



CARNEGIE
ENDOWMENT FOR
INTERNATIONAL PEACE



REFORMING INDIA'S FINANCIAL SYSTEM

Ila Patnaik and Ajay Shah

JANUARY 2014



CARNEGIE
ENDOWMENT FOR
INTERNATIONAL PEACE

REFORMING INDIA'S FINANCIAL SYSTEM

Ila Patnaik and Ajay Shah

© 2014 Carnegie Endowment for International Peace. All rights reserved.

Carnegie does not take institutional positions on public policy issues; the views represented herein are the author's own and do not necessarily reflect the views of Carnegie, its staff, or its trustees.

No part of this publication may be reproduced or transmitted in any form or by any means without permission in writing from the Carnegie Endowment. Please direct inquiries to:

Carnegie Endowment for International Peace
Publications Department
1779 Massachusetts Avenue, NW
Washington, DC 20036
P: +1 202 483 7600
F: +1 202 483 1840
CarnegieEndowment.org

This publication can be downloaded at no cost
at CarnegieEndowment.org/pubs.

Contents

About the Authors	v
Summary	1
Introduction	3
The Problem	4
A Group of Expert Committees	5
Financial Regulatory Governance	8
The Nine Components of the Law	13
A New Agency Landscape	23
From Ideas to Action	25
Carnegie Endowment for International Peace	28

About the Authors

Ila Patnaik is a nonresident senior associate in Carnegie's South Asia Program. She is also a professor at the National Institute of Public Finance and Policy (NIPFP) in New Delhi. Her main area of interest is the study of India as an opening economy and her research includes issues related to capital flows, business cycles, the financial sector, and the study of Indian firms as India opens up its capital account. She writes regular columns in the *Indian Express* and the *Financial Express*.

Before joining NIPFP in 2006, Patnaik served as economics editor of the *Indian Express* (2004–2006), as senior economist at the National Council of Applied Economic Research (NCAER), New Delhi (1996–2002), and as a senior fellow at the Indian Council for Research in International Economic Relations (ICRIER) (2002–2004). Patnaik was a visiting scholar at the IMF in 2003, 2010, and 2013.

Ajay Shah co-leads the Macro/Finance Group at the National Institute of Public Finance and Policy in New Delhi. He has held positions at the Centre for Monitoring Indian Economy, the Indira Gandhi Institute for Development Research, and the Ministry of Finance. He has engaged in academic and policy-oriented research in the fields of Indian economic growth, open economy macroeconomics, public finance, financial economics, and pensions. His work can be accessed on his home page www.mayin.org/ajayshah and on his blog <http://ajayshahblog.blogspot.com>.

Summary

India's financial system has long been inadequate. With an economy worth \$2 trillion, the country's financial flaws are increasingly serious and outright dangerous. But fundamental change is under way. The government-backed Financial Sector Legislative Reforms Commission drafted the Indian Financial Code (IFC), a single unified law that replaces most existing financial law in India and is an important milestone in the development of state capacity. Now the government must work to adopt and implement the full code.

Modernizing Indian Finance

- Existing laws in India are rooted in the notion that the state is benevolent and feature few checks and balances. The draft IFC steps away from this idea of power without accountability.
- Financial law should reflect an understanding of market failures in finance. It should acknowledge that bureaucrats and politicians serve their own interests, not necessarily those of the general public. Objectives for financial regulators and mechanisms governing their functions should be clearly specified, and laws should hold leaders of government agencies accountable for performance.
- The IFC will transform India's financial laws, regulatory architecture, and regulatory functions, providing a modern and consistent framework based on the rule of law, regulatory independence, and accountability.
- The draft code addresses nine areas that require reforms: consumer protection; micro-prudential regulation; resolution mechanisms; systemic risk regulation; capital controls; monetary policy; public debt management; development and redistribution; and contracts, trading, and market abuse.
- The full adoption of the IFC will help build a financial system that allocates resources well, achieves higher growth, and reduces risk.

Preparing for the Law

- The administration that takes power in India following the country's mid-2014 general election should prioritize enacting the IFC. Ideally, parliament will enact the law between 2015 and 2017.
- To pave the way for the law, regulators should voluntarily adopt IFC principles that are consistent with existing laws, such as those related to the

rule of law, accountability, regulation-making processes, and consumer protection regulations.

- The government should build up its institutional capacity now to reduce the delay between enacting and fully implementing the IFC. This requires setting up new institutions and changing the way regulators and the government function and interact with firms and consumers. It will necessitate large-scale training of the staff of the regulatory agencies and the Ministry of Finance.

Introduction

*In the elder days of art
Builders wrought with greatest care
Each minute and unseen part,
For the Gods are everywhere.*

–Henry Wadsworth Longfellow

India is on the cusp of fundamental reform of its financial system. The new draft Indian Financial Code (IFC) is a little-known but groundbreaking initiative to modernize Indian finance by transforming the laws, the regulatory architecture, and the working of regulators.

There have been many efforts in India to rethink financial sector regulation to address persistent problems, such as a lack of financial inclusion, a glacial pace of innovation, the growth of an unregulated shadow financial system, numerous Ponzi schemes, high inflation, and the challenges of international financial integration. In some areas, progress was easy to achieve by removing restrictions imposed by the government. Yet, India's problems call for not just deregulation, but the construction of financial regulatory capacity. This is particularly difficult as it comes in a context where the Indian state has endemically low capacity.

In recent years, a series of expert committees developed a consensus around a strategy for change. The reforms proposed by these committees require legislative changes, leading India's Ministry of Finance to set up the Financial Sector Legislative Reforms Commission to rewrite the laws. After two years of deliberations and consultation, the commission submitted the proposed Indian Financial Code. This draft law is a new, modern, coherent, and consistent framework based on the rule of law, independence, accountability, and an overriding objective of consumer protection. It replaces most existing Indian financial law. It outlines the powers of agencies that regulate the financial sector while recognizing that for those regulators to be effective, they must have clear objectives and be held accountable for achieving those objectives.

Any attempts at building a government agency must begin with a set of hypotheses about the problem in the world that this agency is required to solve. Alongside this market-failure perspective, there is value in looking at reform from the perspective of public choice theory, which views bureaucrats and politicians as self-interested. The IFC is based on such an analysis: an

understanding of the market failures that motivate government interventions in finance, and a framework for thinking about the endemic failures of state capacity in India from a public administration viewpoint with an emphasis on the themes of accountability and the rule of law.

