pension system which leaves a vast majority of workers with no old-age income security (for details of Indian insurance industry in general and life insurance in particular see Ranade and Ahuja (1999a, 1999b). Private foreign players are expected to bring funds, technology and management practices. Such flows typically depend on the investor's perception of the financial health and depth of the economy, which, in turn, is gauged by the stability of not only banking but also the insurance and securities industry. Being a developing country, India's regulatory concerns are heightened further due to its lack of regulatory experience or benchmark[2]. In the initial phase, the insurance regulator, Insurance Regulatory and Development Authority (IRDA), would have to be concerned more with entry guidelines and capital requirements than with the regulatory details of market supervision.

IRDA was formally notified through the IRDA Act of April 2000. It has begun the process of registration of insurance companies, and has also issued guidelines for insurance, reinsurance, accounting, investment, and rural and social sector obligations, although the full regulatory regime will evolve over a period of time. IRDA's sweeping mandate includes stipulation of entry norms, grant of licences, standardisation of policies and procedures regarding intermediaries, public education and awareness campaigns, and development and growth of the insurance sector. It is the development brief of the IRDA which makes it different from the conventional insurance regulators.

INSURANCE REGULATION IN INDIA – SOME KEY ISSUES

Although principles of insurance regulation are the same in both developed and developing countries, the actual crafting of regulation is very much context-specific. On the supply side, the regulator needs to ensure that quality, reasonably-priced products are available from reliable insurers. For this, the regulator must generate healthy competition among financially strong insurers. On the demand side, the regulator must ensure that insurance products take the form that is easily understood by the buyers of insurance. This, of course, depends on the buyers' sophistication. Furthermore, in the event of any dispute, the regulator needs to ensure that an efficient redressal mechanism is in place.

Insurance is basically a contract, often a long-term one, as in the case of life insurance. Insurance involves paying premium now in anticipation of certain payments which may be made in the future. Not only does the buyer expect the insurer to be in business, but also to be financially sound to be able to honour the contract in the future, maybe many years later. This cannot be always

assumed in the changing and uncertain economic conditions characteristic of the developing countries. For this reason, the regulators in these countries must perform their task with greater care. Below we discuss some key issues relating to insurance regulation in India.

Weak Contract Enforcement

Insurance regulation must be responsive to the contract enforcement regime so as to generate customer confidence and enable insurers to meet their financial obligations. India is characterised by a regime of weak enforcement of contracts. This may be due to several reasons, such as lack of resources, lack of sufficiently defined incentives or lack of clearly defined property rights. The court system here is seen as slow and bogged down by many procedural hassles. Illiteracy and relative lack of financial sophistication could also result in the consumer being at a disadvantage in enforcement. In such a case, the regulator might be justified in limiting the set of contracts to a few standardised ones. Some standardisation is desirable even in product markets and takes the form of information and ingredient disclosure, standardisation of pack size, and so on. Product standardisation does not restrict competition; it actually helps consumers to compare products and make informed decisions. This logic applies with greater force to financial transactions where the product sold is in the nature of a contract. Since insurance contracts are more complex than those in banking and other financial activities, some standardisation is called for. Standardisation of insurance contracts makes the job of enforcement tractable, as it limits the opportunities for "fine print" mischief or fraud on the part of the insurer and the insured. Standardisation does impede growth of the industry, since it limits the kinds of products that can be sold, and cramps innovation. Such restrictions, however, depend on the degree of customer sophistication in understanding the terms of the contracts. These restrictions can decline as consumer awareness increases.

Sequencing of Deregulation and Restructuring

In the Indian context, IRDA must address the important issue of deregulation and restructuring of LIC and GIC which are public monopolies. As per the recommendations of the Malhotra Committee report (1994), both these organisations need to be restructured. Such restructuring could take the form of infusion of fresh capital from public and private sources, listing on the stock exchanges, revision of the incentive structure among the management and the agents, and so on. Until this is done, the structural inadequacy of LIC and GIC may become a handicap when it comes to their competing with the newly entering private players. On the other hand, waiting for the public monopolies

to be restructured before allowing private entry, may prove to be too costly in terms of overall growth of the insurance sector and welfare of the insured.

The "Development" Brief

The Insurance Regulation Bill passed by the Indian Parliament has the word "Development" in it. As Pant's (1999) recent analysis of the Bill emphasised, the regulator is charged with the responsibility of conducting a fair competition and also promoting the development and growth of the industry. This, at times, entails allowing for an apparently anti-competitive practice, which in reality is in the interest of long-term growth as also competition. An example would be product innovation, which creates a temporary monopoly for the innovator, but is soon imitated by other firms thereby eroding monopoly powers. An unduly harsh stance which prohibits innovation might harm long-term growth prospects. As such, the insurance business increasingly competes with products and innovations from the rest of the financial sector, as is seen from the worldwide trends (for details, see the section on 'Regulatory Practices in Insurance'). Hence, suppressing innovation is not warranted.

In developing economies like India, China and Sri Lanka, insurance regulation is a two-step process. The first step is to allow private entry and the second one is to ensure sound functioning of the market. The first step involves the creation of an appropriate market structure and the number of players to be allowed, while the second step involves solvency regulation and market regulation. The former is mainly about capital adequacy and restrictions on investments based on risk of the institution product profile, whereas the latter involves supervision of products, pricing, contract details, other trade practices, grievance redressal, and so on.

Independence of Regulator

Another important feature of insurance regulation in India is the establishment of genuine independence and credibility of the regulator, IRDA. A regulator's main objective is to promote competition and efficiency. To the extent competition might not lead to efficiency due to various reasons, such as asymmetric and imperfect information, these concerns are addressed in the nuts and bolts of regulatory design. But this objective of efficiency is not to be confused with the objective of promoting welfare or other social goals, which are the functions of the government. Promoting welfare involves a subjective judgement of the social welfare function (i.e., trading off the welfare of the rich (advantaged) with that of the poor (disadvantaged) which, in turn, is a matter

of social choice. Thus, the regulator's job is only to promote efficiency, both in a static and dynamic sense.

Also, the regulator must maintain sufficient equidistance between government-owned entities, such as LIC and GIC, and private-owned firms which are new entrants. That is, the regulator must ensure level playing field to both. The credibility and independence of the regulator is essential for earning the confidence of the investors and also for ensuring foreign direct investment in the field of insurance. At the same time, the regulator has to be wary of "regulatory capture." Moreover, the level playing field is not only between the sellers of insurance, as is conventionally understood, but also between buyers and sellers. It is in this context that the disclosure norms and regulation regarding "fine print" is important. But it must be emphasised that this function of the regulator, often referred to as "protecting consumer interest", should not be confused with meeting other social objectives, such as providing services to the disadvantaged. This aspect is also discussed under the section 'Rural Sector Obligations'.

Correcting for Informational Asymmetries

Informational asymmetries are likely to be greater in developing countries where database on customers' risk profile is either absent or weak. An important role of the regulator is to correct these informational asymmetries by encouraging insurers to invest in building and sharing such databases. It is well-known from theoretical considerations, that insurance markets are vulnerable to the twin phenomena of moral hazard (the tendency of the insured to aggravate risk) and adverse selection (the inability of the insurer to distinguish between high and low-risk customers, and the resultant pricing of average risk which can only attract high-risk customers). However, in practice, both these phenomena can be circumvented or mitigated by various mechanisms like deductibles and by offering a menu of insurance products. This leads to competitive market outcomes which are not the "first best" because of information constraints (the inability to observe the behaviour of the insured; the inability to distinguish high-risk customers from low-risk customers), but are "second best" or constrained optimum. The regulator has to endeavour to reach outcomes that are constrained optimum, since, typically, efficiency cannot be increased further.

Antitrust Legislation

Unlike developed countries where antitrust legislation checks collusive practices among insurers, antitrust concerns are not so important in the context of a developing country. While regulation should strive to promote competition

and growth in the insurance sector, there are some specific features of the sector that call for the regulatory practice to ignore monopoly and antitrust concerns. Some of these features, such as the need for sharing loss information; cooperation in the insurance of large risks (co-insurance); agreements related to claims settlement; cooperation in risk reduction activities, etc., must be taken into consideration when applying the antitrust law[3]. Such cooperation cannot be assumed to be automatic. In fact, in a developing country, insurance regulator needs to play an active role in the promotion of such cooperation among insurers.

Rural Sector Obligations

Although, in principle, the regulator is distinct from the government, the distinction gets blurred in practice. This blurring is best exemplified by clauses of "universal service obligation", a term we have taken from telecom regulations. Telecom service providers are required to provide their services to areas/sectors that might not be profitable at market prices. In the case of banking, such obligation is exemplified by priority sector lending. In the case of airlines, it takes the form of an obligation to service unprofitable routes. Such a service obligation imposed typically through a regulatory fiat, has to be financed by a cross-subsidy. Provision of cross-subsidy is the norm when there is a public monopoly, as is the case with LIC which sells some products to socially disadvantaged groups below cost. But with private sector entry, such obligations create distortions or become inconsistent with the pursuit of efficiency. The objective of 'universal service obligation' is best pursued by a separate instrument (such as voucher entitlements) or a fund which explicitly provides a subsidy, or an obligation which is tradeable.

REGULATORY PRACTICES IN INSURANCE

In this section, we review some regulatory practices in insurance business as observed in OECD and some of the developing countries. Even though we have discussed in one of the key issues above the separation of welfare and efficiency objectives, in practice, especially in the developed countries, these functions are performed under two main categories of regulation – solvency regulation and market regulation[4]. The former is mainly about capital adequacy and restrictions on investments based on risk of the institution product profile, whereas the latter involves supervision of products, pricing, contract details, other trade practices, grievance redressal, etc. It may be mentioned that since the extent of competition varies across countries, in some countries the insurance industry is lightly regulated (e.g. UK, Ireland, Netherlands), while in others it is strongly regulated (e.g. Germany, Japan, South Korea). Regulatory regimes

in insurance broadly cover four classes of insurance: life insurance, health insurance, property and casualty insurance and reinsurance. The bulk of regulation is common to all these classes. However, there are some specific rules applying to each of these classes and within each class to different subclasses[5].

Solvency Regulation

Solvency regulation of which capital adequacy is a major component, is to ensure the financial soundness of insurers and the need for it is generated by costly information and by agency problems (limited liability diminishes incentive to maintain safety). To check against solvency risk, regulators require that insurers maintain minimum amount of capital to meet their financial obligation. Capital adequacy regulation is applied almost everywhere in the financial services industry. Besides capital adequacy requirements, solvency regulation includes additional restrictions on investments, reinsurance, reserves, asset-liability matching, and so on. Capital and reserves act as a cushion against unexpected increases in liabilities and decreases in the value of assets. Capital is also used to fund rehabilitation or liquidation with minimal losses to policyholders and claimants in case of bankruptcies. Restrictions are also placed on the ownership of insurance companies in several countries to limit influence and contagion effects in case of insolvencies.

Ideally, the capital adequacy requirements should depend only on the risk of the financial institution as a whole. This risk, in turn, depends on the products it provides and the portfolio of assets and liabilities it holds. As the recent report on insurance regulation (OECD [1998]) points out, competitive distortions can occur if capital adequacy is not set appropriately between two competing products. In fact, competing products with similar characteristics should face similar regulatory requirements, independent of the sector in which they are produced.

There are broadly three approaches to capital adequacy. The first one, called the 'pillars approach', treats banking, insurance and securities market separate from each other and hence has a separate regulator for them. This approach has an advantage in accurately setting capital adequacy requirement. But the flip side of this approach is that the line of business restriction and ownership restriction it imposes, limits exploitation of economies of scope in production. Moreover, it increases the cost of bundling products that crosses sectoral boundaries. Under the second approach called the 'conglomerate approach', which allows firm in one sector to enter another sector through a subsidiary, does not limit economies of scope and bundling of cross-sectoral

products. But capital adequacy under this approach may not be applied appropriately thereby leading to competitive distortion. This approach is by far the most common among OECD countries. The third regulatory approach which is in a sense a refinement of the conglomerate approach allows cooperation and coordination between regulators to ensure that the overall capital requirement on the conglomerate takes some account of the risk of the financial institution as a whole. This approach while overcoming the disadvantages of the other two approaches, tends to duplicate regulatory effort. Moreover, in this approach, firm-wide risk assessment may be difficult (for a detailed account on capital adequacy see OECD [1998]).

Presently, the approach to capital adequacy is evolving. Due to the twin phenomena of (a) convergence in the provision of financial services by insurers and banks; and (b) international and cross-border nature of this provision, capital adequacy norms reflect this trend. The Basle Committee on Banking Supervision, which developed norms for capital adequacy in banking, now also requires that all international banks must be supervised on a consolidated basis (i.e., looking at their entire business worldwide) by a capable authority from the country in which they have their head office. At the same time, if other countries in which the bank has branches do not think that the 'home-country' supervisor is doing a good job, they can restrict the bank's activities there. Financial markets are different from other markets in the sense that financial decisions rely on availability and analysis of large data on the current financial position and future prospects of a borrower. This handling of data is subject to economies of scale. What is true of capital adequacy is also true of other financial restrictions.

Most OECD countries separately regulate banks, securities firms, life insurers, general insurers, pension funds and mutual funds. Such separation is ensured through line of business restriction and cross-sectoral restriction. Line of business restriction can be circumvented through the formation of subsidiaries or letting a firm be owned by another company. Therefore, line of business restriction usually accompanies ownership restriction. Banks in OECD countries are not allowed to directly produce insurance products. Similarly, insurers are not allowed to produce banking products. While most OECD countries allow banks to distribute (not underwrite risk) insurance products, insurers are not allowed to distribute banking products. But due to a variety of reasons, such as (a) technological change; (b) liberalisation in financial services; (c) increase in competition from substitute financial products; (d) globalisation; and (e) greater customer sophistication, it has become increasingly difficult for regulators to maintain separate control over different arms of the financial sector. Information technology induced financial innovations have given rise to sophisticated and

complex financial products. This has also increased economies of scope for the production of financial products and blurred the boundaries between traditional pillars of these products. Furthermore, competitive pressures have caused insurers to take on increased financial risk. This has made solvency oversight more difficult for the regulator. The entire financial industry is increasingly being viewed as competing in one market – the market for risk management services. Regulatory developments which this perspective has given rise to are relaxation of regulatory control over prices and ownership, permitting formation of financial conglomerates and erosion of functional boundaries between different types of financial institutions.

