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Regulatory reform

IMPROVING THE BUSINESS ENVIRONMENT THROUGH EFFECTIVE REGULATION

- In the early 2000s, India took important steps to improve its regulatory frameworks, but since then reform efforts have stalled. Regulatory barriers to competition are high and rule-making in India is complex due to the different layers of government.
- India needs to further strengthen the governance of state-owned enterprises, simplify regulations, and reduce administrative burdens on firms.
- India should develop and implement a regulatory governance system following international good practices such as regulatory impact assessment, public consultation, and administrative simplification in priority sectors.
- India should also review its institutions responsible for regulatory delivery, and in particular its regulatory agencies and the compliance regimes for laws and regulations.

What's the issue?

India began its regulatory reforms in the early 1990s, reducing state involvement through the privatisation of companies, by putting in place independent regulatory mechanisms to boost competition and private-sector-led growth, and to strengthen consumer protection. But the reform efforts lacked coherence and, more recently, they have stalled. Even though the economy grew rapidly over the past decade, the slowing-down of reforms created an image of a country where doing business is difficult. As a consequence, the "License Raj" title, which described the system of controls introduced in 1951 to regulate entry and production activities but was used more generally to describe India's approach to regulatory governance, did not fully disappear.

OECD data confirm this image (see Figure). Public involvement in business operations remains higher than in many other emerging countries and the governance of state-owned enterprises is weak, reflecting a lack of accountability, integrity, and transparency. Similarly, barriers to entrepreneurship are more severe due to complex regulatory procedures, considerable administrative burdens on startups, and a strong regulatory production of incumbent firms. One of the few bright spots is in the area of financial regulation, where important reforms have taken place.

Improving regulations also requires strengthening the institutions and processes through which regulations are implemented and enforced. India lacks a modern overall regulatory governance regime. Rule-making is complex due to the different layers of government. Based on the Constitution, all levels of government can regulate, including the Central Government and 29 state governments, along with 7 union territories. This leads to differences and sometimes even inconsistencies in regulations across regions. The creation of national Regulatory Commissions since 2005 was a positive move, but there is lack of accountability and consistency of the overall regulatory system.

Establishing a whole-of-government approach to regulation, using international best practice tools and systems such as regulatory impact assessments and public consultation, and building effective institutions for regulatory quality management, are key. In this sense, India needs to catch up with other emerging economies such as China, Mexico and Vietnam, which have already taken important steps in that direction, in line with the OECD's 2012 *Recommendation on Regulatory Policy and Governance*.

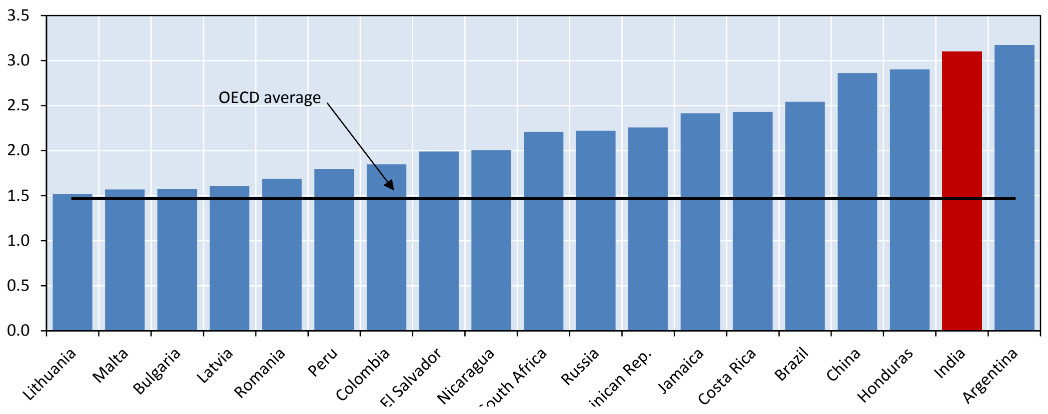
Why is this important for India?

Improving the business environment is essential for boosting investment and productivity growth. OECD estimates suggest that reducing India's score on the OECD's product market regulation indicator by 20% could boost the level of productivity by around 2% over the next 5 years. A more business-friendly regulatory environment would also create strong incentives for small businesses to join the formal economy.

Effective regulatory institutions are critical for India not only for improved economic performance but also for promoting social equality and environmental sustainability, and for ensuring trust in public institutions.

Product market regulation inhibits competition

Product market regulation indicator, index from 0 (least restrictive) to 6 (most restrictive)



Note: The indicators reported for China are based on preliminary estimates as some of the underlying data has not been validated with national authorities. Subsequent data validation may lead to revisions to the indicators for this country.

Source: OECD Product Market Regulation Database

What should policymakers do?

- Adopt a "whole of government" regulatory policy to acknowledge the importance of a coherent and co-ordinated effort to improve the regulatory environment across all levels of government in India.
- Implement a range of regulatory quality tools and instruments to help improve the effectiveness, efficiency and transparency of regulatory systems.
- Strengthen and establish effective regulatory institutions to build and maintain trust in the overall regulatory system.
- Further strengthen the governance of state-owned enterprises, in particular by improving the accountability of boards and raising the transparency of their operations and decisions to reduce uncertainty for other players in the market.
- Lower barriers to entrepreneurship by simplifying regulations, lowering administrative burdens and implementing fewer and more targeted inspections based on risk-assessment and well-structured compliance strategies.
- Introduce an economy-wide programme of competition assessment in different sectors to promote better market operation.

Further reading

OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*. http://www.oecd.org/regreform/regulatory-policy/2012-recommendation.htm

OECD (2014), *Best Practice Principles for Regulatory Policy – The Governance of Regulators*, OECD Publishing. http://www.oecd.org/regreform/governance-of-regulators.htm

OECD (2014), *Best Practice Principles for Regulatory Policy – Regulatory Enforcement and Inspections*, OECD Publishing. http://www.oecd.org/regreform/enforcement-inspections.htm

OECD Indicators on Product Market Regulation. www.oecd.org/eco/pmr