Lessons from the global financial crisis have influenced the IFC in many dimensions. One flawed element of the global financial system revealed by the crisis was underregulation of parts of the system, such as over-the-counter derivatives, and weaknesses in handling unsound financial firms, particularly large ones. Under the IFC, no part of finance is unregulated. Financial firms face forms of regulation appropriate to their roles, including regulations to prevent consumer abuse, maintain the safety and soundness of financial firms, ensure the orderly resolution of failing financial firms, and enhance the oversight of systemically important firms.

While a draft IFC was released to the public on March 22, 2013, there is a long journey ahead. In the ideal scenario, the code will be enacted as law by parliament somewhere between 2015 and 2017. The draft code, however, is already having an impact. The Ministry of Finance has begun work on an implementation process in which a subset of governance-enhancing measures from the IFC is voluntarily adopted by all existing financial agencies, and project teams are being established to lay the groundwork for new institutions required under the IFC.

The Problem

India embarked on substantial economic liberalization in 1991. In the field of finance, the major themes were the scaling back of capital controls and the fostering of a domestic financial system. This was part of a new framework of embracing globalization and of giving primacy to market-based mechanisms for resource allocation.

From 1991 to 2002, progress was made in four areas, reflecting the shortcomings that were then evident. First, capital controls were reduced substantially to give Indian firms access to foreign capital and to build nongovernment mechanisms for financing the current account deficit. Second, a new defined-contribution pension system, the New Pension System, was set up so that the young population could achieve significant pension wealth in advance of demographic transition. Third, a new insurance regulator, the Insurance Regulation and Development Agency, was set up, and the public sector monopolies in the field of insurance were broken to increase access to insurance. Fourth and most important, there was a significant burst of activity in building the equity market because of the importance of equity as a mechanism for financing firms and the recognition of infirmities of the equity market. This involved establishing a new regulator, the Securities and Exchanges Board of India, and new infrastructure institutions, the National Stock Exchange and the National Securities Depository. The reforms of the equity market involved ten acts of

parliament and one constitutional amendment, indicative of the close linkage between deeper economic reforms and legislative change.

While all these moves were in the right direction, they were inadequate. A large number of problems with the financial system remain unresolved. In cross-country rankings of the capability of financial systems, India is typically found in the bottom quartile of countries. A financial system can be judged on the extent to which it caters to growth, stability, and inclusion, and the Indian system is deficient on all of those counts. By misallocating resources, it hampers growth. The entire financial system suffers from high systemic risk.

The households and firms of India are extremely diverse, and often have characteristics not seen elsewhere in the world. For finance to reach a large fraction of firms and households, financial firms need to energetically modify their products and processes, and innovate to discover how to serve customers. But in the field of finance, the forces of competition and innovation have been blocked by the present policy framework. This means there are substantial gaps between the products and processes of the financial system, and the needs of households and firms.

It is likely that around 2053, India's GDP will exceed that of the United States as of 2013. In the coming forty years, India will need to build up the institutional machinery for markets as complex as the financial system seen in advanced economies today. The IFC puts India on that path.

A financial system can be judged on the extent to which it caters to growth, stability, and inclusion, and the Indian system is deficient on all of those counts.

A Group of Expert Committees

By 2004, it was becoming increasingly clear that while some elements of modernization of the financial system had taken place from 1992 to 2004, financial economic policy needed to be rethought on a much larger scale to address the problems facing the system. As is the convention in India, the consensus on desired reforms was constructed through reports from four expert committees on:

1. International finance, led by Percy Mistry in 2007
2. Domestic finance, led by Raghuram Rajan in 2008
3. Capital controls, led by U. K. Sinha in 2010
4. Consumer protection, led by Dharendra Swarup in 2010

These four reports add up to an internally consistent and comprehensive framework for Indian financial reforms. The findings were widely discussed and debated in the public discourse (see table 1 for the main recommendations of these expert committees). The four reports diagnosed problems, proposed solutions, and reshaped the consensus.

Table 1. Expert Committee Recommendations

Group and Chairman	Result
High-Powered Expert Committee on Making Mumbai an International Financial Center; Percy Mistry; 2007	The report outlined the prerequisites for making Mumbai an international financial center. According to the report, the quality and reputation of the regulatory regime is a key determinant of the market share of an IFC, in addition to the capabilities of the financial firms. It recommended increasing financial market integration, creating a bond-currency-derivatives nexus, and ensuring capital account convertibility and competition.
The Committee on Financial Sector Reforms; Raghuram Rajan; 2008	The committee was tasked with proposing the next phase of reforms for the Indian financial sector. The report focuses on how to increase financial inclusion by allowing players more freedom and strengthening the financial and regulatory infrastructure. It recommended leveling the playing field, broadening access to finance, and creating liquid and efficient markets.
Committee on Investor Awareness and Protection; Dhirendra Swarup; 2010	The report outlines the need for regulation of the market for retail financial products in India and educating the consumers. The report points to the inadequate regulatory framework governing the sellers of financial products that induces problems like misselling, the chief cause of which is rooted in the incentive structure that induces agents to favor their own interest rather than that of the customer. The report proposes a reconfiguration of incentive structure to minimize information asymmetry between consumer and seller.
Working Group on Foreign Investment in India; U. K. Sinha; 2010	The working group's primary focus was on rationalizing the instruments and arrangements through which India regulates capital flows. The regulatory regime governing foreign investments in India is characterized by a system of overlapping, sometimes contradictory and sometimes nonexistent, rules for different categories of players. This has created problems of regulatory arbitrage, lack of transparency, and onerous transaction costs. The working group proposed reforms for rationalization of capital account regulation. It recommended the unification of the existing multiple portfolio investor classes into a single qualified foreign investment framework, and the promulgation of know-your-customer requirements that meet the standards of best practices of the Organization for Economic Cooperation and Development.

Some parts of these reports were readily implementable, and have been gradually put into practice in the following years. However, the bulk of the work program envisaged by these four expert committees is incompatible with the present laws. More and deeper change was needed.

Weaknesses of Existing Laws

Most existing financial laws in India were enacted when the country was a command and control economy. They are guided by the objective of containing and controlling financial markets and banning activity, rather than regulating and supervising markets and achieving sophisticated interventions through which market failures are addressed. The existing laws are not rooted in an understanding of the market failures that are found in finance and the mechanisms through which these are addressed.