Market Regulation

Market regulation refers to regulatory practices that affect the conduct of insurance firms, rather than their solvency. The various categories under which market regulation is applied are pricing, products (including contractual details) and trade practices. Such market supervision applies to rates and tariffs, operation of an industry funded guarantee fund, specification of "fine print" language in products and contracts, grievance redressal and dispute resolution, arbitration, and so on. Institutionally speaking, there are various modes of market supervision. On the one extreme, supervision can be through a governmental agency administered by public servants, and on the other extreme, it can be through self-regulation by insurers. In between, there can be several combinations where supervisory responsibilities can be shared by government, insurers' board of directors, independent professionals, such as auditors and actuaries, and an industry association that can evolve its own codes and ethics. Such self-regulatory organisations are seen as a desirable goal toward which many developed countries have moved. Because industry has better information than a government supervisory body, self-regulation tends to cost less than government supervision and shifts the cost of supervision directly to industry, self-regulation is considered to be superior to government regulation. On the other hand, in developing countries, such as India, government supervision is likely to be more effective in the early stages. But a robust supervisory system with an increasing component of self-regulation through procedures of sound corporate governance is more likely to be able to cope with the growing complexity of a rapidly emerging financial sector than the system that relies on government supervision. Hence, the system adopted by developing countries should be such that it allows phasing in of these elements over a period of time. The various issues in market regulation and some of the observed practices are given below:

(a) *Rate regulation:* The issue involved in rate regulation is whether to impose a price floor, or price ceiling or both on the premiums. The

justification for imposing price floor lies in the fact that price competition in insurance can be unhealthy as it might bring some firms close to insolvency or bankruptcy, which in turn could cause a panic and "bank run" type of domino effect. High rates of inflation can also lead to premiums being insufficient to cover claims and, as such, might justify price floors. On the other hand, price ceilings are justified because of the presence of consumer search costs that impede competition and result in excessive prices and profits. In many lines of business, governments require premium rates to be filed with the supervisor for approval. In general, in developed countries, there is a clear trend towards deregulation of controls on insurance premiums. In the USA, where insurance regulation is under the domain of states, rates and policy forms are subject to regulatory approval. US state laws typically require that rates should not be inadequate, excessive or unfairly discriminatory. With the exception of workers' compensation and medical malpractices, commercial property/casualty lines in most states of USA are also subject to a competitive rating approach. Premiums for life insurance and annuity products are generally not subject to regulatory approval, although regulators may seek to ensure that policy benefits are commensurate with the premiums charged[5].

(b) *Guarantee fund:* This is a fund created by contributions from insurers. The purpose of the fund is to cover an insolvent insurer's financial obligation within statutory limits to policy owners, annuitants, beneficiaries and third-party claimants and to compensate victims of uninsured or unidentified drivers. There are arguments both against and in favour of the guarantee fund. On the negative side, it has a "free-rider problem" effect, i.e. it takes away the public's incentive to deal with financially strong, well-run companies, and reduces the incentive of insurance firms to be more prudent about their investment and business decisions. On the other side, it is said that few consumers are in a position to assess the financial strength of the insurance firms and that owners and managers of these firms still stand to lose their capital and livelihood. A system of coinsurance and deductibles can be designed to ensure that both consumers and company officials have the requisite incentive. If a guarantee plan is to be introduced, it must be done under the supervision of the regulator.

(c) *Contract design and disclosure:* Insurance salespersons generally require licensing by the government, and for this purpose most governments specify standards of knowledge and competence that must

be attained. It is also important to ensure that insurance agents actually provide necessary information to the consumers. This is ensured through contracts written in plain language, salespersons' code of ethics, need analysis, cooling off period (provide time to change or reconsider purchase decisions), and providing other sources of insurance information, such as informative government brochures. The regulator is also responsible for enhancing consumer awareness about insurers' prices, products and financial strength.

(d) *Dispute resolution:* This aspect of market regulation deals with grievance redressal, arbitration and so on. Recourse to courts is usually not a satisfactory option for consumers. A system of dispute resolution could be designed that encourages mediation which involves making the parties meet with a trained mediator as a first step. If this breaks down, then, as a second step, dispute resolution process involving binding arbitration could be made available. Complaint monitoring by an insurance ombudsman is another possibility. Market monitoring which is more proactive than reactive might also include tracking of written and telephoned complaints.

(e) *Regulation of intermediaries:* Insurance in most countries is sold through intermediaries, as they are indispensable in the provision of such services. They are subject to both occupational licensing and consumer protection regulation. Though recent trends in technology (e.g. telecom, internet, etc.) are leading to dis-intermediation in many financial services, including insurance, in India and China, intermediaries are expected to continue to play an important role.

CONVERGENCE

Financial convergence is taking shape in the form of retail cross-selling, integrated financial products and alternative risk transfers. Cost-cutting imperative of the retail business, increasing demand both from retail and wholesale side, and reduction or removal of regulatory barriers are the main drivers behind financial convergence. Rapid technological change in computing and communication has facilitated information processing and delivery. This technological change is also aiding the convergence process and intensifying competition in the marketplace. Hence, there is a continuous innovation in financial products, which cut across the traditional divisions of the financial markets. Insurance, banking as well as securities firms are increasingly seen to be providing a range of 'risk management services'. This term applies to services which meet consumption smoothing needs and address contingency needs.

Presently, there is considerable overlap in products sold by the three branches of the financial services industry (insurance, banking and securities). This has put pressure on regulatory regimes in the mature insurance markets of developed countries. These regimes are in the process of restructuring away from micro-management of the insurance market and companies and towards solvency-based supervision, which targets insurer solvency through management performance and business strategy. Under newer regimes, regulatory responsibilities are also being shared with actuaries, auditors, industry associations and other professional advisors. Regulations which require prior approval of the terms and conditions of insurance contracts, and which are in the form of general prohibitions against certain terms, are seen in the developed countries as factors limiting competition.

But these trends are emerging only in the developed economies that have had a long tradition of competitive insurance market. Developing countries like India and China are just opening up their insurance markets to competition[6]. Developing country characteristics, such as weak contract enforcement, less sophisticated buyers, low professional standards, shortage of trained personnel, absence of database for setting premium rates, and social-equity considerations requiring explicit cross-subsidisation, call for greater restrictions on pricing and design of insurance products.

CONCLUDING COMMENTS

Insurance regulation in India is a challenge and a necessity for the healthy growth of the industry. It is a challenge mainly because of lack of prior experience, and the need to build a strong and credible regulator who can assure new entrants of a level playing field in the presence of hitherto monopoly incumbents. The challenge for the regulator, therefore, is to remain equidistant between private players and the government in the garb of incumbents. The recent experience of the telecom regulator, TRAI, with the government-held incumbents, MTNL and DOT, has not earned the confidence of the investors. Of course, the telecom policy has been plagued by certain non-regulatory problems as well. The recent court judgement which upheld the challenge to TRAI's jurisdiction, has confirmed Niranjan Pant's (1999) fears that the wording of the IRDA Act can be very crucial. Insurance is big business, and will certainly grow. Insurance, mutual funds and pension funds are the domain of big institutional investors who will play an important role in the functioning and deepening of the financial sector, and also in the area of corporate governance. The regulatory experience in developed countries shows a trend towards a conglomerate approach to regulation. While India begins with a pillar approach, it is inevitable that convergence in financial sector products and distribution will call for a coordinated approach to regulation.

SOME LESSONS FOR INDIA

1. In the Indian context, there are separate regulators for banking, insurance and capital market. This is what has been described as the 'pillars approach' to regulation. In fact, a separate regulator for pension funds has been proposed by Dave Committee on Pension Reforms (see OASIS (2000). Also, institutional investors – pension funds, mutual funds and insurance companies – are expected to grow in importance at the expense of banks[7].
2. The initial focus of IRDA must be financial soundness and prior experience of entrants. Market development and competition issues would not be paramount in the early stages.
3. The initial stage would also benefit from tariff and contract standardisation, even if it comes at the expense of hindering competition and innovation. This is important for several reasons, such as lack of sophistication of buyers, a relatively poor legal environment for enforcement of contracts, uninformed sellers who need time to build a database and be better equipped to estimate demand, categorise risk, etc.
4. Social obligations of serving the relatively backward sections of the society are best undertaken through a separate instrument. This could be in the form of entitlement vouchers which should be tradeable. Mandatory coinsurance arrangements with LIC or GIC could also be an option.
5. In a country like India with an evolving financial sector, the IRDA may not feel that corporate responsibility has reached a point where investment functions are left to directors and senior managers of insurance firms. Hence, investment norms initially would need to be much more detailed and strict, with gradual phase out.

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NOTES

1. In fact, in developed countries where insurance has been competitive, the current trend is to move away from regulation and controls which limit competition toward those which focus on the financial soundness of insurers. This trend is also seen in regulations which do not require prior approval of terms and conditions of insurance contracts, and are in the form of general prohibitions against certain terms.
2. The telecom regulator, TRAI, has had a tough time dealing with monopoly incumbents and assuring new private entrants of a level playing field. Similarly, SEBI's initial forays in regulating brokers and being alert to abuses in the stock markets were only partly successful.
3. Each of these has been discussed in greater detail in OECD (1998).
4. The material in section 3 on solvency and market supervision is drawn mainly from Savage (1998) and Klein (1995).
5. Some examples can be given as illustrations. Life insurance business competes with other contractual savings businesses, such as banks and mutual funds. Hence, regulation of life business may be subjected to prudential norms that apply to banks. Recently, the Reserve Bank of India issued guidelines (RBI (2000) for banks who wish to enter into insurance business in India. Another example is health

insurance, in which case recent regulations in some states in the USA have prohibited genetic testing to determine risk factors. Property and liability insurance tend to have a much shorter time horizons as compared to life insurance.

6. For a detailed study of Chinese insurance market and regulation, see Qu (1998) and for the regulatory problems with the Chinese insurance, see Lu and Zhang (1999).

7. Since life insurance is as much about savings as about protection, it would increasingly compete with banks and mutual funds for people's savings.

REGULATION OF AVIATION SERVICES

Tulsi Kesharwani*

Aviation industry has made tremendous progress since the end of the second world war. While in 1945 only nine million passengers travelled on scheduled services world-wide, in 2000, almost 1.7 billion passengers were carried, nearly a 190-fold increase. Among different modes of transport, the aviation industry has been the highest regulated industry in the world. This situation stemmed from certain special characteristics of the industry, including users' high profile and the declaration in the Chicago Convention recognising exclusive sovereignty of states over the air space above their respective territories.

A number of international conventions and agreements, including the Chicago Convention, and several other documents prepared by the International Civil Aviation Organization (ICAO) guide such regulation. In the absence of a complete multilateral agreement regarding international airline operations, states depend upon bilateral agreements for such operations. Similarly, the domestic airline services have also been highly regulated. However, with the growing trend towards globalisation and liberalisation, the shackles of regulation for the airlines are gradually giving way to deregulation.

The situation of airports and air navigation services is, however, different. As these services have a monopoly character and are also being increasingly privatised, it is neither desirable nor practical to deregulate them. On the other hand, regulation in their case needs to be strengthened though a balance has to be struck between the interest of the state and that of the operator. As regulations have a price, it is necessary to ensure that they are the minimum essential. Regulation of airports is a complex matter and a number of issues require consideration before proceeding with it. There are no global answers to these issues and, as such, each state must address the issues according to its own specific conditions.

INTRODUCTION

The world over, expansion of civil air transport has been, in the main, a post second world war phenomenon although limited commercial flying had commenced earlier. The Convention on International Civil Aviation (the Chicago

* Senior Research Fellow, Asian Institute of Transport Development, New Delhi.

Convention), which provides the fundamental legal foundation for the regulation of world civil aviation and establishment of the International Civil Aviation Organization (ICAO), was signed in Chicago in December 1944. The aims and objectives of ICAO are to develop the principles and techniques of international air navigation and to foster the planning and development of international air transport so as to, inter alia, insure the safe and orderly growth of international civil aviation; encourage the development of airways, airports, and air navigation facilities for international civil aviation; meet the needs of the peoples of the world for safe, regular, efficient and economical air transport; prevent economic waste by unreasonable competition; avoid discrimination between contracting states, etc.

The post second world war state of the aviation industry and its growth thereafter can be gauged from the fact that while in 1945, only nine million passengers travelled on scheduled services world-wide, in 2000, almost 1.7 billion passengers were carried, nearly a 190-fold increase. Presently, several airlines and airports individually handle much more traffic than nine million passengers in a year.

Among different modes of transport, the aviation industry has been the highest regulated industry in the world. This situation stemmed from certain special characteristics of the industry, including its international character, its perceived economic importance to the economy of states, users' high profile, its sensitivity to media reporting, especially regarding safety and other important aspects, declaration in the Chicago Convention recognising exclusive sovereignty of states over the air space above their respective territory, over-jealous nature of states to support their national carriers (which are called flag carriers), and the states considering the aviation industry to be of strategic importance.

ECONOMIC vs. TECHNICAL REGULATION

Regulatory aspect of aviation industry is basically divided into two categories. First category of regulations includes what are generally called technical regulations. These primarily relate to safety and security of aircraft operations, including air navigation services, such as, licensing of pilots, air traffic controllers, aircraft maintenance engineers, and other technical personnel; certification of airworthiness of aircraft; safety of aircraft operations; certification of aerodromes; security regulations, etc. The second category of regulations is generally called economic regulations (or commercial aspects of air transport). These include licensing of national carriers; operating authorisation to foreign carriers; route operation regulations; control on fares and rates; slot allocation at the airports;

bilateral air services agreements and exchange of traffic rights; ownership of airlines including transnational ownership; control over mergers and alliances; facilitation and non-discrimination in the usage of facilities and services at international airports open for public use; fixing of charges for facilities and services at airports and for air navigation services, etc. The regulations for international air transport are generally different from the regulations for domestic operations in several respects.

Chicago Convention

Article 1 of the Chicago Convention recognises exclusive sovereignty of the state over airspace above its territory. This provision thus debars a state from operating air transport services in the territory of another state without specific agreement of the latter. The provision has given rise to regulation of international air transport through a number of bilateral and also a few multilateral agreements.