A large number of laws exists, each of which was designed to solve a small problem that was prevalent at the time the law was developed. These laws are often inconsistent with each other, and generally out of touch with the requirements of India as a middle income economy. As an example, the very preamble of the Reserve Bank of India Act, which was enacted by the British in 1934, includes a candid admission about the lack of knowledge of monetary economics at that time:

And whereas in the present disorganization of the monetary systems of the world it is not possible to determine what will be suitable as a permanent basis for the Indian monetary system;

But whereas it is expedient to make temporary provision on the basis of the existing monetary system, and to leave the question of the monetary standard best suited to India to be considered when the international monetary position has become sufficiently clear and stable to make it possible to frame permanent measures.

Such a “temporary” arrangement, serving the objectives of colonial authorities, is not optimal for the India of 2013 or 2053.

The Financial Sector Legislative Reforms Commission

In India, laws traditionally evolve piecemeal and on a problem-by-problem basis. The government made no attempt to comprehensively rethink the laws that govern an entire sector. In the case of financial law, the Ministry of Finance started grappling with this problem in 2009, and chose to adapt an existing institution of Law Commissions, which are nonpartisan bodies that propose modifications of laws, to the task of writing laws for finance.

A former judge of the Supreme Court, Justice B. N. Srikrishna, was chosen to lead the project, which ran for two years, involved 146 persons, and had a dedicated 35-person technical team. The commission itself was nonpartisan and in most cases did not have representation of the special interests of existing financial agencies. A multidisciplinary approach was taken, drawing together skills in economics, finance, public administration, and law. The commission weighed the infirmities of the Indian financial system, the recommendations of expert committees, and the international experience, and designed a new legal foundation for Indian finance.

The Indian Financial Code is the commission's product. It is a single, internally consistent law of 450 sections that is expected to replace the bulk of existing Indian financial law.

Financial Regulatory Governance

Constructing effective financial law requires an understanding of market failures in finance that will shape appropriate interventions by the government and good public administration practices, which impact the working of government agencies. An essential feature of sound public administration is laws that embed effective accountability mechanisms. The pressure of accountability will impel the leaders of an agency to reshape their organization in ways that deliver performance.

Constructing effective financial law requires an understanding of market failures in finance that will shape appropriate interventions by the government and good public administration practices, which impact the working of government agencies.

The four committee reports identified numerous shortcomings in the present arrangements, most of which can be identified as improperly drafted regulations. At first blush, it appears that these problems merely require writing better regulations. The deeper question that needs to

be asked is why existing financial regulators have made faulty regulations.

The proximate source of underperformance of government agencies is their poor organization and the low quality of their staffing. Their functioning is characterized by ineffective management structures and processes.

In the private sector, the leadership of a firm gets feedback from the market. When the firm is faring poorly, reduced profits are immediately visible and generate an impetus for the firm to reshape itself even though this involves making uncomfortable decisions to restructure the organization and change personnel, for instance. Firms that fail to reinvent themselves go out of business.

These feedback loops are absent in India's government agencies. A lack of performance does not generate feedback loops that force the leadership to reinvent the agency.

In this environment, leaders are biased toward decisions that keep them in a comfortable position. As an example, when a financial agency sees a new class of financial products, such as Internet-based payment systems, it faces

the problem of constructing regulatory and supervisory capacity to deal with this—a difficult process. It is easier to claim that innovation is dangerous and to ban new financial products.

At the core of this issue is the fact that existing laws in India are rooted in the notion that the state is benevolent. They feature little in terms of the checks and balances and accountability mechanism, that is, the feedback loops that keep the leadership of government agencies in check. By contrast, in the United States, a general strategy for dealing with public bodies is embedded in the Federal Administrative Procedure Act of 1946. This shapes the agency problem for all financial agencies in the United States. No comparable law exists in India.

The draft legislation aims to solve the principal-agent problem that every legislature faces when establishing financial regulators. The conventional discourse in India uses the term “functions” to describe the responsibilities of a government regulatory agency. Existing laws give certain functions to an agency. The agency is then equipped with certain powers to perform these functions. The IFC consciously steps away from such a notion of power without accountability. It sets up the relationship between the principal (parliament) and the agent (the financial agency) through clarity of objectives, precise and enumerated powers, and extensive accountability mechanisms.

For an analogy, consider the relationship between a consumer and the person that is contracted to paint a house. Conventional Indian laws say that the painter can go into a house and paint it as he likes, using all possible choices of colors and equipment. Conventional Indian laws believe the painter is benevolent and will pursue the welfare of the people. This is a breeding ground for laziness and corruption. The IFC would give the painter precise instructions for how the house must be painted and defined and limited powers to use in pursuit of his objective. It sets up an inspector to verify that the house has been painted correctly and imposes negative consequences on the painter when the work is poor.

Separation of Powers

Under India’s current system, parliament gives independent regulators three responsibilities—a legislative function of writing regulations that have the status of law, an executive function of enforcing regulations, and a judicial function of awarding penalties. Commonly accepted practice in many systems holds that these three functions should be kept separate under the separation of powers doctrine. India’s lack of separation of powers in this area is one source of underperformance of existing financial agencies. The IFC takes one step toward separation of powers by requiring that the judicial responsibilities be held separate from the legislative and executive functions in the internal working of the regulator.

The IFC takes one step toward separation of powers by requiring that the judicial responsibilities be held separate from the legislative and executive functions in the internal working of the regulator.

Independence

All over the world, laws governing the financial sector enshrine regulatory independence. This protects the regulatory process from the political imperatives of the administration that is in power. Independence is also required to protect against the attempts by financial firms to unduly influence decisions.

To achieve regulatory independence, numerous modifications are required in financial laws. These include: sound structure for the appointment process for senior regulatory staff, fixed contractual terms for them, removing the power for the administration to give directions to financial agencies, and transparency of board meetings where nominees of the Ministry of Finance are present.

Accountability

The key insight of the IFC is the idea that the failures of financial agencies in India stem from the lack of accountability for the leadership. For example, many existing laws establish independent regulators with the broad mandates of serving the public interest or improving the welfare of the people of India, and they then arm those agencies with sweeping powers. Instead, as the IFC proposes, laws should be explicit about agencies' objectives, powers, and accountability mechanisms. There are four components of accountability in the IFC: clarity of purpose, a well-structured regulation-making process, the rule of law, and reporting mechanisms.

Clarity of Purpose

Agencies' objectives should be defined clearly to ensure that these bodies do not have unfettered discretion over how to exercise their power and to hold specific actors accountable for failures.

One important barrier to clarity of purpose is conflicts of interest. When one goal conflicts with another, agencies can explain away failure in one dimension by claiming that the conflicting goal was being emphasized. Conflicting objectives are at the foundation of chronic underperformance of some financial regulators in India today.