Article 15 of the Convention is another major article regulating the use of the facilities and services at an international airport open to public use. This article sets out three basic economic principles relating to the use of airports and air navigation facilities and services at international airports and the charges for their use. These principles are: (a) application of uniform conditions for all the airline operators in the usage of facilities and services; (b) non-discrimination in charging aircraft operators; and (c) no charges to be levied solely for the right of aircraft transit over, entry into or exit from the territory of a contracting state. These principles reflect the concern of the contracting states to avoid the possible abuse of monopoly power by the providers of airports and air navigation services.

The Convention includes several other articles having a bearing on economic regulation of air transport. These are: Article 5 on non-scheduled flights; Article 6 on scheduled services; Article 7 on cabotage (the privilege of a state to operate domestic air services in another state); Articles 17 to 21 on nationality of aircraft; Article 22 on facilitation; Articles 23 and 24 on customs and immigration; and Articles 37 and 38 covering standards and recommended practices regarding facilitation, etc. It is to be noted that the provisions of the Convention are binding on all the contracting states (185 at present) and no state can exempt itself from any of the provisions of the Convention.

Other International Regulatory Agreements

The second major international agreement of considerable importance was the International Air Services Transit Agreement signed at the time of the adoption

of the Chicago Convention, which provided for the multilateral exchange of rights of overflight (the privilege to fly across the territory of other contracting states without landing, generally known as the "first freedom of air") and non-traffic stop for scheduled air services among its contracting states (the privilege to land for non-traffic purposes, generally known as the "second freedom of air"). As many as 115 states, including India, have ratified this agreement. The world-wide Air Transport Conference organised by ICAO in 1993 recommended that states pursue and ICAO promote, universal adherence to and implementation of the International Air Services Transit Agreement.

The third major agreement was International Air Transport Agreement which was of far reaching consequence in liberalising international air transport operation and granting contracting states the right to five freedoms of air, namely, (1) the privilege to fly across its territory without landing; (2) the privilege to land for non-traffic purposes; (3) the privilege to put down passengers, mail and cargo taken on in the territory of the state whose nationality the aircraft possesses; (4) the privilege to take on passengers, mail and cargo destined for the territory of the state whose nationality the aircraft possesses; and (5) the privilege to take on passengers, mail and cargo destined for the territory of any other contracting state and the privilege to put down passengers, mail and cargo coming from any such territory. However, this agreement could be ratified by only 19 states out of which 8 states, including the United States, later withdrew. One more state has since ratified the agreement, making it a total of 12 parties to the agreement. Thus, this agreement is of limited international value. It may be mentioned here that India is not a signatory to this agreement.

There are several other conventions dealing with specific subjects. The Warsaw System – a group of air law documents – governs air carrier liability with regard to the death of or injury to passengers and loss or damage to cargo, and includes the Warsaw Convention, the Hague Protocol, the Guadalajara Convention, Guatemala City Protocols, Montreal Protocol, etc. Other international regulatory documents, which affect international air transport, include Geneva Convention, which recognises the various rights in aircraft (property, acquisition, possession, etc.), Other conventions deal with safety and security aspects and the related legal issues.

There are a few intra-regional multilateral agreements, such as the Multilateral Agreement on Commercial Rights of Non-scheduled Air Services among the Association of South-East Asian Nations (ASEAN), signed at Manila on 13 March 1971, which liberalised non-scheduled air services within the subregion.

ICAO Guidelines on International Economic Regulation

Apart from several international conventions and agreements, ICAO has developed manuals and guidelines for economic regulation. Among these, the important ones are: Manual on the Regulation of International Air Transport, Policy and Guidance Material on the Economic Regulation of International Air Transport, Statements by the Council to Contracting States on Charges for Airports and Air Navigation Services, Airport Economics Manual, and Manual on Air Navigation Services Economics. Annex 9 of the Chicago Convention contains recommendations on facilitation in civil aviation and establishment of facilitation committees.

It will thus be seen that international air transport is considerably regulated by the Chicago Convention and various other documents developed by ICAO or produced at the initiative of ICAO.

Bilateral Air Services Agreements

The lack of success of efforts by the international aviation community to establish a multilateral regulatory regime for the commercial aspects of international air transport led to the community falling back on bilateral air services agreements.

Bilateral agreements are undertaken jointly by two parties, most typically by two states, although one or both parties might also be a group of states, a supra-state (i.e. a community or other union of states acting as a single body under authority granted to it by its member states), a regional government body or even two airlines (for example, in the determination of capacity or prices). The goal of bilateral regulation in the international air transport field is typically the conclusion, implementation or continuance of some kind of inter-governmental agreement or understanding concerning air services between the territories of the two parties.

The bilateral regulation of international air services has evolved over a period of many decades. Such agreements constitute the largest volume of international air transport regulatory documents, which date from the Chicago Convention signed in 1944. The extensive use of bilateral agreements to regulate international air transport is a consequence of the agreement in the Chicago Convention on the principle of national sovereignty over territorial airspace.

Contents of Bilateral Agreements

Although each bilateral air services agreement is unique in nature, these agreements typically have in common numerous essential provisions most of which, while not identical, have a similar thrust. Such commonly found substantive provisions include: grant of rights, a fair and equal opportunity, airline ownership, designation of air carrier and authorisation, principles for regulation of capacity, fixation of tariffs, exchange of traffic statistics, right to carry out commercial activities in the territory of the other party, mutual recognition by the parties of each other's certificate of airworthiness, certificate of competency and licences, procedure for cooperation regarding security, use of computer reservation system, provisions regarding exemption from payment of customs duty and taxation of earnings of the air carrier, user charges, and application of national laws, etc.

ICAO also provides guidelines for dealing with various aspects included in the bilateral agreements and also certain model clauses covering these aspects. Wherever appropriate, alternative clauses have also been provided. For example, in the case of airline capacity regulation, three alternative model clauses have been provided. In regard to tariff fixation, the model texts encompass basically three alternatives, namely, "double approval" approach (whereby tariffs proposed by airlines must be approved by both the parties to the bilateral agreement); "country of origin" approach (whereby each state regulates only those tariffs for carriage which commence in its own territory); and "double disapproval" approach (whereby tariffs come into force unless disapproved by both parties to the bilateral agreement within a specified period). Sometimes, "tariff zone" is specified whereby tariffs falling within certain agreed parameters are automatically approved. In regard to computer reservation system (CRS), it has developed a code of conduct for regulation and operation. The code provides guidance with world-wide applicability in the form of general principles concerning the operation and regulation of computer reservation system. The obligations in the code for states, system vendors, air carriers and subscribers are based on fair competition, accessibility, transparency and non-discrimination, while taking into account current market practices and the particular interest of developing countries. In the interest of the critical need for harmonisation of various national and regional CRS regulations, common approaches have been included where they exist. Further, guidelines have also been provided on commercial matters, such as ground handling, currency conversion and remittance of earnings, employment of non-national personnel, use of local services and sale and marketing of air services products.

The provisions of a bilateral agreement between two states are not fixed for all times to come. Depending upon the requirements, they are reviewed from

time to time and suitably amended. Reciprocity is the foundation of every bilateral agreement. In the case of most bilateral negotiations, hard bargaining in regard to grant of traffic rights is in vogue.

Liberalisation of Bilateral Agreements

Within the limits of bilateral agreements, liberalisation is gradually taking place almost on a continuing basis. The contents of the recently signed bilateral agreements are more liberal than those signed in the past. The number of states following 'open sky' policy, which grants unlimited access to airlines of other states, is growing. However, most of the liberalisation processes are generally within well-defined regions. The United States follows an 'open sky' policy with regard to Canada and Mexico. For other countries, airline operations are based on the provisions of bilateral agreements. Airlines of the European countries, which are members of the Common Market, have free access within the region. African airlines have a policy to liberalise grant of traffic rights including fifth freedom right among the airlines of the continent. Moreover, COMESA, an association of 20 eastern and southern African states is liberalising aviation and other services in the region. In Asia, the Association of South and East Asian Nations (ASEAN) is liberalising operation of air services within the region.

Airline Mergers, Alliances and Code Sharing

Airlines are on the constant lookout for innovative measures to give a fillip to their competitive strength and thereby improve their finances. Mergers and transnational ownerships of airlines are considered one such measure. However, such moves in the eyes of states and regulatory authorities is somewhat suspect as they may make the carriers monopolistic. States, accordingly, wish to regulate mergers and transnational ownerships. Many proposals of mergers of airlines and transnational ownerships are being questioned, especially in the United States, to avoid monopoly or near monopoly situation.

Short of mergers and transfer of ownerships, which may often be difficult, the airlines are entering into alliances. Such alliances are growing in number and the existing alliances are becoming stronger. Presently, there are two major alliances, namely, Star Alliance and One World Alliance of which major alliances are members.

Codesharing is another practice followed by the states whereby one carrier permits another carrier to use its airlines designator code on a flight or where two carriers share the same designator code on a flight. This system leads to better utilisation of the rights under bilateral agreements. ICAO generally supports this practice.

WORLD TRADE ORGANIZATION (WTO) AND AIRLINE SERVICES

The Final Act of the eighth round of trade negotiations sponsored by the General Agreement on Tariffs and Trades (GATT), known as Uruguay Round, signed in April 1994, contained, *inter alia*, the General Agreement on Trade in Services (GATS) which included air services as well. The focus of GATS is on liberalisation. Three core liberalisation principles are: (a) market access or specification of the levels of access to be granted to other parties; (b) national treatment, that is, treatment to foreign services and suppliers of services no less favourable than that accorded to a party's own services, and service suppliers; and (c) Most Favoured Nations treatment, that is, non-discrimination, the provision of treatment to all parties no less favourable than that accorded to any party.

Contrary to the general provisions in the Chicago Convention and bilateral and multilateral agreements, in GATS, reciprocity in the grant of rights is not required. The application of GATS to civil aviation is, however, limited to only three relatively minor items: (a) repair and maintenance of aircraft; (b) selling and marketing of air transport; and (c) Computer Reservation System. It does not include basic items in air transport regulation, like traffic rights and airline tariffs and, consequently, the impact of GATS on the aviation industry is of limited significance.

According to Dr. Assad Kotaite, President of the ICAO Council, "the liberalisation of air transport is progressing on the basis of specific needs, interests and circumstances of states and a wholesome application of the GATS is not required". In this situation, it is difficult to imagine what type of role WTO will play in future towards further relaxation in the operations of international air transport services, especially in regard to traffic rights and tariffs. Nevertheless, in the long run, the possibility of the international airlines coming under the purview of WTO in an increasing measure cannot be ruled out. Such a development may have an adverse impact on the national carriers of developing countries, including India, as they might find it difficult to effectively compete with mega carriers of the developed world.

REGULATION OF INTERNATIONAL AIRLINES IN INDIA

In India, international air services are governed by bilateral agreements. Although India is a member of a regional grouping, named SAARC, its impact on air services has been negligible. A major problem faced by India in dealing with bilateral agreements, especially the capacity aspects, is lack of adequate

capacity available with its national carriers. They are unable to fully utilise the traffic rights granted to them under various bilateral agreements. However, in the case of international cargo traffic, India follows an 'open sky' policy with no controls either on entry of foreign airlines or the capacity offered or the freight rates charged. This was necessitated by a serious imbalance between the demands for carriage of outbound cargo and inbound cargo. Such an imbalance still continues. For example, during the year 1999-2000 the total international export cargo was 347,207 tonnes as against only 184,637 tonnes of import cargo. Seasonal imbalances were still higher. At times, it is difficult to meet the demand for outbound cargo, thus affecting exports. The market forces, including the supply and demand, from time to time determine the actual freight rates from and to India.

DEREGULATION OF DOMESTIC AIRLINE SERVICES IN THE USA

As in the case of international airline services, the domestic airline services were also heavily regulated in the past throughout the world. States themselves were responsible for imposing such regulations. This was in keeping with the general environment of regulation of industries at that time. The Government of the United States, however, took the first major initiative towards deregulation of domestic aviation industry in early seventies of the last century. Several events led to this step. The advent of wide-body aircraft, which significantly boosted airline capacity on many routes was one of the important factors. The oil embargo in 1973, which led to skyrocketing of fuel costs, had a crippling effect on the aviation industry. These factors combined with the economic downturn in the country put severe strain on airlines.

The United States' Airline Deregulation Act, 1978 provided for a complete elimination of restrictions on US airlines for operations on domestic routes by December 1981 and end of all rate regulation by January 1983. The deregulation process in the United States had a significant impact on the domestic airline industry. Numerous new airlines came into being and the established ones expanded in many new markets. Deregulation resulted in fierce competition on several routes, leading to cost cutting and generally lower fares and better services for most air travellers.

Deregulation of the domestic airline industry in the United States along with general global trends in deregulation and privatisation of other industries had their impact on the regulation of domestic airline industry in other parts of the world, including developed and developing countries. This resulted in the

opening of the domestic routes to private carriers and abolition of monopoly of state-owned national carriers. However, such opening has been limited to the carriers substantially owned and effectively controlled by the nationals of the state. Furthermore, there has been considerable dilution in the state ownership of domestic airlines. Controls on fares and rates have been gradually relaxed or abolished. Competition is being encouraged. The overall impact of deregulation has been a decrease in fares and rates and a surge in the demand for air services.

DEREGULATION OF DOMESTIC AIRLINE SERVICES IN INDIA

In India, liberalisation of domestic air transport services commenced in the year 1986, but it was not properly planned. It progressed gradually in a rather haphazard manner. Scheduled services were legally opened to private operators only in March 1994 after the repeal of the Air Corporations Act, 1953, which gave monopoly to the national carriers, Air India and Indian Airlines. Both the national carriers are now being partially privatised. However, even now there are a number of restrictions on the entry and operation of private carriers on domestic routes. These restrictions relate to minimum fleet, size of aircraft, minimum equity capital, compulsory operation of a part of total scheduled services in remote and backward areas of the country, etc. Besides, grant of permits for new operators is not automatic. While granting permits, various aspects, including the need for the services in the proposed area, are to be considered by the government. Limitations are also placed on foreign equity participation and management by foreign airlines.

The above policy has limited the induction of new operators on the domestic routes and, consequently, restricted the competition among the airlines. Heavy taxation (high administered price of aviation turbine fuel, high sales tax on the fuel and inland travel tax of 15 per cent of the fares) and compulsory operation of a proportion of scheduled services in backward and remote areas have added to the problems of domestic aviation industry in India. (Presently, there are some good signs regarding lowering of prices of aviation turbine fuel.)

In contrast to the United States experience, where liberalisation brought about a general reduction in fares and increased air travel, in India, liberalisation led to increase in fares. Immediately after the entry of private operators on domestic routes, there was a surge in traffic, but it has not been sustained. India is one of the few Asian countries where domestic air traffic is less developed. It requires serious consideration how and to what extent further liberalisation should be pursued in the operation of domestic services.

REGULATION OF AIRPORTS AND AIR NAVIGATION SERVICES

Initially, aviation support services, namely airports and air navigation, which were owned and operated by governments and government-owned corporations world over, were relatively less regulated than the airlines. The primary reason for this situation was that the provider and the regulator were the same and also there were no private operators in competition.

The recent moves towards liberalisation and privatisation of aviation services, have led to a major change in the concept and scope of their regulation throughout the world. As brought out earlier, generally, the regulations governing the airlines, both international and domestic, have been considerably relaxed. On the other hand, in the case of airports, the trend is just the opposite. With privatisation of airports, regulatory oversight has become especially important, because airports possess certain characteristics of natural monopoly. It has to be noted that a private unrestricted monopoly could do more harm to the economy of a state than a relatively inefficient public monopoly. If not restricted, a private airport operator may use his market power to increase certain tariffs beyond reasonable limits to maximise his profits. Some of the charges may have serious impact on airline operations, which may not be in public interest.

The principal objectives of economic regulation of airports are designed to promote sound development of civil aviation, establish a system of regulation that serves the interests of airport users as well as the airport operator, and encourage the economically efficient development and operation of the airport.

It may be noted that regulations have a price. Each successive level of higher regulation demands greater government involvement and greater costs or reduced sale price or concession fee for the government. Moreover, higher level of regulation leaves less flexibility to the operator in introducing innovative ways of developing and managing airports. Accordingly, it is essential that regulations should be the minimum essential. While framing regulations, an appropriate balance needs to be maintained to safeguard the interests of users as also of the private operator. Apart from the minimum level of regulation, it is necessary that regulation should be precise and clear. Any ambiguity will neither be in the interest of the government nor of the provider of services.

Major Issues in Economic Regulation of Airports

There are a number of issues involved in the economic regulation of airports. Some of the major issues are briefly discussed in the following paragraphs:

International obligations. All the ICAO contracting states are under several international obligations in regard to the operation of international air transport services. The Chicago Convention has placed a number of obligations on contracting states. In the context of private participation and privatisation in the provision of airports and air navigation services, the most important provision in the Chicago Convention is Article 28 which places on each contracting state the responsibility for the provision of airports and air navigation services in its territory in accordance with the standards and practices recommended or established from time to time, pursuant to the Convention. Thus, the ownership and management of airports and air navigation services may be delegated to private sector but the overall responsibility for the provision of the services in accordance with ICAO Standards and Recommended Practices remains with the states. There are several other international obligations which the states have to fulfil. Accordingly, while proceeding with privatisation of airports, it is essential to ensure that the private operator is fully committed to various international obligations of the state.

Earmarking privatised airports in bilateral agreements. Privatisation of airports does not change the prerogative of the government to sign bilateral air services agreements with various governments. However, the provisions of bilateral agreements may sometime have a favourable or unfavourable impact on the traffic generated at an airport. While proceeding with privatisation of airports the government may like to clarify its policy regarding granting of traffic rights covering various airports.

Slot allocation. With the growing congestion at airports, slot allocation has become a major issue. With the growing privatisation of airports, the issue becomes complex as the private operator may exploit the situation. It needs to be considered whether the power to allocate slots should be retained by the state or the regulatory authority or by the private operator. If this function is entrusted to the private operator, should some guidelines be provided to the private operator or he be allowed to commercially exploit the operation of the slots.

Taxation of profits of the lessee company. Many governments levy income and other taxes on the profits of the airport operator, even though the airport operator is a fully state-owned company or corporation. However, some governments do not levy taxes on the profits of the government-owned undertakings. Some governments give special incentive to private operators by exempting them from payment of taxes for a fixed initial period with a view to encouraging them to make investments in airports and other infrastructures. Thus, for example, in the Central Budget for the year 2001-02, the Government of

India has proposed to exempt the new investments in infrastructure including airports for a limited period. It will be desirable to make such a policy clear before moving towards privatisation of airports

Restrictions on foreign shareholding of the lessee company. Some countries place restrictions on the foreign shareholding of the lessee company. For example, in the case of Australian airports, the regulations restrict the majority shareholding in the leasing company to be Australian citizens. However, in the case of privatisation of Latin American airports, there is no such restriction on the leasing company. It might be useful to have local participation in the equity of the lessee company but having a majority of locals may not attract many bidders. Similar is the case with restrictions on the appointment of foreign directors of the lessee company. Another connected issue is restriction on transfer of shares of the lessee company after the contract has been awarded. These issues need to be considered carefully before proceeding with privatisation of airports. The decision on these issues should take into account the local conditions and the economic and financial policy of the government. It should, however, be pointed out that the developing countries are not in a position to be very strict on these issues and have to have a liberal approach. Unless private operators have effective control over the operations of the privatised airports, the privatisation exercise may not be quite successful. In any case, these issues must be settled before action is taken on privatisation of airports.

Maintaining the quality of services. A major objective of privatisation of airports is to improve the quality of services at the airports. This should be an important item of economic regulation. Quality of service, to an extent, is qualitative and unless it can be quantified it may not be possible to enforce it. However, benchmarks are now being developed and considerable amount of quantification has taken place. It will be necessary to lay down targets and also make general provisions regarding maintaining the quality of services at the airports.

Future expansion and development programmes. The traffic at airports is expected to grow in future and, therefore, the facilities must also increase. If traffic can be forecasted correctly, it should be possible to identify the future development programme and provide for it in the contract. However, as the future traffic cannot be determined precisely, the development programme has to be flexible. In a normal situation, the operator would like to minimise his investment. In particular, he would not like to invest in facilities a few years before the expiry of the contract. To avoid such a situation, it will be desirable to provide for some incentive to the operator so that he could fully recover his

investment within the remaining period of lease. At the same time, it should be ensured that the operator makes intended profit. Again, the system would have to be carefully established.

Development of new airports and sharing of traffic. Construction of new airports within the vicinity of the privatised airport would have a far-reaching impact on the traffic and finances of the privatised airport. In India, there is a proposal for development of a new airport in New Mumbai. At Chennai also some proposals for a new airport are being floated. In Delhi, people are loosely talking about a new international airport in Gurgaon and also in Ghaziabad. Such issues need to be settled before privatisation takes place, especially in the case of Mumbai Airport, where the proposal to build another international airport is a distinct possibility.

Airport tariff regulation. Universally, airport charges are divided into aeronautical charges and non-aeronautical charges. Sometimes, these are called charges for air traffic operations and for ancillary services. Charges for aeronautical services are considered more sacrosanct and, according to ICAO guidelines, these have to be cost-based. Aeronautical sources of airport revenues include landing and parking charges, passenger service charges, cargo charges, security charges, noise abatement charges, aerobridge charges, etc.

All other revenues are treated as non-aeronautical for which ICAO encourages full development with the exception of concessions directly associated with the operation of air transport services, such as aviation fuel, in-flight catering and ground handling services. Accordingly, the level of regulation for aeronautical services needs to be higher. While the level of regulation for fuel concession, in-flight catering and ground handling should be lower. For other non-aeronautical activities, the operator should generally be given the freedom to determine the tariffs.

ROLE OF REGULATORY AUTHORITIES

Ideally, all the requisite regulations should be clearly identified and included in the lease deed or sale deed. This would avoid any uncertainty, both for the government and for the private operator. However, world is dynamic and future cannot be seen with any degree of certainty. The privatisation of airports covers a relatively long period and, therefore, a regulatory authority is required to provide answers to the new developments as they occur from time to time.

In almost all the states where privatisation of airports has taken place, regulatory authorities have been established (where they did not exist earlier) to

ensure that monopoly power is not abused, especially in the case of aeronautical charges. For example, in the United Kingdom, the aeronautical charges are controlled by the Civil Aviation Authority by applying a Retail Price Index (RPI) minus X formula (i.e. the charges are capped on an annual basis according to a percentage, X, less than general inflation). The X factor is adjusted every five years, taking into account, *inter alia,* major investment projects, when the Civil Aviation Authority is also required to refer the rates for review to the Monopolies and Mergers Commission. For Manchester airport, it is the average yield per passenger, which is capped.

In other European states, similar formulae with a few more parameters including growth in traffic have been adopted. Thus, for example, Vienna Airport takes a tariff basket approach in which inflation and traffic are the guiding parameters. In Portugal, the tariff basket includes airport costs, traffic growth, commercial income and inflation. In South Africa, aeronautical charges may increase at the same rate as inflation for the first two years after privatisation, followed by three years at RPI minus X (initially 2 percent); guidelines have been provided to the Regulating Committee in regard to valuation of X. In Australia, provision has been made for reduction in aeronautical charges in real terms over a period of five years by capping it with RPI minus X. The value of X differs from airport to airport. In Colombia, a system of indexing has been evolved which takes into account a number of parameters. However, in Canada, no defined mechanism has been established and the issue is left to be settled between the airport operators and the airlines through consultation. Regulation in regard to rents and other charges, including ground-handling charges, is generally loose or non-existent.

None of the formulae for price regulation can be considered perfect but all the formulae presently include the desirable objective of reduction in aeronautical charges in future in real terms. The most common formula is RPI minus X. This system can work efficiently if the base level of charges is fixed correctly on the basis of comprehensive and transparent cost data. Moreover, there should be a general review of the charges after a few years, taking into account both the cost of providing the services and the need to ensure a reasonable return on investment.

Need for Independent Regulatory Authorities

With growing privatisation of airports, the responsibility of the states to monitor and also to take corrective action as a regulator has increased considerably. Accordingly, the existing regulatory body within the concerned state will need to be refocused and suitably strengthened, not only quantitatively but also

qualitatively. Moreover, the new regulatory authorities should be independent as has been recommended by the ICAO.

There can be different approaches to the establishment of an independent regulatory authority. One approach can be to establish a general body for regulating all the sectors of the economy. In Australia, the Australian Competition and Consumer Commission, whose jurisdiction covers all sectors of the economy, is also responsible for the regulation of the privatised airports. In the United States, the Department of Transportation, created in the year 1966, is the regulatory authority for all modes of transport including air transport. In the United Kingdom, the Civil Aviation Authority controls the aeronautical charges. However, after every five years, the rates are referred to the Monopolies and Mergers Commission for review. All these agencies are independent and backed by legislation. It is difficult to pass a judgement that one particular system is superior to the other; it all depends upon the special situation obtaining in the concerned country.

The Indian Scene

In India, historically, different modes of transport are regulated differently. For all practical purposes, it will be desirable to continue to follow the existing policy. Accordingly, an independent agency for regulating airports and air navigation services needs to be established. To minimise uncertainty, it will be desirable to spell out as many provisions as possible within the privatisation contract and leave only the residual issues to be addressed by the regulatory authority.

The scope and powers of the regulatory authority need to be clearly defined. Moreover, it needs to be ensured that the regulatory authority does not question the provisions of the basic agreement between the government/ Airports Authority of India and the private operator. Such a regulatory authority should not be only for the four airports, namely Mumbai, Delhi, Kolkata and Chennai, which are proposed to be leased now, but for all the airports. With this approach, a regulatory authority with a chairman and two members (who could be part-time) with limited staff may suffice for the time being.

New Aviation Policy in India

The basic civil aviation legislation in India is encompassed in the Aircraft Act of 1938. There are a few other legislations, a host of rules and regulations and also several policy decisions. The government has decided to bring forth a new comprehensive civil aviation legislation incorporating the latest policy

decisions and also introducing certain new policies. Among the strategic objectives of the new civil aviation policy which has a bearing on economic regulation for airports are: (a) all players and stakeholders should be assured of a level playing field; and (b) private participation should be encouraged and opportunities created for investors to realise adequate returns on their investments.

The new aviation policy and the draft civil aviation legislation are still being debated. It is hoped that the final outcome of this debate will lead to improvement in the quality of air transport services and will also give a major boost to the sustained development of civil aviation sector in India.

CONCLUDING REMARKS

Civil aviation industry is one of the most regulated industries in the world. The shackles of regulation for the airlines are gradually giving way to deregulation. However, the situation of airports and air navigation services is different. As these services have a monopoly character and are also being increasingly privatised, it is neither desirable nor practical to deregulate them. On the other hand, the regulations need to be strengthened though a balance needs to be struck between the interest of the state and that of the operator. As regulations have a price, it is necessary to ensure that they are the minimum essential. Several issues pointed out earlier require consideration and need firm decisions before embarking on privatisation of airports. There cannot be global answers to these issues as the political, economic and social philosophy of each state is different and, accordingly, each state must consider the issues according to its own specific conditions. However, a study of the practices followed by other countries in regard to the economic regulation of airports and air navigation services would be of considerable help.

REGULATION IN URBAN PUBLIC TRANSPORT

O. P. Agarwal*

With growing urbanisation and increasing demand for public transport, the government has found itself unable to finance the required capacity. This has led to increasing dependence on personal vehicles, resulting in virtual gridlock and severe air pollution. There has, thus, been a growing need for involving the private sector, both to augment the capacity of public transport and to improve its quality.

Unfortunately, experience has shown that the unrestricted entry of private operators has had disastrous effects on safety, the case of the 'red line' buses in Delhi being an oft-cited example. Of late, environmental concerns due to the use of polluting fuels have been occupying the headlines. Issues relating to fair pricing, adherence to good environmental practices, adequate availability, proper integration of the services of different operators, etc. are also matters of concern. All of these highlight the need for proper regulation, preferably through an independent agency.

This paper looks at the main features of the regulatory framework for urban public transport and discusses the scope of such regulation.