Conflicting objectives are at the foundation of chronic underperformance of some financial regulators in India today.

One example is found in the Reserve Bank of India. It has the power to set interest rates, and it is also responsible for raising debt for the government and for regulating banks. These functions are in conflict. Banks are the main buyers of government debt, and with the power to regulate banks and set interest rates, the Reserve Bank of India can potentially exert influence over those bodies and push them toward purchasing government debt. It can also keep interest rates low to ensure that the government's cost of debt stays low. Its interest-rate-setting function may be used to pursue objectives other than those related to monetary policy as well—because,

for instance, when interest rates are raised, banks may suffer losses on their portfolio.

The IFC structures regulatory bodies with greater clarity of purpose and minimizes conflicting objectives.

Regulation-Making Process

In the current system, parliament delegates regulation-making power to unelected officials in independent regulators. There is a danger that these officials will choose to draft regulations that are the easiest to implement. For instance, regulators in India have often been very reluctant to grant permissions for businesses to operate, perhaps because it makes their supervisory tasks more difficult when they have to oversee large numbers of businesses. There are also substantial restrictions against creating new kinds of products or processes that cater to the convenience of existing staff and organization structures.

These limitations hinder competition and innovation. Through this, they interfere with the ability of the financial system to serve the needs of the diverse kinds of households and firms present all across the country. Alongside these barriers are numerous regulations that stray from the economic purpose of financial regulation—identifying and addressing market failures in finance—toward central planning where the government usurps the role of designing financial products and processes.

The regulation-making process of the IFC has checks and balances to help avoid such suboptimal outcomes. Under the IFC, the regulator is obliged to analyze the costs and benefits of a proposed regulation. The costs to society of implementing the regulation must be compared to costs of the market failures that motivate the regulation before a decision can be made. For every regulation that is proposed, the IFC requires:

1. A compact statement of the objectives of and reasons for the legislation
2. A description of the market failure that motivates the regulation
3. Demonstration that solving this market failure is within the objectives of the regulator
4. Clear and precise exposition of the proposed intervention
5. Demonstration that the proposed intervention is within the powers of the regulator
6. Demonstration that the proposed intervention would address the identified market failure
7. Demonstration that the costs to society through complying with the intervention are outweighed by the gains to society from addressing the market failure

The documentation of these elements must be produced by a regulator every time a regulation is drafted. This will help ensure that adequate thinking precedes regulation making. It will also show the full regulatory intent to citizens and to judges who have to adjudicate disputes.

After the relevant documentation is produced, a consultative process will commence in which the regulator releases this material and the draft regulation into the public domain. Market participants will be given sufficient time to review the draft regulation and to comment on it, and the regulator will be required to substantively respond to all public comments. Following that period, a modified regulation will be released to the public with a starting date that is far enough in the future to give firms and households adequate time to cope with the changes.

One key element of this regulation-making process is appeal. If the regulator strays from either the objectives or powers specified by the IFC, or the regulation-making process required in the IFC, the regulation in question can be struck down through judicial review.

Following the implementation of a regulation, the IFC requires an ex-post analysis to be conducted. In this process, the objectives of a regulation are reviewed, including an examination of data to determine the extent to which the stated objectives have been met and a review of the enforcement experience and litigation that has been undertaken in relation to the regulation.

The Rule of Law

When a financial agency is not bound by the rule of law, it wields power without accountability. Upholding the rule of law introduces checks and balances that induce greater accountability. In India, there are weaknesses of regulatory governance that lead to violations of the rule of law. The IFC addresses these issues in a comprehensive manner.

Legislation that reinforces the rule-of-law framework is accessible, intelligible, clear, and predictable. Under the IFC, the operation of the formal process of financial regulation, as well as the body of laws and jurisprudence, would be visible to the public. This would provide stability and certainty about the law and its application.

Questions of legal rights and liability should be resolved by application of the law rather than through bureaucratic discretion. The IFC significantly limits the discretionary powers given to regulators and other agencies by specifying powers for these actors that can only be used for pursuing specific objectives.

In a system that respects the rule of law, legislation should apply equally to all parties, except if objective differences justify differentiation. Under the IFC, by default, all regulated entities would be treated alike. The draft legislation puts the onus on the regulators to justify any variation in treatment between two firms or two subsectors on the basis of differences in risks posed and other material differences.

Public officers at all levels must exercise the powers conferred on them in good faith, fairly, for their intended purpose without exceeding their limits. The IFC's accountability mechanisms, especially the regulation-making process, ensure that public officers carry out their duties in this manner.

The IFC provides for a system that would help consumers find redress for disputes with financial firms. Appeals against actions of financial agencies would be heard at the Financial Sector Appellate Tribunal, a court with specialized skills in financial law that would feature modern court processes.

Reporting

Once the objectives of a regulatory agency are defined, reporting mechanisms are envisioned under the IFC to determine the extent to which the agency has achieved its objectives. Under the IFC, each agency would submit such a progress report to the government. As an example, for a supervisory process, the agency would be obliged to release data about investigations conducted, orders issued, orders appealed, and the orders that struck down. Transparency would be required with a functional classification of the expenditure of the agency across its objectives.

The Nine Components of the Law

Within this framework of independent and accountable financial agencies, the draft IFC groups the substantive efforts the Indian government must undertake to address market failures in finance into nine categories:

1. Consumer protection
2. Micro-prudential regulation
3. Resolution
4. Systemic risk regulation
5. Capital controls
6. Monetary policy
7. Public debt management
8. Development and redistribution
9. Contracts, trading, and market abuse

Consumer Protection

The existing strategy on consumer protection in Indian finance emphasizes a disclosure-based approach. Firms are obliged to disclose a great deal of detail, and consumers are left to their own devices to avoid being mistreated.

But this approach does not solve the problems of consumer protection in finance. Consumers of financial services are often more vulnerable than consumers of ordinary goods because of the complexity of the services, the long

time horizons in which consequences unfold, and cognitive biases. Hence, consumer protection in finance requires a special effort by the state.

This is a major gap in current Indian financial law and regulation that is imposing substantial costs upon the consumers of India. The overlaps and cracks in the regulatory apparatus, and the weak framework for consumer protection, have resulted in a procession of scandals such as Ponzi schemes. There is a recurrent threat that financial firms that achieve undue influence over their regulators will take unfair advantage of customers.