INTRODUCTION

Over the last few decades, most infrastructure services in India, like in several other countries, were provided by government-owned monopolies. These were established in the belief that monopolies enjoy economies of scale in the delivery of such services. Since the average unit cost of the delivery of services typically declines as output increases, it makes economic sense for a single firm to supply the services in the market. Thus, electrical power was generated, transmitted and distributed through the agency of the State Electricity Boards; telecommunication services were provided through the Department of Telecommunications; and public bus services were provided through State Transport Corporations (STCs). Unfortunately, a monopoly service provider tends to conduct his business with little regard to quality and protection of consumer

* *Joint Secretary, Ministry of Personnel, Public Grievances and Pensions, Government of India. The views expressed here by the author are, however, in his personal capacity.*

interests. The absence of competition leads to operational shortcomings as also inefficient allocation of resources which gets compounded by the government's growing inability to fund the necessary expansions and to capitalise on technological changes.

A reassessment of the performance of the infrastructure sectors led to the belief that market forces and competition can improve the production and delivery of services without affecting the economies of scale. As a result, over the past two decades, infrastructure reforms in this area have been the driving force in several countries.

These developments were hastened by several other factors. First, most countries looked for additional resources for financing the infrastructure sectors because of the large investment required. Second, the government's inability to supply infrastructure services efficiently and in a commercially viable manner was recognised. Third, providing efficient and cost-effective infrastructure services became necessary for countries if they were to compete globally. Fourth, the integration of global financial markets made it possible to raise capital for infrastructure from overseas. Finally, technological breakthroughs altered the traditional concept of managing infrastructure services through monopolies, and it became possible to unbundle services and to introduce competition.

WHY REGULATION ?

Regulation can be justified both on economic and social grounds. The most dominant is the economic argument of market failure. In certain industries or services, economies of scale may warrant a monopolistic market. In the absence of competition, service providers would tend to charge unreasonable prices and compromise on quality. In other cases, the problems of asymmetric information would constrain the development of a truly competitive market. The social justification is that, without regulation, industries and companies might tend to ignore certain social costs in their accounting, leading to undesired imbalances, be it economic, social or environmental.

The recent debate on CNG vs. diesel, resulting in the Supreme Court of India directing the use of only CNG fuels by all forms of public transport in Delhi, also highlights the need for regulation. Since the court did not have the requisite technical expertise, it had to seek the advice of a specially constituted expert group. Other experts are now questioning the recommendations made by this group and the debate goes on. In the interim, both the commuters and the transport operators have had to face a lot of inconvenience, without being sure

if they would really have a cleaner environment in the long run. Perhaps, the Supreme Court would have had the benefit of more informed advice if an independent regulator had been in place.

Governments are required to protect consumer interests by acting as a surrogate for the marketplace. At the same time, they have to provide a level playing field and conditions for fair returns to new investors. It also becomes necessary for them to develop a framework for public-private partnerships, enabling efficient delivery of essential services.

The above considerations provide a sound rationale for regulation. However, it needs to be recognised that regulation is no substitute for competition. It is a means of holding the fort until true competition arrives. Therefore, the segments that are currently subjected to tight-fisted regulation may require light-handed regulation with the progressive arrival of competition.

INDEPENDENT REGULATION

Independent regulation essentially means that the regulator is independent of any of the stakeholders and is in a position to discharge his responsibilities in the best interest of all, without any bias or special leaning towards any particular stakeholder. This is considered important, as the regulator is required to ensure a level playing field for different operators and also a fair deal to both the consumers and the service providers. A regulator should also be insulated from the pulls and pressures of the political process, so that he can discharge his responsibilities on the basis of sound social and economic principles. Without an independent regulator, the credibility of the institution suffers and, as a result, it cannot be effective.

A primary question with regard to independence is the regulator's relationship with the government. There has to be a clear delineation of responsibilities and an understanding of each other's positions. The government would have to retain the authority to give policy directions to a regulator. However, such directions should conform to the objectives of the relevant regulatory legislation. It is equally important that the reasoning behind the policy directives is clearly spelt out and made public. This would enhance transparency and help in winning public support for the policies sought to be followed.

A regulator, on the other hand, should enjoy some degree of freedom to effectively discharge his duties under the statute. The survival of the regulator should not be dependent upon the 'pleasure' of the government executive and his

autonomy should be guaranteed by law. This independence, however, cannot be absolute – it must be subject to the laws of the land and the policy of the government. A regulator must recognise that he cannot be a substitute for the government and can only perform a set of functions entrusted to him by the government in the belief that he would be better placed to perform it than the government itself.

Some parameters that have been considered essential worldwide to ensure the independence of a regulator are a transparent selection process, a prescribed tenure, authority to incur expenditure without the government's prior approval and well-established criteria for removal.

RELEVANCE OF PUBLIC TRANSPORT

Major metropolises in India have witnessed a rapid growth in the number of motor vehicles in the last decade and a half. Along with the rise in vehicle population, increased mobility demand is reflected in rising utilisation rates of personalised vehicles. The problem has been accentuated by the gradual reduction in the share of public transport in the cities. This has led to a greater dependence on personalised modes of transport, which are more energy intensive, occupy more road space, and have higher levels of emission per passenger kilometer travelled. As a result, the productive efficiency of our cities is threatened by a virtual gridlock and there is uncontrolled air pollution, adversely affecting the health of the people and their quality of life. An effective method of resolving this problem would be to encourage greater use of public transport instead of personal vehicles.

CURRENT STATUS OF PUBLIC TRANSPORT

Unfortunately, despite an urgent need, the public transportation systems in most cities are largely road-based. Only Mumbai and Kolkata have prominent rail transit systems, while Chennai is having a relatively less used rail system. A rail transit system is also presently under construction in Delhi. Bangalore has also been contemplating building up of such a system for several years.

Till the late 1980s public bus services were largely operated and managed by the State Transport Corporations (STCs), set up under the Road Transport Corporations Act, 1950. Since then, a limited entry of private operators has been permitted in many of the cities largely as a result of the inability of the STCs to finance new additions to capacity in the face of their mounting deficits. This trend has gained momentum but privatisation efforts are still not well structured.

Most cities have a mix of private operators and the STC services. The private operators are mostly single vehicle owners with no corporate house coming forward to get into the business of running public bus services. In fact, the recent initiatives taken by the Delhi Transport Corporation (DTC) to divide the city into several zones and induct only one private operator for running services in each zone, is reported to have drawn a discouraging response.

An inadequately regulated entry of private operators has resulted in:

- Unacceptable compromises on safety, as seen in the case of 'Red-line' buses in Delhi;
- Inadequate coverage on low density routes and during off-peak periods;
- Inadequate attention to environmental factors;
- Poor integration between services, such as passes on one system not being applicable on another; and
- Overall deterioration in service quality.

A need has, therefore, been felt for a structured and well regulated entry of private operators into public bus transport

CURRENT REGULATORY FRAMEWORK FOR PUBLIC TRANSPORT

The two main enactments that regulate the functioning of public bus transport services are the Motor Vehicles Act, 1988 (MV Act) and the Road Transport Corporations Act, 1950. The Indian Railways Act, 1989 regulates rail transport.

Under the Motor Vehicle Act, 1988, the State Transport Authority (STA) and the Regional Transport Authority (RTA) are the main regulatory bodies for public bus services. They have the following four regulatory functions:

- Granting route/area permits for stage and contract carriages;
- Fixing fares in accordance with the directions given by the government;
- Registration of vehicles, after verification of the safety aspects; and
- Licensing of drivers and conductors.

The STCs do not have the authority to carry out any route allocation under the present law. They can only operate buses on the strength of permits granted to them, though the MV Act makes a concession to the extent that preference is to be given to the STCs when they apply for a permit.

The provisions of the Indian Railways Act, 1989, govern rail transport. This Act requires that no railway be opened for public carriage of goods and passengers until the Central Government has sanctioned the opening of the railway. Before sanctioning the opening of the railway, the Central Government is required to obtain a report from the Commissioner of Railway Safety in respect of the safety aspects of the railway system concerned.. Besides, Section 30 requires the Central Government to fix the rates for carriage of passengers and goods. Thus, the Central Government has the responsibility to ensure safety of rail transport systems and also to fix the fares on rail systems.

Clearly, the existing enactments did not visualise a large-scale involvement of private operators and only envisaged private operations as a minor supplement to largely government-run services. It has, therefore, become necessary to review the current regulatory framework and introduce a fresh regulatory regime that would facilitate a greater involvement of the private sector for a more efficient public transport system. Without this, it would be extremely difficult to control, let alone reverse, the rising trend of congestion and pollution in our cities.

RESTRUCTURING URBAN PUBLIC TRANSPORT

Before we consider new regulatory arrangements, it is necessary to look at the changes that may be required in the prevailing systems of public transport provisioning. Given the current problems being faced with regard to public transport, it has become imperative to look at the possibility of restructuring at least the urban public transport. The primary feature of this restructuring has to be an unbundling of the range of services into those that can be provided in a competitive market and those that are natural monopolies. Activities that can be performed in a competitive market would be good clients for privatisation whereas those that are natural monopolies would have either to be retained in the state sector or opened out to regulated private provisioning.

It is possible to classify the urban public bus transport activities into the following broad categories:

- Operation of bus services;
- Management of workshops and repair facilities; and
- Management of bus depots and terminals.

The operation of buses, as also the workshops, is not a natural monopoly. It is possible to secure the involvement of the private sector in operating these services. As against this, the management of depots, terminals and bus stations

is a natural monopoly because it would be inefficient to have these infrastructure facilities provided by a multiplicity of operators. It would be most economical if these were provided as common facilities, available to all operators.

The existing public transport institutions are grossly inadequate to provide the levels of services required to effectively deal with the rapidly increasing congestion and pollution. This situation is not peculiar to India alone. It has been faced in most major cities around the world. Several of them have undertaken drastic reforms and restructuring of the system of public transport provisioning (both bus and rail) with a view to meeting the increasing demand and the expected quality of service. The approach to restructuring has broadly been the same as outlined above. Thus, the reforms carried out in Argentina, UK and Australia first sought to unbundle the monolithic and integrated services into more manageable and compact constituent units. This was followed up by greater involvement of the private sector in providing services in a competitive environment.

The unbundling, in some cases, was done on geographic basis and, in others, on functional basis. Thus, in certain cases, separate units were formed for operating services in different geographic areas while, in others, the unbundling created separate units for providing different kinds of services. Unbundling on a geographic basis was done in cases where a clear delineation of the areas of operation was possible, as in the case of Argentina's rail systems. As against this, unbundling on a functional basis was done where the different functions of the monolithic organisation comprised a combination of activities that were natural monopolies and those that were not natural monopolies. This approach was adopted in London.

The advantages that emerge from such a restructuring are as follows:

i. It enables separation of activities that are natural monopolies from those that are not natural monopolies. Such separation makes it possible to bring about competition in activities that are not natural monopolies. Competition, in turn, enables:
   - improvements in efficiency;
   - enhancement of capacity by tapping private financial resources;
   - induction of more professional management;
   - induction of 'state-of-the-art' technology; and
   - greater attention to consumer convenience rather than to operational convenience.

ii. It becomes possible to channel scarce public funds into those activities that the public sector is best suited to perform and not use them up in activities that the private sector is better equipped to perform.

iii. It enables retention of only natural monopoly activities (in which competition is not possible) in public hands so as to be appropriately regulated.

Thus, it creates the right environment for developing a public transport system which is more attractive from consumers' standpoint and which would go a long way in persuading users of private vehicles to shift to public transport.

REQUIRED REGULATORY FRAMEWORK

This brings us to the question of what the regulatory framework and scope of regulation should be. Should regulation only aim at setting prices or go beyond that and regulate the entire gamut of public transport services.

The scope of regulation differs widely across sectors. Whereas the Telecom Regulatory Authority of India (TRAI) has been specifically mandated to regulate the telecom sector as a whole and recommend the timing of entry of players (licensing conditions, modification of licence, spectrum management, etc.), the Central Electricity Regulatory Commission (CERC) only regulates tariffs for central power generating agencies and for interstate transmission of power. TRAI has been specifically mandated to monitor quality of service with a view to protecting the interests of the consumers, whereas in the case of CERC these issues have been entrusted to a Central Advisory Committee (CAC). In contrast, the scope of the state-specific legislation (e.g. in the electricity sector of Orissa or Haryana) is more focused and exhaustive – the OERC (Orissa Electricity Reforms Commission) can issue a licence, regulate the working of the licensee, promote competition, set tariff, monitor quality, and protect consumer interests.

The global consensus seems to be that a regulator must have functions relating to tariff control, checking quality of service, monitoring compliance and also the authority to settle disputes. The executive or the policy-maker may retain jurisdiction over other areas, such as the process of privatisation, sector restructuring, subsidies and taxation. There is no unanimity as to who should deal with licensing issues or matters related to concessions. Broadly speaking, a typical regulatory authority should have the following three distinct functions:

i. Its core function should include tariff regulation; checking quality of service and monitoring compliance; monitoring the utility's financial

viability; adjudication of disputes between operators, between licenser and operators, and between the consumers and operators; consumer protection; and enforcement of licensing conditions.

ii. It should be allowed to issue licences. Wherever this is not allowed, it should be permitted to make recommendations to the policy-makers in such areas as determining the terms and conditions of licence, and modifications, if any, in those terms and conditions.

iii. Its advisory role should include providing information to the government and advising the relevant ministry on important issues or whenever its advice is sought.

In determining the scope of regulation for urban public transport, it is first necessary to look at some of the essential features of a good urban public transport system and then ensure that the regulatory mechanism enables these features to be put in place. Some of the essential features are:

- A fare structure that is not too harsh on the passengers and yet allows a reasonable return for the service providers.
- Good coverage of public transport, both on profitable and unprofitable routes.
- Good intermodal integration and seamless transfer within the network, so that passengers view it as a single system rather than a crude combination of multiple operations.
- Good accessibility, so that passengers do not have to travel long distances to avail of public transport.
- Adequate availability during peak and off-peak hours.
- Comfort and convenience during travel.
- Use of technologies that do not lead to negative externalities, such as severe air pollution, etc.
- Safety of operations.

Given the above, it appears that the scope of regulation would have to cover the following aspects:

Fixation of Fares and Fees

Currently, the government fixes the fares for bus services. These are usually done as a compromise between competing pressures from operators for an enhancement in the fares and pressures from the passengers' associations for not

effecting any increase. Usually, the motivation for seeking enhancement in the fares is an increase in the input costs. Invariably, there is a time-lag between increase in the input costs and increase in the fares. Besides, there is neither an agreed formula for the automatic enhancement of fares with increases in the prices of critical inputs like diesel, nor a periodic reassessment of the need for any increase in fares. As a result, bus fare hikes tend to be infrequent but steep, the entire system being unscientific.