In order to forestall this, the IFC places consumer protection at the heart of financial regulation. It establishes mechanisms for both prevention and cure. Prevention involves making and enforcing regulations across the entire financial system. This has three components: a set of rights and protections for consumers, a set of powers through which financial agencies will uphold these rights and protections, and principles that guide which powers should be used under which circumstances. These three components would shape the detailed regulations surrounding consumer protection.

Some of the rights and protections that the IFC would guarantee consumers are protection against unfair contract terms and against misleading and deceptive conduct. The draft legislation also outlines the right to receive reasonable quality of service and to data privacy and security.

Regulators are empowered under the IFC to impose a range of requirements upon financial service providers, from disclosures to suitability and advice requirements to regulation of incentive structures. The legislation also embeds fairly intrusive powers for regulators, such as recommending modifications in the design of services and products. The choice and application of these powers will be informed by a set of principles that ensure that they are used where they are most required. The powers do not excessively restrict innovation, competition, or other balancing considerations.

Part of the reason consumer protection issues are so prevalent in India is that the financial regulatory structure has traditionally been defined by sector, with multiple laws and often multiple agencies covering various sectors. This has led to inconsistent treatment, and regulatory arbitrage. The Ponzi schemes in operation, for instance, often exploit the gaps between existing laws. There is a greater risk of regulatory capture of sectoral regulators where they come to adopt the worldview of the firms with which they deal. These problems would be reduced by having a single, principles-based law—the IFC—that covers the entire financial system.

Turning from prevention to cure, the IFC envisions a unified Financial Redress Agency. The agency would have a presence in every district in India and would be a place where consumers of all financial products could submit complaints. Consumers would only have to deal with one agency in this area rather than multiple regulators. The local operations would be connected to a centralized and streamlined adjudication process, and a well-structured work flow would support the speedy and fair handling of cases. The analysis

of patterns in the complaints of consumers at the Financial Redress Agency would feed back into improved regulations.

Micro-Prudential Regulation

The Indian financial system has traditionally been dominated by public sector firms. When consumers deal with a government-owned firm, for all practical purposes, they deal with the government; there is no perceived possibility of failure.

But in order to build a modern Indian financial system, private firms will have to proliferate. These firms can fail, and that can be highly disruptive for households who are customers of a failing firm, and for the economy as a whole. The aim of micro-prudential regulation is to reduce the probability that financial firms fail.

When a consumer deals with any financial firm, there should be a high probability that it will be solvent and able to make good on its promises. It is the responsibility of financial regulatory agencies to achieve this objective, as individuals do not have the incentive or capacity to ensure that companies are solvent.

Beyond the individual consumer, the failure of a large number of financial firms within a small period of time can disrupt the whole financial system. Sound micro-prudential regulation can help reduce this systemic risk.

Firms are generally eager to avoid their own bankruptcy and failure. However, this does not always result in a low failure probability. Managers and shareholders stand to gain handsomely if a firm does well, but they can simply walk away when a firm fails. Many financial firms in India assume that the Indian government will come to the rescue and bail out the failing firm. Indeed, the history of bank failures in India is replete with examples of forbearance and support of failing firms by the Reserve Bank of India and by the government. This generates incentives for financial firms to ratchet up risks, profit from the outcomes if things go well, and fall back on the support of the government if they do not. For these reasons, financial agencies are required to conduct micro-prudential regulation, which pushes firms into having a ceiling on their failure probability.

How intrusive micro-prudential regulation would be under the IFC depends on the nature of the promise made by a given financial firm. The IFC enjoins upon regulators to think about each promise that is made by a financial firm from three points of view: first, how difficult it is for the financial firm to honor the promise; second, how difficult it is for consumers to assess the ability of the financial firm to keep its promise; and third, how much hardship would be caused to consumers if the promise were not kept.

To illustrate these three ideas, consider two examples. In a bank deposit, since the promise is to make the payment at par on demand, there is an inherent difficulty in keeping the promise. The opacity of a bank's balance sheet makes an assessment of creditworthiness difficult, and there is significant hardship for households if the bank should fail. These problems shape the micro-prudential

strategy for bank deposits. In contrast, consider a mutual fund that reports a net asset value (NAV) every day and makes no promise about future returns. This product involves a very different set of promises (that the NAV is correctly calculated, that the consumer can cash out his investment at an NAV-linked value, and requires a commensurate micro-prudential regulatory strategy).

The ability of consumers to coordinate and influence the behavior of a firm is also a factor to consider in determining how intrusive regulatory agencies should be. For some firms with a small number of investors, such as private equity funds, investors wield considerable influence over the firm. This is not true of many firms that have numerous consumers each with a small exposure to the firm, so the IFC would call for more intrusive regulation in that case.

The IFC's objective to reduce the probability of failure of financial firms is balanced by a principle that requires the regulator to consider the consequences for efficiency. Regulators have the power to impose requirements on capital adequacy, corporate governance standards, liquidity norms, investment norms, and other instruments. But in imposing those requirements, a principle of proportionality is in play; regulatory interventions should be proportional to the risks faced.

Under the IFC, all of these issues are governed by a single micro-prudential law that would ensure uniform treatment of all aspects of the financial system and largely eliminate areas of regulatory arbitrage. At the same time, multiple regulators could enforce the law for various components of the financial system.

Resolution

Eliminating all firm failure is neither feasible nor desirable. Failure of financial firms is an integral part of the regenerative processes of the market economy: weak firms should fail and thus free up labor and capital that can then be utilized by stronger firms. However, when micro-prudential regulation is not enough and disruptive firm failure looms, the government needs to be able to step in to help avoid such an outcome.

The IFC proposes a resolution corporation that would oversee all financial firms that have made significant promises to households, such as banks, insurance companies, defined benefit pension funds, and payment systems, and intervene when the net worth of such a firm is near zero (but not yet negative). The corporation would force the closure or sale of the financial firm and protect small consumers either by transferring their investments to a solvent firm or by paying them what they are owed. In the case of banks, for instance, the deposit insurance program in which all households are guaranteed up to 100,000 rupees of their bank deposits would be operated by the resolution corporation. (While India currently has deposit insurance, there is no resolution corporation.) The proposed entity will also take responsibility for the graceful resolution of systemically important financial firms, even if they have no direct links to consumers.

A key feature of the resolution corporation is the speed with which it takes action. International experience has shown that delays in resolution almost always leave the firms in question with negative net worth, which generally imposes costs on the taxpayer. The IFC embeds the full legal framework for a resolution corporation that will act swiftly to stop weak financial firms while they are still solvent. The resolution corporation will choose between many tools through which the interests of consumers are protected, including sales, assisted sales, and mergers.