Such a state of affairs is not conducive to the healthy operation of public transport services by private operators. It is necessary to have a system under which the fixation of fares is done on economic considerations rather than be guided by political considerations. This would be possible only if an agency, independent of the political decision-making process, could undertake this task. It would make the decisions more credible and conducive to the healthy operation of private bus services.

Network Coverage

It is necessary for a public agency to ensure that there is adequate coverage of public transport. If left entirely to a commercial organisation, which has profit as its primary motive, only those routes that are commercially viable would be served and those that are not commercially viable would be neglected. Similarly, profit motive would only permit services during peak periods and would discourage services during off-peak hours. As against this, the universal service obligation of government requires that services be available during off-peak periods as also on the relatively less profitable routes.

An independent regulatory agency should discharge the universal service obligation of the government in a fair and equitable manner.

Route Allocation and Issue of Permits

The current system of allocating routes amongst operators is not scientific. The usual practice is for an operator to apply for a permit on a particular route. If the STA finds the application to be in order and is of the view that an additional service is needed on that particular route then the permit is given. The procedure is not transparent and there is scope for undue pressure to grant permits that are otherwise not justifiable on merit. There is no mechanism either for an ‘a priori’ assessment of the demand on various routes or for a scientific projection of the quantum of service required on each route. It is necessary that such an assessment be made at periodic intervals, in a scientific manner, and route permits

given only after such an assessment has been made. It is also necessary that the route permits be issued in a transparent manner. Unless this is done, it will be difficult to have a well-coordinated system. This exercise has to be carried out by an agency that has the necessary skills, or can procure them. It would also be greatly helpful if these decisions are taken independently of political considerations.

Once the demand and supply requirements on individual routes have been assessed, it is necessary to have a well-designed and transparent system of allocating routes amongst operators. Such an allocation needs to be done in a fair and equitable manner, not only to ensure adequate coverage on each route but also to ensure a reasonable return to each operator. Some agency needs to decide who would be best placed to operate buses on a particular route and what would be the best terms on which such services should be obtained. Several cities around the world, including London, have adopted the practice of competitive bidding for route allocation. This needs to be done in the major cities in India as well.

All of this can be best accomplished by a regulatory body that is independent of the political decision-making process so that it is guided by economic considerations and principles of sound transport planning rather than by political or other extraneous considerations.

Setting Quality of Service Standards and Their Enforcement

Quality of service in public bus transport essentially comprises parameters like:

- Safety record
- Punctuality record
- Number of scheduled trips missed
- Cleanliness and upkeep of vehicles
- Behaviour of operating staff

Being guided by the profit motive, a purely commercial operating company would tend to reduce costs by compromising on quality and safety.

At present, quality of service standards are set and enforced by the STA through the mechanism of including these as a part of the permit conditions. However, these are not done in a well-planned and scientific manner and are largely a repetition of standard conditions that were decided upon at some point of time in the past. There is hardly any review of these conditions to determine

if any changes are called for. Setting the quality of service standards is a specialised task, requiring a proper understanding of passenger behaviour and operational constraints. It would, therefore, be an advantage to have a specialised agency to lay down and enforce the quality of service specifications on a scientific basis.

Safety and Environmental Considerations

The short-term profit motive of a private operator is likely to result in poor maintenance of vehicles and the use of cheaper technologies. These would compromise on environmental and safety norms. A regulator needs to set standards that would ensure safety and keep emissions within acceptable levels. The regulator should also be in a position to recommend the right type of technologies for facilitating larger policy decisions to be taken by the government in these areas.

Coordination Functions

With several operators providing services throughout a city, it would be necessary to ensure proper coordination among them on several matters. For example, city bus services may require to have a system of passes or a common ticket that would entitle passengers to use the services of different operators. In such a case, it would be necessary for some agency to coordinate the proper sharing of revenues from such common tickets or passes. This would become even more complex if a common ticket or pass is available for use on different modes of travel within a city. Apart from this, an efficient public transport system requires that there should be a comprehensive passenger information system, which incorporates data on the services provided by various operators. It would be very clumsy if each operator maintained his own passenger information system without a proper linkage to similar information system of other operators.

Further, as a matter of policy, the government may offer a concessional travel facility to certain segments of passengers. Among them could be students, the physically handicapped, senior citizens, etc. The cost of such concessional travel should rightfully be borne by the government and should not be added to the cost of operation. A separate agency would need to channelise subsidies to the different operators in proportion to the extent of concessional service provided by them.

The above are some examples of coordination that may be required. Many others are likely to come up as efforts are made to have a more passenger friendly public transport system in the city. It is thus necessary to have a separate agency to discharge this coordination responsibility.

Dispute Resolution

With several operators providing services, there is the possibility of many disputes arising amongst them. The regulator would be well placed to function as a dispute resolution agency for faster remedies. This would obviate the need to go in for lengthy litigation and would be in the overall interest of a reliable and efficient public transport system.

Data Collection and Management

Scientific planning requires availability of reliable data, which is collected on a regular basis and maintained in a systematic manner. At present, adequate data for scientific planning of public transport is not available in respect of our cities. Quite often, some of the data collected as part of specially commissioned studies is used for planning purposes. However, such data does not lend itself to any kind of trend analysis and is inadequate for purposes of planning. A specialised agency is, therefore, necessary for proper data collection and management.

Make Recommendations to Government

In making its policy decisions, the government would benefit from the recommendations made by a professional agency. This agency needs to have the required skills and expertise, or the means to procure them at market-related fees, to render sound advice to the government.

CONCLUSION

In conclusion, it may be stated that a quantum improvement in capacity and quality of public transport is the key to mitigating the problems of urban congestion and air pollution. This cannot be achieved through the provision of public transport services by government agencies alone. A structured and well-regulated entry of private operators is essential. The existing regulatory framework is inadequate for fulfilling this purpose and independent regulation of public transport through a separate enactment is called for.

While independence would have to be ensured through a transparent selection process, a specified tenure and prescribed criteria for removal, the public transport regulator must also have a wide scope of functions so that a meaningful public transport service could be put in place. This should cover fixation of fares and fees, network designing, route allocation, specification of quality of service standards, coordination, dispute resolution amongst operators, data management and making recommendations to the government.

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REGULATION OF BROADCAST MEDIA

Sunetra Sen Narayan*

Till recently, broadcast media in India were regulated on the basis of an archaic legislation. Regulation of the electronic medium bears witness to our colonial past, with the state exerting control over wireless communications. Initially radio and later television were assumed to be wireless communications and, hence, fell under the purview of the state. Matters were fairly stagnant till the last decade. The emergence of competition, both from foreign and domestic players has, however, changed the rules of the game beyond recognition. The national broadcaster has been granted formal autonomy, but is still struggling to carve out a niche for itself. The urgent need for regulation of the broadcast and cable industries has been recognised. The Broadcast Bill of 1997 and the Draft Communications Bill of 2000 represent the attempts to grapple with fairly complex issues. Technological convergence and expansion of telecommunications in India have added another layer of complexity to the regulation of broadcasting. This paper attempts to outline the important milestones in the regulation of broadcasting in India, and the current policy issues that regulators are attempting to address.

INTRODUCTION

From colonial times right up to the recent past, the state has had active control over the broadcast medium in the Indian subcontinent. The four major South Asian countries, namely, India, Pakistan, Bangladesh and Sri Lanka have many similarities in the functioning of the broadcasting sector, particularly the role of the national broadcaster. Satellite television has had a major impact on all these nations, and the initial response of the state to this perceived threat has often not been a coherent one. India's case is particularly complex because of its greater size, cultural and linguistic diversity and strong secular and democratic traditions.

Throughout the last decade, the government's response to the new developments in broadcasting has often been a knee-jerk, defensive one as it seeks to safeguard its domain in the face of a perceived threat . As Usha Reddi

* *Doctoral candidate at the College of Communications, The Pennsylvania State University, USA.*

(1996), an academic, expresses herself with respect to the former state-controlled broadcaster, “every milestone in Doordarshan’s (DD’s) growth has been dogged by ad hocism”(p.232). While the Indian government has been fairly pro-active in encouraging the information technology sector, especially the production of software, the same cannot be said of the broadcasting sector. In spite of the plethora of committees set up to examine various aspects of broadcasting and cable spanning the last four decades, an independent regulator is yet to be established to oversee the sector.

It is significant to note that though the monopolist national broadcaster was suddenly facing stiff competition on its home turf, the legal provision of banning the reception of satellite television was never resorted to by the Indian government. This is in direct contrast to the Chinese government. In studying the political economy of communications in India in the last decade, it would appear that this openness in television was permitted as part of the new *glasnost* strategy of the Indian state. Sinha (1998) believes that adopting a *laissez-faire* policy towards transnational broadcasters actually sent out the right signal as far as the Indian government, which was bent upon promoting liberalisation, was concerned.

HISTORICAL BASIS FOR REGULATION

Till the mid-nineties, regulation of the broadcast media in India revolved around two major pieces of legislation. These were the Indian Telegraph Act of 1885 which assigns powers over wireless broadcasting to the Central Government and article 19 of the Indian Constitution which guarantees freedom of speech subject to certain restrictions (Ninan, 1998). As in other countries, regulation of the airwaves represents an attempt to balance the rights of the individual with the rights of the broadcaster, in this case the state broadcaster.

It is interesting to note that till the mid-nineties, laws that were not specific to the industry governed broadcasting. Broadcasting was technically subsumed under the Wireless Act even though it was archaic and ill-suited to the governance of non-telephony subjects. However, it clearly reflected the state’s attempt to control the electronic medium. After Independence, the Indian government which took over from the colonial masters used the nascent broadcasting medium as a means of furthering its own agenda.

Certain developments took place in the nineties, which forced a re-examination of the regulation of television, radio and telephony. Changes in technology fuelled a kind of back-door liberalisation and globalisation of television through the vehicle of satellite television. Doordarshan no longer had

a *de facto* monopoly over television; in fact, India witnessed explosive growth in television in this decade. The *de jure* finally began to catch up with the *de facto*. The Cable Act of 1995 represented an attempt by the Central Government to control the anarchy in the satellite broadcasting and cable industry. Judicial activism on the part of the Supreme Court of India in the mid-1990s helped to bring the rights of the public (as opposed to the government) to the forefront. The Broadcast Bill of 1997, the Prasar Bharati Act of 1997 and the draft Information, Communications and Entertainment Bill introduced in the Parliament in 2000 reflect the vast changes that have occurred in the broadcasting and telecommunication sectors in the last decade.

To understand current attempts at regulation by the Central Government, it is necessary to delve into the Indian Telegraph Act of 1885, which is really the cornerstone of the government's monopoly of the industry. This Act explicitly stated that "within India the Central Government shall have the exclusive privilege of establishing, maintaining and working telegraphs" (Indian Telegraph Act 1885, pt. II, cited in Ninan, 1998). This Act was amended on five occasions. In 1957, a significant amendment to this Act stretched the term telegraph to include telegraph lines, appliances or apparatus used for telegraphic communications. Thus, broadcasting was caught in the telegraph net and made subservient to the Central Government.

Unlike the First Amendment in the US, the Indian Constitution does not make explicit a provision for freedom of the press. Article 19 (a) guarantees the citizens a fundamental right to freedom of speech and expression. While the UK does not have an explicit 'First Amendment' type of clause in its Constitution, restraining the government from abridging the freedom of the press, it has a long history of independence of its media. In fact, the social and cultural factors discouraging political interference in the press go back at least to Milton's *Areopagitica* in 1644 which was a strident defence of the free press.

Media is of course included, but the Constitution also declares that India is sovereign, secular, socialist and democratic. It is interesting to note that the provisions of Article 19 sub-clause (a) do not imply that the rights of the individual override the interests of the state with regard to issues of sovereignty, integrity, security, decency and other vital issues. Whereas a whole body of laws has evolved around the First Amendment and freedom of speech and the press in the US, these issues are still relatively new where broadcasting in India is concerned; any debate about the rights of the individual versus the rights of the broadcaster is still in its infancy. Issues pertaining to the freedom of the press for the printed medium in India are another matter.

Broadcast media also fall within the purview of Article 246 of the Indian Constitution whereby Parliament has exclusive powers to make laws with respect to 'post and telegraphs, telephones, wireless broadcasts and other like forms of communications' (Constitution of India, 2000, p.216). Broadcasting is thus lumped together with telephony, both figuring on the Union List of Article 246 of the Constitution. The implication is that broadcasting is subject to regulation by the Central Government. In addition, broadcasting in India has been regulated by the archaic Indian Telegraph Act of 1885 under which the Government of India has the exclusive right to establish, maintain and run 'wireless apparatus' (Reddi, 1996). The monopoly of broadcasting by the Central Government is explained by this Act which came into existence as an imperial tool of command and control.

The broadcasting sector is also reined in by the Ministry of Information and Broadcasting (I&B), which is the main policy-making entity. It is headed by the Minister who is a political appointee and a Secretary to the Government of India who is a civil servant from the Indian Administrative Service. The post of Director General may also be held by civil servants, rather than specialised media professionals (Reddi, 1996).

The roles of radio and television in India, were a topic of political debate, right from the time India gained Independence in 1947. Attempts at regulating the broadcasting sector reflect these political deliberations. Different governments established expert committees to review the structure and functioning of television. These included the Chanda Committee 1966, the Verghese Committee 1978, the Joshi Committee 1985, the Varadan Committee 1991 and the Sen Committee 1999-2000. While appointment of committees was set in motion by different governments, implementation of their recommendations is another story altogether. Despite the repeated recommendations of various committees suggesting autonomy and increased efficiency for DD, the organisation suffered from the evils of ad hocism and politicisation right through the nineties (Ninan, 1992; Reddi 1996, Karnik 2000).

The Chanda Committee Report (1964)

Indian television was first reviewed in 1964 by the Committee on Broadcasting and Information Media, popularly called the Chanda Committee. The Committee recommended that Doordarshan be separated from Akashvani. It also recommended that autonomous corporations be set up to run both these organisations. The first recommendation was accepted and was implemented fairly soon. The second recommendation, however, ran into rough weather. In

fact, in April 1970, the government stated in Parliament that "the time was not opportune for considering autonomy for the broadcast media" (cited in the Joshi Committee Report, 1985, p.31). This was one in a series of skirmishes on the autonomy issue. Despite the recommendation of the Chanda Committee, the political opposition to autonomy for the state broadcaster was so strong that it could not be set in motion.

The Verghese Committee Report (1978)

The second review of broadcasting in India was undertaken in 1977-78 by the Working Group on Autonomy for Akashvani and Doordarshan, popularly known as the Verghese Committee. The appointment of the Verghese Committee directly grew out of the imposition of the Emergency by Indira Gandhi in 1975. During the period 1975-77, the Congress government overtly misused the broadcast media for its own purposes. As soon as it assumed office, the Janata government set up the Verghese Committee to examine the possibility of freeing AIR and DD from the government's stranglehold (Gill, 1991). The report of this Committee proposed some radical changes, including the establishment of an independent National Broadcasting Trust. Again, while important issues such as use of the broadcast media for propaganda and suppression of the freedom of the press were raised, no action was taken because of a lack of political will.

The Joshi Committee Report (1985)

The Joshi Committee examined the role of Doordarshan and of television programming in a development context at length. The Committee expressed the opinion that DD's expansion had emphasised hardware, while software or programming had been given short shrift. It stressed the need for developing indigenous programming, which was more local and participatory. Its report was replete with references to 'cultural sovereignty' and 'cultural domination,' which arise in the context of television in developing countries. It brought into focus the threat faced by the developing nations from the influx of foreign programming, even before satellite television had appeared on India's horizon. The recommendations of the Joshi Committee like the committees before it were swept under the carpet. Centralisation and a lack of 'localism' at Doordarshan continued to be the order of the day.

The Prasar Bharati Act (1990)

In a significant development, the non-Congress minority government which won the general election in 1989 decided to act upon its campaign promise of

autonomy for the official media (Ninan, 1998). The Verghese Committee report resurfaced, but in a new avatar; the Prasar Bharati Bill was born. The Prasar Bharati (Broadcasting Corporation of India) Act, 1990 was passed, "to provide for the establishment of a Broadcasting Corporation for India, to be known as Prasar Bharati, to define its composition, functions and powers and to provide for matters connected therewith or incidental thereto" (Prasar Bharati Act, DAVP, Ministry of Information and Broadcasting, Government of India, July 1999, p.1). The chronology of events pertaining to the Prasar Bharati Act are such that even though the draft bill was introduced in Parliament in 1989, and was passed in 1990, it actually became an Act when it was officially notified, bringing the statute into force only in 1997.

This Act decreed that the management of the affairs of the Corporation should be vested in the Prasar Bharati Board. The composition of the Board was specified as follows:

- a Chairman;
- one Executive Member;
- one Member (Finance);
- one Member (Personnel);
- six Part-time Members;
- Director General (Akashvani), *ex-officio;*
- Director General (Doordarshan), *ex-officio;*
- one representative of the Union Ministry of Information and Broadcasting, to be nominated by that Ministry; and
- two representatives of the employees of the Corporation, of whom one shall be elected by the engineering staff from amongst themselves and one shall be elected by the other employees from amongst themselves (Ibid. at 4).

The Act also laid down the conditions for the appointment of the Chairman and other Members. The appointment of key Board members was mandated as follows:

- The Chairman and the other Members, except the *ex-officio* Members, the Nominated Member and the elected Members shall be appointed by the President of India on the recommendation of a committee consisting of:
  - the Chairman of the Council of States, who shall be the Chairman of the Committee;

– the Chairman of the Press Council of India established under section 4 of the Press Council Act, 1978; and
– one nominee of the President of India (Ibid. at 5) .

The Executive Member was also designated to be the Chief Executive of the Corporation exercising powers and discharging functions subject to the control of the Board.

In the subsection pertaining to functions and powers of the Corporation under the Prasar Bharati Act, it was stated that the primary duty of the Corporation was to "organise and conduct public broadcasting services to inform, educate and entertain the public and to ensure a balanced development of radio and television" (Ibid. at 12). It was further clarified that the provisions of this section were in addition to the existing Indian Telegraph Act of 1885.

It is interesting to note that though in this document the Corporation professed to safeguard the citizen's "right to be informed freely, truthfully and objectively on all matters of public interest, national or international, and to present a fair and balanced flow of information including contrasting views without advocating any opinion or ideology of its own," it also mentioned the power of the Central Government to give directions (Ibid. at 12). In fact, even though the whole of the Prasar Bharati Act revolves around the notion of autonomy, the heavy hand of the Central Government is evident from the following extract:

> 23. (1) The Central Government may, from time to time as and when occasion arises, issue to the Corporation such directions as it may think necessary in the interests of the sovereignty, unity and integrity of India or the security of the state or preservation of public order requiring it not to make a broadcast on a matter specified in the direction or to make a broadcast on any matter of public importance specified in the direction (Ibid. at 20).

However, seen in the historical perspective, these provisions appear milder than the original wording of the Akash Bharati Bill of 1978 that was moved in Parliament by the then Minister of Information and Broadcasting, L. K. Advani. The relevant clause stated that "the Central Government may from time to time, issue to the Corporation such directions as it may think necessary for the efficient administration of this Act, and a copy thereof shall be laid before each House of Parliament" (Akash Bharati Bill, 1979, Clause 23, Ministry of Information and Broadcasting). The 1990 version of the bill, though still

crippling, at least limited the powers of the government and specified the reasons for governmental interference.

In a regressive step, the degree of autonomy finally conferred on DD and AIR in 1990 was reduced as compared to the more liberal provisions of the Verghese Committee report of 1978. The Prasar Bharati Bill was finally passed by Parliament in 1990, but it was not officially notified because of the change in the government. In fact, the Congress government in spite of its election promise of granting freedom to the electronic media, mothballed the Prasar Bharati Bill. It was finally notified by a non-Congress coalition government in 1997.

The Cable Television Networks (Regulation) Act, (1995)

The Cable Television Networks (Regulation) Act, 1995, as the name suggests, was passed to regulate the cable television industry. According to this Act, all cable operators were required to be registered with the 'registering authority' specified by the Central Government. The registering authority was specified as the Head Post Master of a Head Post Office within whose territorial jurisdiction the office of the cable operator was situated.

Apart from the requirement of being registered by an authority specified by the Central Government, all cable operators were also required to adhere to a programme code, advertisement code and to maintain a register of programmes transmitted. The programme code and advertising code were those which were already existing for DD and AIR. Exemptions from the programme and advertising codes were " programmes of foreign satellite channels which can be received without the use of any specialised gadgets or decoder" (Ibid, Clauses 5 and 6).

A must-carry provision for DD channels was also stipulated as, "every cable operator using a dish antenna or TVRO shall, from the commencement of this Act, re-transmit at least two Doordarshan channels of his choice through the cable service" (Ibid, clause 8). The specifications of the Programme Code are fairly stringent. The advertising code has similar stipulations about safeguarding the rights of women, children and not violating any Constitutional provisions. In addition, the advertising code mentions that advertisements must not be directed towards any religious or political end.

The registration requirements, must-carry provisions and adherence to a strict programme and advertising code were all attempts by the government to regulate a hitherto anarchic and rapidly proliferating industry.

The Hero Cup Case (1995)

In 1995, the government's exclusive right to the airwaves was challenged by the Supreme Court decision in the Secretary, Ministry of Information and Broadcasting vs. Cricket Association of Bengal (1995) case, popularly referred to as the 'Hero Cup Case'. The judicial activism displayed in the Hero Cup judgment helped to reduce the State's *de jure* stranglehold over domestic television. In 1993, the Board for Cricket Control of India (BCCI) and Transworld International (TWI), a foreign sports television entity, had a contract whereby TWI was given the right to telecast the international Hero Cup Cricket tournament. TWI had submitted the highest bid in a global tender, including DD amongst the rival bidders. The Ministry of I&B and DD attempted to stop TWI from telecasting the match from Calcutta and tried to prevent it from up-linking live to its satellite. DD accused TWI of transgressing India's foreign exchange rules and the BCCI of disloyalty to the nation by preferring TWI to DD (Sinha, 1998). The Supreme Court ruled that "airwaves constitute public property and must be utilised for advancing public good".

Justice Sawant in the above judgement emphasised that airwaves were a *public* property. Accordingly, he stressed the need for an autonomous public authority to regulate the use of airwaves. In a concurring judgement, Justice Reddy noted that, "airwaves being public property, it is the duty of the state to see that airwaves are so utilised as to advance the free speech right of the citizens which is served by ensuring plurality and diversity of views, opinions and ideas". However, he clarified that the free speech right guaranteed to every citizen of India did not encompass the right to use the airwaves in an unrestricted manner, as this would be detrimental to the body of citizens, since only a few powerful economic, commercial and political interests would be dominant.

The vital issue of the right to operate a private TV station was touched upon in this landmark judgement. Justice Reddy opined that this right, "does not flow from Article 19 (1) (a); that such a right is not implicit in it ". He went on to say that this was a matter of policy for Parliament. If Parliament conferred such a right, it could only be done by an Act passed by the Parliament. Commenting on the nature of such an Act, Justice Reddy said that it should be consistent with the right of free speech of the citizens and should have strict programme and other controls. It is interesting to note that the judge referred to the Broadcasting Act of 1991 in the United Kingdom, as an example.

Echoing Justice Sawant's sentiments, Justice Reddy emphasised that, "monopoly of this medium (broadcasting media), whether by government or by

an individual, body or organisation is unacceptable…..the broadcasting media should be under the control of the public as distinct from government". Thus, this Supreme Court judgement opened up the Pandora's box of domestic competition to DD. It also succeeded in placing on the agenda prominently the issue of competition rather than mere autonomy for Prasar Bharati. It also pointed out that the archaic Indian Telegraph Act of 1885 was inadequate to govern the broadcasting media as it had not kept pace with changes in communications technology. Comparing India to other democracies, Justice Reddy observed that "while all the leading democratic countries have enacted laws specifically governing the broadcasting media, the law in this has stood still, rooted in the Telegraph Act of 1885…..It is, therefore, imperative that the Parliament makes a law placing the broadcasting media in the hands of a public/statutory corporate or the corporations, as the case may be" [(1995) 2 S.C.C. pp. 298-301]. The ball was thus put in Parliament's court.

The views of these two judges seem to be veering towards a public trustee model for broadcasting, which lies at the heart of many broadcasting issues in the US. The notion that the airwaves are public property as opposed to governmental property was popularised by this Supreme Court judgement. It had important repercussions. At the same time, the judgement did not take cognisance of the cable television industry, which is not constrained by limited spectrum as it is a closed circuit medium.

The Broadcasting Bill (1997)

After the Hero Cup Case decision of 1995 and some other cases involving programmes on private television channels in 1995 and 1996, the issue of reform in the broadcasting sector gained prominence in the public agenda. During this period, satellite and cable television was expanding rapidly in India. STAR TV's plans regarding introduction of direct-to-home (DTH) services in late 1996 acted as a spur to the government. The Prasar Bharati Act of 1990 did not deal with a plethora of new issues. Even though it was officially notified in 1997, it was already recognised to be defunct. Therefore, urgent need was felt for a new broadcast legislation.

In a note prepared on the Broadcasting Bill by the Ministry of I&B (Broadcasting Bill: Issues and Perspectives, 1996), it was reiterated that the airwaves were public property and should be used for the larger public good. The fear of monopoly was expressed with respect to the airwaves as, "these cannot be a source of merely a commercial venture in the hands of a few affluent people and, therefore, cannot be left to market forces" (Ibid. at 223).

It was further stated that the basic framework of the broadcasting law should be based on existing models from democratic countries. Broadcasting systems obtaining in USA, UK, France, Germany, Italy and Australia were subjected to close scrutiny. Finally, it was decided that the broadcasting law should be modelled on the UK pattern as it “has much more elaborate rules and regulations on broadcasting, which have been tried and tested for at least 6 to 7 years” (Ibid. at 225). Another point stressed in this ministerial note was that India did not want to follow the restrictive route of countries like Singapore, China and Malaysia. The reasons given were pragmatic as well as ideological.

It is significant that these views about the inadequacies of AIR and DD were acknowledged only after the foreign satellite channels had presented the policy-makers with a *fait accompli*. As discussed earlier, private terrestrial competition to the national broadcaster was never seriously contemplated till the mid-1990s. The note quoted at length from the Hero Cup Supreme Court judgement and reiterated that the airwaves were public property. Interestingly, this document also refers to the classic judicial decision in the Red Lion Broadcasting Co. vs. FCC case in the US when it expresses the opinion that broadcaster’s rights may be regulated, notwithstanding the fact that airwaves are public property. Thus, the note states that “the broadcasting media needs to be regulated and such a regulation is not in conflict with the freedom of speech and expression as enshrined in Article 19 (1) (a) of the Constitution of India…”.

The Broadcasting Bill, 1997 was introduced in Parliament “to provide for the establishment of an independent authority to be known as the Broadcasting Authority of India, for the purposes of facilitating and regulating broadcast services in India and to provide for matters connected therewith or incidental thereto” (The Broadcasting Bill, Bill No.71 of 1997, p.1). This bill was finally drafted in the wake of the realisation that an independent regulator was the need of the hour. In a parallel development, the Telecommunications Regulatory Authority of India (TRAI) had also been set up as an independent regulatory body to oversee the functioning of the telecommunications sector.

Amongst the functions of the proposed Broadcasting Authority of India, the following are salient: frequency planning for the purposes of broadcasting services; granting licences for broadcasting services (including terrestrial radio and TV, satellite radio and TV, DTH, local delivery and other services); ensuring fair competition in the provision of broadcasting services; ensuring that a wide range of broadcasting services are available throughout India; and determining by regulations the programme code and standard and receiving complaints for violation of the code. In other words, the Authority was to be given a wide

range of powers. However, these powers could be limited by the Central Government.

While the TRAI is functioning effectively, the establishment of an independent broadcast regulator is still in the doldrums. Thus, the unhealthy scenario of the Ministry of Information and Broadcasting acting as a policing agent for the broadcast industry, while it still has influence over the 'autonomous' Prasar Bharati, continues into the year 2001.