For strong firms, the resolution corporation will largely be removed from the firms' operations. It will only assume primacy if a firm approaches default. In this way, it is analogous to a specialized disaster management agency, which is not involved in everyday matters of governance but assumes primacy after a natural disaster.

Systemic Risk Regulation

Systemic risk is the probability that a financial system will stop functioning altogether, which then adversely affects the real economy. This has moved to prominence in the aftermath of the 2008 financial crisis, when governments and lawmakers worldwide saw the need to employ regulatory strategies that would avoid systemic crises and reduce the costs to society and to the treasury of resolving them.

Addressing systemic risk requires a bird's eye view of the financial system as a whole. This is a very different perspective when compared to conventional financial regulation, which tends to analyze one consumer, one financial product, one financial market, or one financial firm at a time. Conventional micro-prudential regulators are oriented toward seeing one firm at a time, and sectoral regulators are oriented toward information, regulatory instruments, and the interests of one sector at a time.

To a certain extent, systemic crises are the manifestation of failures in carrying out the core tasks of financial regulation—that is, consumer protection, micro-prudential regulation, and resolution. The road to the global crisis of 2008 in the crisis countries was paved with numerous failures in these three elements. By addressing these issues, systemic risk can be reduced, but it will not be eliminated. Moreover, there is always the possibility that errors will be made in those areas.

Mechanisms to address systemic risk must thus be established by law. At the same time, a precise set of steps must be outlined for government agencies to perform, or else the law could degenerate into vague, sweeping powers that lack clear objectives. The IFC addresses the question of systemic risk in four steps.

First, it requires the establishment of a comprehensive database about all financial firms and markets. That information should be analyzed, and any systemic concerns that arise should be brought to the attention of the Ministry

of Finance and all financial agencies. A council of regulators could choose to act in response to the evidence.

Second, systemically important financial firms and conglomerates should be identified. Those entities would be subjected to enhanced micro-prudential regulation and supervision in a coordinated manner across all agencies. This would help target a lower desired failure probability.

Third, tools for modifying the risk taken by the financial system as a whole, across all sectors, should be established to act as a countercyclical influence, reining in risk taking when times are good and avoiding abrupt deleveraging and fire sales when times are difficult.

Fourth, an array of coordinated emergency measures is necessary when there is a financial crisis.

Under the IFC, these steps are placed at a council of regulators called the Financial Stability and Development Council. The IFC intends that this body will have five members: the minister of finance, the head of the central bank, the head of the Non-Banking Financial Agency, the head of the Resolution Corporation, the head of the Debt Management Office.

Capital Controls

Capital controls are restrictions on cross-border contracting. In the IFC, capital controls are classified into three groups:

1. Those motivated by the desire to observe and prevent criminal activities
2. Restrictions against foreign direct investment (FDI), motivated either by political considerations (which are applied in the Indian retail sector, for instance) or national security considerations (for example, barriers aimed at preventing hostile nations from controlling vital infrastructure)
3. Restrictions against cross-border financial flows

There are significant differences between the objectives and instruments required in the three areas. Hence, each requires a distinct strategy to ensure rule of law and accountability.

The first—observing and preventing criminal activities—is adequately addressed by the Prevention of Money Laundering Act of 2002 and by India's ongoing membership in the Financial Action Task Force.

On the second front, the IFC defines inbound FDI and gives the government the powers necessary to introduce restrictions on FDI. While the IFC does not explicitly state this, over the years, it would make sense if the focus of restrictions against FDI shifted away from political objectives toward national security objectives.

In the third area, cross-border financial flows, there is a question about the appropriate sequencing and pace of India's capital account liberalization. All prosperous countries have negligible capital controls, and India's peers among developing countries have greater capital account openness than India. Indian policymakers have stated that in the long run, India will move toward capital account openness. Under the IFC, the timing and sequencing of capital account liberalization is left to future policymakers.

As with everything else in the IFC, these three elements of capital controls are placed under an environment of sound governance with the rule of law. This would be a significant improvement when compared with the present arrangements.

Monetary Policy

Low and stable prices lay a sound foundation for long-range planning by households and firms, and improve the information processing of firms. For these reasons, low and stable inflation is an essential ingredient of macroeconomic stability and sustained growth.

In the long run, the dominant determinant of price stability in a country is the conduct of monetary policy. While price fluctuations on a horizon of a few months can be influenced by other considerations, such as monsoons, such considerations do not explain sustained price inflation over a number of years. Many advanced economies and sophisticated emerging markets have achieved price stability by establishing appropriate institutional arrangements for monetary policy.

In India, policymakers have long operated with an informal target zone where year-on-year consumer price inflation of between 4 and 5 percent is desired. However, in recent decades, this aspiration was only achieved for seven years from 1999 to 2006. This raises questions about the soundness of present monetary policy arrangements.

The IFC lays out three key elements of the monetary policy arrangement. The Ministry of Finance will specify a quantifiable objective for the Reserve Bank of India that can be monitored. The bank will have independence in the pursuit of the clearly outlined objective. And the interest rate at which the central bank lends to banks, the policy rate, will be determined by voting in an executive monetary policy committee.

Public Debt Management

The problem of public debt management involves cash management for the treasury and investment banking capabilities for borrowing across an array of maturities and contractual arrangements. A competent debt management capability would deliver low costs of borrowing on average in the long run. In India, a series of expert committees have suggested that this should be done in a professional debt management office.

Debt management requires an integrated picture of all onshore and off-shore liabilities of the government. At present, this information is fragmented between the Reserve Bank of India and the Ministry of Finance. Unifying this information, and the related debt management functions, will yield better decisions and improved debt management.

Moreover, a central bank that sells government bonds faces conflicting objectives. When the Reserve Bank of India is given the objective of obtaining low cost financing for the government, this may make the bank favor low interest rates, which could interfere with the goal of price stability.

For these reasons, the IFC gives this task to a new agency, the Public Debt Management Agency.

Development and Redistribution

The development and redistribution agenda in Indian financial policy involves the development of missing markets, such as the bond market, in which there is nonexistent or weak activity. It also involves redistribution and financial inclusion initiatives, in which certain sectors or income or occupational categories are the beneficiaries.

India's markets are significantly underdeveloped. As an example, the bond market and the currency market are characterized by illiquidity and failures of market efficiency. The lack of a long-term bond market hampers corporate financial planning in the field of infrastructure investment, for instance. The effectiveness of monetary policy is limited as small changes in the policy rate (made by the central bank) do not impact a large number of economic agents, as they do in a more developed financial system. This has contributed to a sustained failure to achieve low and stable inflation. While dramatic progress was obtained in the last twenty years on the equity market, commensurate progress has not been obtained on the bond and currency markets. In the last decade, there has been a substantial shift in the trading of interest rate and currency derivatives to overseas locations such as London, Dubai, and Singapore.

The development of these missing markets requires information gathering and analysis on the scale of the full financial system, rather than within one sector at a time. Interregulatory coordination is necessary to achieve this aim.

Prominent and well-known initiatives in the area of interventions that foster financial inclusion include restrictions on branch licensing (to force banks to establish branches in rural areas) and priority sector lending. However, the full landscape involves a large number of lesser-known initiatives. As an example, the Reserve Bank of India has subsidized the installation of cash machines or point-of-sale terminals in northeastern states as it believes this will improve the welfare of residents of these states. The logic of these initiatives is questionable, and no cost-benefit analysis has been done.

From the perspective of drafting laws, these issues pose difficult puzzles of public administration. For one, a regulation that forces banks to give more

loans to a certain target group imposes a cost—a tax—on other recipients of loans as well as on depositors and shareholders. When the power to impose costs on certain individuals in society is given to unelected officials that head government agencies, this raises fundamental questions of democracy and political system design.

Another problem is achieving accountability. There is considerable global knowledge and experience in constructing financial regulators that are held accountable for delivering consumer protection and micro-prudential regulation. If market development or redistributive objectives are also given to regulators, then there would be a considerable loss of accountability as many actions that damage financial regulation can be justified as part of the pursuit of political objectives. For instance, an agency can explain away failures in the core activities of financial regulation—consumer protection and micro-prudential regulation—on the grounds that developmental objectives were being pursued. It may be possible to quickly increase the number of households that buy insurance, which is a developmental objective, by reducing the regulatory burden of consumer protection in insurance.

Reflecting these tensions, on a global scale, no financial regulatory agencies have been tasked with development or redistributive functions. When redistributive functions are performed by a financial regulatory agency, it induces economic inefficiency in two ways.

First, taxing a narrow set of consumers to redistribute gains to others is an inefficient form of taxation. It would be more efficient for a society to raise resources from more broad-based taxes that impose lower deadweight costs, such as the income tax, the value-added tax, and the property tax. Second, even if subsidizing a particular group were the political goal, the government has a more comprehensive view of the group's needs, and a fuller array of instruments, than a financial regulator does. Financial regulators are limited to a narrow set of interventions, and their efforts have less impact per unit rupee spent. As a result of these two problems, tax-and-transfer schemes within any one sector are inefficient in terms of both taxation and transfer.

If greater financial inclusion were a political objective, one important instrument that could be used is on-budget subsidies. A subsidy could be paid by the government to banks that open an account for a household that has none. Such a policy might produce greater returns than the inclusion strategies available at a financial regulator, such as forcing banks to open rural branches or restricting entry of new banks to those that will have more rural branches. However, a regulator is unable to evaluate instruments such as on-budget subsidies and cannot make sound choices about the strategy to achieve greater financial inclusion.

When the power to impose costs on certain individuals in society is given to unelected officials that head government agencies, this raises fundamental questions of democracy and political system design.

Redistribution and development are legitimate political goals that should be pursued by the government, not independent financial regulatory organizations. Regulation-making functions related to development should be delegated to the fiscal authority, while financial regulators should verify compliance, that is, perform the supervisory function.

Certain technical developmental functions can be performed by financial regulators, given their substantial knowledge of the field. These include building market infrastructure or forcing markets to shift away from problematic mechanisms (such as over-the-counter derivatives) toward better alternatives such as electronic exchanges.

From this perspective, the IFC envisages the following arrangement:

1. An objective of financial regulatory agencies will be market development, but this objective will be a lower priority than the prime functions of consumer protection and micro-prudential regulation.
2. The Ministry of Finance would have the power to enact regulations for market-development schemes or for redistribution.
3. When such regulations are issued by the Ministry of Finance, they would have to utilize the full IFC regulation-making process. In addition, the ministry would be obliged to capture data, release data into the public domain, and evaluate the costs and benefits of each scheme every three years. Each regulation would expire after three years and would then go through the full regulation-making process again.
4. Financial regulatory agencies would enforce the regulations issued by the Ministry of Finance.

In addition to this, financial regulatory agencies could undertake development initiatives for building market infrastructure and strengthening market processes.

Contracts, Trading, and Market Abuse

Another component of financial law is the set of adaptations of conventional commercial law to questions of contracting and property rights that is required in fields such as securities and insurance.

Securities markets require legal foundations for the issuance and trading of securities. At the time of issue, investors must have adequate information to make an informed decision about valuation. Once trading commences, a continuous flow of information must be provided to investors to keep them informed. Finally, all holders of a given class of securities must obtain the identical payoffs. These three objectives are achieved through regulations.

Financial markets feature an important role for so-called infrastructure institutions that, to a substantial extent, develop rules governing the design of financial markets. The draft IFC constrains the behavior of these organizations by requiring them to issue bylaws and abide by them. The IFC also defines the objectives those bylaws must pursue, and the infrastructure institutions must obtain approval from the regulator for bylaws.

The IFC has provisions that require infrastructure institutions to disseminate information about prices and liquidity. The falsification of this information is termed market abuse. The IFC defines market abuse and establishes the framework for identifying and punishing persons who engage in it.

A New Agency Landscape

The division of the overall work of financial regulation across a set of regulatory agencies is also a focus of the IFC. Many structures can be envisioned for financial regulatory architecture. Parliament evaluates these various regulatory architectures and hands out the work associated with laws to a suitable group of statutory agencies.

At present, Indian law features close connections between a particular agency (for example, the Securities and Exchange Board of India) and the work that it does (in this case, securities regulation). The IFC does away with such integration because changes in work allocation should not require changes to the underlying laws. Under the IFC, from the outset, and over coming decades, decisions about the legal framework governing financial matters would be kept separate from decisions about financial regulatory architecture. This would yield greater legal certainty, while facilitating rational choices about financial regulatory architecture that are motivated by considerations about public administration and public economics.

Work is currently allocated in India between the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority, the Pension Fund Regulatory and Development Authority, and the Forward Markets Commission. But the allocation was never deliberately designed. It evolved over the years through a sequence of piecemeal decisions that responded to immediate pressures.