The Communications Bill (Draft, 2000)

The Broadcasting Bill of 1997 appears to have become defunct even before it could be notified in order to become an Act. Various drafts of a new bill have been under consideration during the past year. According to some press reports, this was initially labelled the Information, Communications and Entertainment Bill (ICE) draft 2000, but as the year 2000 entered its last quarter, the bill was increasingly being referred to as the Communications Bill (Draft, 2000). A committee headed by noted jurist F S Nariman has prepared the Communications Bill. The bill when enacted as law will supersede the existing Indian Telegraph Act, the Information Technology Act, the Broadcasting Law, as well as the Cable Network Television Act (Mukul, 2000).

While there has been speculation of a supra-national regulatory body to replace the current Telecommunications Regulatory Authority of India and the proposed Broadcasting Authority of India, there has even been talk in the press of combining the information and broadcasting ministry, the communications ministry and the ministry of information technology. The Communications Minister, Ram Vilas Paswan, has indicated that the government may accept the controversial proposal to merge these three ministries (TOI, Oct. 21, 2000, p.1). According to Fali Nariman, the architect of the draft bill, the recent legislation was attempting to be pro-active in a period of rapid technological change. In an editorial published in *The Economic Times*, he opines that "the impact of convergence upon regulation will probably far exceed the impact of regulation upon convergence" (Nariman, 2000, 3 Nov., p.12).

The proposed Communications Commission will have the authority to issue licences for telecasting, broadcasting, Internet, FM and related fields (Mukul, 2000). It would also be vested with the authority to manage spectrum, resolve disputes and determine the conditions for fair, equitable and non-discriminatory access to network facility and service. Nariman has proposed that the chairperson and the seven members of the Commission be appointed by the President of

India on the recommendation of a committee consisting of the Prime Minister, Leaders of Opposition of both the Houses, House leader of the Rajya Sabha and the Ministers of I&B, Telecommunications and IT (Nagaraj, 2000). Furthermore, he has suggested that two members should have international experience in the functioning of similar Commissions as "the Commission cannot function like the Monopolies Commission or any other statutory commission – it is *sui generis* – it requires breadth and vision" (quoted in Nagaraj, 2000).

It is an interesting historical fact that while the Broadcasting Bill (1997) drew on the UK experience as a source of inspiration, the Communications Bill (Draft, 2000) talks about the establishment of a Communications Commission along the lines of the Federal Communications Commission of the US. The rhetoric of convergence also seems to be the magic mantra of the policy-makers from Sushma Swaraj (quoted in Sehgal, 2000) to Fali Nariman (2000).

The objectives of the bill given in its preamble are as follows:

- to facilitate the development of national infrastructure for an information based society, and to enable access thereto;
- to provide a choice of services to the people with a view to promoting plurality of views, news and information; and
- to establish a regulatory framework for carriage and content of information in the scenario of convergence of telecommunication, broadcasting, data communication, multimedia and other related technologies and services (Ibid.).

While the expressed objectives of the draft bill are unexceptionable, it remains to be seen in what form they are finally adopted.

Amendments to the Cable Act of 1994

The BJP-led government announced some important amendments to the existing Cable Act in September, 2000. The salient features of these amendments are:

- a complete ban on the telecast of alcohol, tobacco and synthetic baby food advertisements;
- deletion of the clause enabling telecast of "adult" programmes between 11 p.m. and 6 a.m.;

- prohibition of advertisements that contain references which may hurt religious sentiments;
- addition of a clause which controls cable piracy by making it mandatory for cable operators to secure copyrights for all the programmes they telecast (TOI, 2000, 9 September, p.1).

While the clause seeking to prevent cable piracy was lauded by the film industry, the cable operators opposed these amendments as being unfair. In fact, they protested that even though they did not create the content, the new rules provided for penal action against them. The general complaint from the cable industry was that the satellite broadcasters operated unfettered, even though they were the real creators of content (TOI, 2000, 10 September, p.8).

RECENT DEVELOPMENTS

The large number of committees appointed recently to examine various aspects of broadcasting may indicate the importance of this sector from a political viewpoint. Khanna (2000) is instructive on this point:

> Like most government actions the only thing which is apparent is a plethora of committees. There is a Group of Ministers (GoM) headed by finance minister Yashwant Sinha which is looking at the new converged environment. There is another GoM headed by home minister L. K. Advani which is looking at direct-to-home (DTH) television. There is a committee headed by legal-eagle and MP Fali Nariman which is drafting the new Information, Communications and Entertainment Bill. A Prasar Bharati review committee comprising Kiran Karnik, Shunu Sen and N. R. Narayana Murthy has just submitted a report on the recast of Prasar Bharati (Khanna, 31 May, p.3).

While the multitude of committees suggests the importance of broadcasting on the political agenda, the lack of progress in amending the Prasar Bharati and in making appointments to the Board speaks for itself. Masterly inaction may itself perhaps be a government policy aimed at stymieing any attempts at real autonomy for the Prasar Bharati.

While the contents of the Draft Communications Bill (2000) are being debated, some of the provisions of the erstwhile Broadcasting Bill have been de-linked as separate policies, such as uplinking for private Indian networks, DTH, and notification for must-carry provisions for two DD channels – DD National and DD Metro – on the cable operators prime band (Editorial, Business India, 1999, Oct. 4-17, p.9).

The Union Cabinet approved the new domestic satellite uplinking policy in July, 2000. While this policy would relax various constraints, it would give the government a tool with which to control the content of all the telecast channels. Firstly, this policy would allow any Indian firm (even if not a broadcaster/telecaster) to establish uplinking hubs or teleport facilities for hiring these out. Limitations on foreign equity would be set at 49 per cent, the same as in the telecommunications sector. Secondly, these firms would be permitted to uplink only those TV channels as are allowed by the government. In other words, all TV channels may uplink from India if they comply with the official code on content. Thirdly, all news agencies incorporated in India and accredited by the Central Government's Press Information Bureau and fully owned by Indians are allowed to establish/use uplinking. In a major change, such uplinking will be permitted on Indian satellites, as well as foreign ones.

Another major policy initiative is that the decision allowing DTH television has finally been taken by the government in November 2000. The opening up of this sector compounds the liberalisation in the broadcasting sector resulting from a recent change in policy allowing uplinking. The DTH story has been unfolding over the last 3-4 years when STAR TV indicated its desire to enter this platform. The government used delaying tactics and did not take a decision on DTH till November last year. According to an editorial in *The Economic Times*, "DTH is an example of a technology which has been delayed by political manoeuvering. It should have been introduced three years ago in 1997, but the United Front government came out with a notification banning DTH broadcasts using the Ku band" (2000, 31 October, p.12).

The group of ministers examining DTH is headed by home minister L.K. Advani. The DTH policy announced by the government has capped foreign direct investment at 20 per cent. The limit of the total foreign investment including that of NRIs, OCBs and FIIs has been delineated as 49 per cent. The government has further indicated that no individual company would own more than 20 per cent of the paid up capital of a DTH company, with a view to preventing monopoly (Sinha, 2000, TOI, 21 November, p.13.). Some media analysts feel that the DTH policy finally announced has some inconsistencies. For example, the condition that the licence is valid only for DTH broadcasting, and voice, data, fax, and Internet would require specific and additional licences. Since 'convergence' is supposedly being encouraged by the state, this separation of licences strikes an odd note. Another odd condition is that DTH licensee would be bound to carry channels of Prasar Bharati on the 'most favourable financial terms offered to any other channel' (Nagaraj, 2000, ET 3 November, p.5). N. Bhaskar Rao, Chairman of the New Delhi based Centre for Media

Studies believes that while there might be technological convergence taking place, in reality, the DTH policy was divergent (Rao, 2001).

The information & broadcasting minister Sushma Swaraj finally announced the DTH guidelines in March 2001. The ban on the reception and distribution of television signals on 'Ku band' was withdrawn. As mentioned earlier, the foreign equity holding has been capped at 49 per cent, while the foreign direct investment component has been capped at 20 per cent. An additional requirement is that the applicant company should have Indian management control with majority representatives on the board as well as the chief executive of the company being a resident Indian. The government has attempted to prevent media monopolies by stipulating that broadcasting companies and/or cable network companies shall not be eligible to collectively own more than 20 per cent of the total equity of the applicant company at any time during the licensed period. Similarly, the applicant company should not have more than 20 per cent equity in a broadcasting and/or cable network company. There would be no restriction on the total number of DTH licences, as long as certain minimum requirements are met (TOI, March 17, 2001, p.1).

POLICY ISSUES

As mentioned earlier, an incredibly diverse country like India requires a special recipe for regulation of broadcasting and cable media. Regulators have to make allowances for different religions, castes, languages, and other aspects of diversity. Concerns with development and the trade-off between education and entertainment have also to be factored into the regulatory structure. Regulatory policies for the communications sector have to be viewed against the backdrop of liberalisation and deregulation in the Indian economy. The rapid rate of technological change and convergence in the electronic industries has added another dimension that regulators will have to take into account.

The state in India has played a central role in the development of the broadcasting and telecommunication sectors. Scholars working in the field of communications have argued that the state and corporate uses of communications have reduced the array of social uses of communications (Nordenstreng and Schiller, 1993). It has been pointed out that broadcasting policy in India has emphasised state control and commercialisation of audiences through advertisement supported programming (Melkote, 1991). This accusation had been made, even prior to the appearance of satellite television and the mad scramble for ratings and audiences thereafter. Although the state adopted a 'paternalistic' role with respect to broadcasting policy (as is evident from the emphasis on

developmental programmes), this model of broadcast regulation and the policy choices made by the state actually inhibited a more participatory, grassroots level and localistic growth of broadcasting in India.

CONCLUSIONS

From the preceding sections it is evident that there are intricate and myriad links between the state and the broadcasting sector. While the state has radically changed its economic strategies in the last decade, the case of the broadcasting sector is peculiarly complex. Various governments seemed to cherish DD and AIR for their propaganda value. Thus, the state appeared to be reluctant to grant these institutions autonomy, although some half-hearted attempts were made in this direction. Incidentally, the recent pro-active measures were taken by non-Congress governments, most of which did not even enjoy an electoral majority. According to Karnik (2000), this may be because these governments felt that it would be to their advantage to push through autonomy for the state broadcaster, as their governments in all probability would not last long. The changing nature of politics has also impinged the broadcasting sector, with the increased representation of other demand groups.

During most part of the last decade, the state managed to hold the reins of the national broadcaster. It is interesting that even when broadcast-related issues surfaced on the public agenda, they revolved around autonomy for Prasar Bharati and not domestic competition in a terrestrial form. Such as argument was mooted when fierce competition emerged in the form of satellite competition. Initially, the state appeared to be caught unprepared for this onslaught. However, it did not react by banning satellite TV as happened in other Asian nations. This was perhaps due to the fact that such a measure might have been unpopular in a democracy which prides itself on its freedom of press. Alternatively, Sinha (1998) suggests, that this may have been a strategy pursued by the state as a plank in its economic liberalisation measures which relied on opening up an autarkic economy and encouraging consumerism. One may also argue that the safest option for the state was to do nothing initially as satellite TV was only available to the high-income populace, in mostly urban locations. With the increasing popularity of satellite and cable TV, however, the picture changed.

The issue of foreign satellite channels was gathering momentum in the print media and even Parliament by the second half of the nineties. While the old chestnuts about cultural imperialism and the threat to Indian values were re-examined, there was increased pressure on the state to react to the developments. It may be cynical to observe that the notification allowing the

Prasar Bharati Act was made in 1997 resulting in formal autonomy for DD and AIR at a time when *de facto* liberalisation had already surfaced in the industry. Since the government no longer monopolises the airwaves, it may as well make the Prasar Bharati autonomous, at least on paper.

There was a fresh impetus by the state to redraw the contours of its control by seeking to regulate the new entrants. The Ministry of I&B tried to bring the satellite channels within the ambit of the government's regulations by seeking their adherence to a programming and advertising code. The various drafts of the Communications Bill of 2000, also reflect the state's concern with establishing control over an industry that is regulated on the basis of an archaic piece of legislation.

It is a truism that liberalisation is often accompanied by or followed by increased regulation. After all, deregulation often requires re-regulation. It is a mistake to perceive liberalisation as a simplistic withdrawing on the part of the state. While the state may withdraw from some areas, it may actually advance in others. While the broadcasting sector has undergone a *de facto* liberalisation in India in the past decade, the state is responding by attempting a comprehensive regulation of both broadcasting and telecommunications sectors under one bill. In the area of information technology, the Indian state has actually been pro-active, encouraging foreign investment in the sector.

While Prasar Bharati was finally granted autonomy in 1997, the dilution of the state's development agenda had started much earlier. Doordarshan (DD) had begun to show increasing number of entertainment programmes as compared to educational programmes over its national and regional networks. However, this may also be viewed at a survival tactic on the part of the state. Increased competition meant that DD had to be concerned about audiences, revenues and ratings. The dilution of its public broadcasting mandate, especially the commercialisation of DD2 is a direct result of DD's battle to retain its market share.

The overall picture that emerges is that the Indian state for the first half of the nineties responded to developments in the broadcasting sector by permitting global competition more by default than by design. Local enterprise in the shape of the cable industry was the subject of regulation by 1994-95. The second half of the nineties witnessed much fiercer competition for the national broadcaster, which had 'global' dimensions. The state's reaction to its perceived dilution in control has been apparent in the field of regulation.

The road to reform in the area of electronic communications in India has had to negotiate the difficult terrain between reaping the developmental benefits of liberalisation of communications on the one hand, and coping with the problems of cultural imperialism on the other. One of the specific issues to emerge is that, in the future, a single regulatory entity, rather than the current two separate bodies regulating telecommunications and broadcasting, may prove to be more effective for India.

A single regulatory body to regulate broadcasting and telecommunications could take advantage of synergies between the two sectors. In this era of technological convergence, where cable operators are providing access to the Internet and Internet telephony has become a reality in urban India, it stands to reason that regulation should also exhibit convergence. If the American model inspires one, then it is worthwhile to note that the Federal Communications Commission (FCC) is an independent regulatory commission, which combines two bureaucracies broadly relating to broadcasting and telephony. In fact, this Commission has bureaus which cover radio, television, cable, cellular telephony, satellites, conventional telephony and amateur radio operators. Interestingly, the FCC does not regulate the Internet (Krattenmaker, 1998). India could study this model of regulation and make suitable adaptations to take into account our own experience and problems. Instead of a situation where the 'left hand does not know what the right hand is doing', the regulatory body could actually anticipate developments in electronic communications across the spectrum.

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