The current arrangement includes gaps where no regulator is in charge. The diverse Ponzi schemes, for instance, are not regulated by existing agencies. Moreover, overlaps in work allocation and conflicts between laws have consumed the energy of top economic policymakers, and poorly defined allocation of responsibilities has generated regulatory turf battles.

Going forward, these problems will be exacerbated through technological and financial innovation. Financial firms will harness innovation to conduct activities in unregulated areas. And when there are overlaps, financial firms

will forum-shop, searching for the most lenient regulator and portraying their activities as taking place within the favored jurisdiction.

At present, many activities that naturally sit together in one financial firm are forcibly spread across multiple financial firms to suit the contours of the Indian financial regulatory architecture. The financial regulatory architecture should be conducive to greater economies of scale and scope in financial firms. In addition, when the true activities of a financial firm are split up across many entities, each of which is overseen by a different supervisor, no one supervisor has a full picture of the risks that are present.

When a regulator focuses on one sector, certain unique problems of public administration tend to arise. Assisted by the lobbying of financial firms, the regulator tends to share the aspirations of the regulated financial firms. These objectives often conflict with the core economic goals of financial regulation such as consumer protection, safety and soundness, and swift resolution. Having multiple sectoral regulators that construct “silos” leads to economic inefficiency.

The IFC's take on financial regulatory architecture stems from a number of considerations. The IFC seeks to ensure accountability, which is best achieved when an agency has a clear purpose and clear jurisdiction. It also seeks to avoid conflicts of interest by constructing regulatory architecture that minimizes such conflicts. Political objectives are best pursued by the Ministry of Finance. Only technical objectives can be contracted out to independent regulators that can then be held accountable for objectively defined outcomes; an independent agency cannot be expected to pursue the political objectives of the administration.

The financial regulatory architecture should also enable a comprehensive view of complex multiproduct firms and a full understanding of the risks that they take.

Another consideration is that in India, there is a paucity of talent and area-specific expertise in government, and constructing a large number of agencies is relatively difficult from a staffing perspective. Placing functions that require correlated skills into a single agency is more efficient.

Finally, the IFC also considers transition issues, breaking up the overall change desired into a set of small and implementable measures.

Based on these considerations, the IFC envisages a financial regulatory architecture made up of seven agencies.

First, the Reserve Bank of India will continue to exist, but its functions will be slightly modified. It will conduct monetary policy, regulate and supervise banking by enforcing the proposed consumer protection and micro-prudential laws, and regulate and supervise payment systems by enforcing these two laws.

Second, the existing Securities and Exchange Board of India, Insurance Regulatory and Development Authority, Pension Fund Regulatory and Development Authority, and Forward Markets Commission will be merged into a new Unified Financial Agency, which will implement the consumer protection and micro-prudential laws for the entire financial system except

banking and payments. This would yield benefits in terms of economies of scope and scale in the financial system; it would reduce the identification of a regulatory agency with a particular sector; and it would help address the difficulties of finding appropriate talent in government agencies.

The Unified Financial Agency would take over the work on organized financial trading that is currently conducted by the Reserve Bank of India. It would thus unify all organized financial trading, including in equities, government bonds, currencies, commodity futures, and corporate bonds. The unification of regulation and supervision of financial firms—such as mutual funds providers, insurance companies, and a diverse array of firms that are not banks or payment providers—would yield consistent treatment in consumer protection and micro-prudential regulation across the range of organizations.

Third, the existing Securities Appellate Tribunal will be subsumed into the Financial Sector Appellate Tribunal. This entity will hear appeals of regulatory actions of the Reserve Bank of India, appeals of Unified Financial Agency actions, appeals of Financial Redress Agency actions, and appeals of some elements of the work of the resolution corporation.

Fourth, the existing Deposit Insurance and Credit Guarantee Corporation will become part of the resolution corporation.

Fifth, the new Financial Redress Agency will provide consumers a single venue to lodge complaints against all financial firms.

Sixth, a new Public Debt Management Agency will be the government's investment banker and cash manager.

And seventh, the existing Financial Stability and Development Council will persist with its functions and statutory framework modified. It will become a statutory agency with different responsibilities in the fields of systemic risk and development.

This proposed financial regulatory architecture is a modest change from present practice that will serve India well in coming years.

From Ideas to Action

The draft Indian Financial Code is currently being debated in the public domain. If the political leadership supports the draft, the law may be enacted by the new parliament created after the elections of May 2014.

In the meantime, regulators have chosen to voluntarily adopt principles contained in the IFC, such as those related to the rule of law, accountability, improved regulation-making processes, and improved consumer protection regulations. The Ministry of Finance has released a guidance handbook on actions that will be taken by all existing agencies to enhance governance, drawing on ideas from the IFC that are compatible with existing laws.

In addition, the government is likely to embark on the process of building institutional capacity by setting up the bodies that have to be initiated

from scratch and so need longer transition periods. The government should also undertake widespread consultations on the draft law and present the law for a vote in parliament.

Building state capacity to implement the changes proposed by the Financial Sector Legislative Reforms Commission is going to be a huge challenge. Not only will it require new institutions to be set up, but it will also require a change in the way regulators and the government function and interact with firms and consumers. This will necessitate large-scale training of the staff of the regulatory agencies as well as of the Ministry of Finance. The judiciary will be faced with the challenge of learning and interpreting the new law. This body of jurisprudence will continually interpret the IFC in a dynamic environment with changing products and processes.

The full adoption of the draft IFC will have a profound impact on India, contributing to a financial system that allocates resources well, achieves higher growth, and reduces risk. This is an important milestone in the development of state capacity in India.

Carnegie Endowment for International Peace

The **Carnegie Endowment for International Peace** is a unique global network of policy research centers in Russia, China, Europe, the Middle East, and the United States. Our mission, dating back more than a century, is to advance the cause of peace through analysis and development of fresh policy ideas and direct engagement and collaboration with decisionmakers in government, business, and civil society. Working together, our centers bring the inestimable benefit of multiple national viewpoints to bilateral, regional, and global issues.

The **Carnegie South Asia Program** informs policy debates relating to the region's security, economy, and political development. From the war in Afghanistan to Pakistan's internal dynamics to U.S. engagement with India, the Program's renowned team of experts offer in-depth analysis derived from their unique access to the people and places defining South Asia's most critical challenges.

BEIJING

BEIRUT

BRUSSELS

MOSCOW

WASHINGTON

THE GLOBAL THINK TANK



CARNEGIE
ENDOWMENT FOR
INTERNATIONAL PEACE

CarnegieEndowment.org