LAW, FINANCE, AND POLITICS: THE CASE OF INDIA

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Abstract
The process of liberalisation of India's economy since 1991 has brought with it considerable development both of its financial markets and the legal institutions which support these. An influential body of recent economic work asserts that a country's 'legal origin'—as a civilian or common law jurisdiction—plays an important part in determining the development of its investor protection regulations, and consequently its financial development. An alternative theory claims that the determinants of investor protection are political, rather than legal. We use the case of India to test these theories. We find little support for the idea that India's legal heritage as a common law country has been influential in speeding the path of regulatory reforms and financial development. There is a complementarity between (i) India's relative success in services and software, (ii) the relative strength of its financial markets for outside equity, as opposed to outside debt, and (iii) the relative success of stock market regulation, as opposed to reforms of creditor rights. We conclude that political explanations have more traction in explaining the case of India than do theories based on 'legal origins'.

Keywords: India, Law and Finance, Investor Protection, Economic structure and financial structure

JEL Codes: G28, G38, K22, K40, O16, P37

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1. Introduction

A growing literature emphasises the importance of legal institutions for economic development. Two significant claims within this tradition are as follows. First, that ‘law matters’ for firms’ access to finance: that is, the quality of a country’s legal protection of investors affects the ability of its firms to raise outside finance. Secondly, that a country’s ‘legal origin’ significantly affects the evolution of its legal rules. That is, ‘common law’ legal institutions are thought both to exhibit a greater degree of adaptability than ‘civil law’ systems, through relying more on ‘bottom up’ rule-making by the judiciary, as opposed to ‘top-down’ codifications, and to be less susceptible to corrosion by rent-seeking politicians and bureaucrats, owing to the greater constitutional independence of their judiciary. This paper uses the case of India, one of the world’s most significant developing economies, as a case study for exploring the applicability of these theories.

The Indian economy liberalised dramatically in 1991. Since then, there have been rapid and far-reaching law reforms intended to ensure that legal institutions keep pace with the needs of the growing economy. To shed light on the mechanisms by which these legal changes were brought about, and their relationship with the needs of investors, we conducted interviews with a range of Indian lawyers, policymakers, regulators, judges, businesspeople and investors. We focus our enquiries on changes to the legal protection of outside investors: that is, shareholders and creditors. These yield interesting findings both as regards the modalities of legal change and its relationship with development.

As regards the modalities of law reform, the most effective institutions for producing improved legal rules have been regulatory agencies to which rule-making power for specific sectors have been delegated: for example, the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI). In contrast, statutory changes have been slower to implement: the nature of coalition politics in India, coupled with very activist judicial review, means that legislation is a slow and erratic process. Moreover, the Indian judiciary has not played a significant role in ‘adapting’ the substantive law to the changed needs of an open economy. Very long delays in Indian civil procedure mean that courts have simply been too slow to play a significant role in updating law. This strongly contradicts the ‘legal origins’ claim, at least as regards India.

There appears to be a correlation between effective legal protection of investors in India and the development of markets for outside finance in India. Thus the laws protecting equity investors have been dramatically improved, and equity markets are flourishing; much less has been achieved in the way of legal protection for creditors and markets for arms-length debt finance—that is, corporate bonds—are practically non-existent. In turn, this complements sectoral trends in the pattern of Indian development: those sectors for which equity finance is more complementary (e.g. 'new economy' sectors such as software, pharmaceuticals and high-tech manufacturing) have been highly successful, whereas 'old economy' sectors, such as heavy manufacturing, traditionally more reliant on debt finance, have seen rather more limited growth. This implies a link between the quality of legal institutions and the real economy. However, we find little evidence that these sectoral differences in economic development have been caused by differences in the quality of legal protection of investors. Rather, both appear to have been influenced by the legacy of political choices taken during the era of central planning. In industries that were subject to planning, the dominant interest groups lobby for redistributive rules to maintain their protected status. By contrast, in sectors that were never subject to central planning, the dominant interest groups seek rules that allow markets to function more effectively. In short, the quality of investor protection and sectoral development have both co-evolved on paths that have been to a large degree determined by past political choices. This in turn contradicts the 'law matters' claim, as applied to India.

The rest of this paper is structured as follows. Section 2 gives a brief review of the principal claims in the 'law and finance' literature. Section 3 is a snapshot of the distinctive complementarities between India's industrial structure, financing patterns, and legal institutions protecting investors. In Section 4, we explore whether, and to what extent, this pattern is a function of India's common law legal heritage, focusing in particular on the role of the judiciary and judge-made law. Section 5 then turns to the role of politics in India's legal and financial development. Section 6 concludes.

2.The role of law in financial development: a review

Economists have recently become interested in the links between institutions—that is, the formal and informal rules that effectively constrain agents' actions—and growth. This programme began with the pioneering work of North (1990). By the late 1990s, systematic comparative research into micro-level institutions, such as the quality of corporate and financial laws, had begun, in the pioneering and highly influential work of La Porta, Lopez-de-Silanes, Shleifer and Vishny (La Porta et al., 1997, 1998, 2006, 2008; Djankov et al., 2002, 2003, 2007, 2008; Glaeser and Shleifer, 2002, 2003; Botero et al., 2004).[1] The 'law and finance' analysis is based on an empirical and theoretical evaluation of different legal systems, and has been conducted at two discrete levels of generality. The first claim, which may be termed 'quality of law', is that the greater the protection afforded to investors (that is, minority shareholders and creditors) by a country's legal system, the more external financing firms in that jurisdiction will be able to obtain. La Porta *et al* (1997) constructed indices for a range of different aspects of the law relating to business organisation.[2] However, many of the regressions rely on cross-sectional data, creating difficulties over the interpretation of causation. Whilst 'good quality' legal rules could enhance investment, it is also plausible that financial structure influences the creation of legal norms (Cheffins, 2001; Coffee, 2001).[3]

A second claim, which may be referred to as 'legal origin', is a response to the causality issue. This asserts that the quality of legal institutions varies systematically with the 'origin' of a country's legal system—whether it falls into the Anglo-American 'common law', or Napoleonic, German or Scandinavian 'civil law' systems. This idea emerges empirically from significant correlations between legal origins and the quality of law scores. As legal origin is, for most countries in the world, exogenous—deriving from whichever of the western powers colonized the country in question—LLSV argue that this supports the view that law drives financial development, rather than *vice versa* (La Porta *et al*, 2006).

The legal origins claim has in turn been criticised on the basis that the practical application of the fourfold classification that forms the explanatory variable—namely, into common law and French, German, and Nordic civil law systems—is fraught with difficulties. Whilst one may clearly distinguish the legal systems of the 'mother countries'—England, France, and Germany—the appropriate characterisation of most of the countries included in the regression studies—that is, the legal systems of countries in Eastern Europe, Asia, Africa and Latin America—is anything but clear (Pistor *et al*, 2003; Dam, 2006; Siems, 2007).

To be sure, the classification by legal origins is really no more than a proxy for underlying differences. In order to avoid problems of classification, therefore, it would be better to seek to code these differences directly. This, however, begs the question as to the nature of the particular mechanisms by which legal institutions are thought to influence the content of legal rules. One hypothesis (the 'adaptability' claim) concerns the way in which new rules are produced (Beck et al, 2003a; 2003b). Civilian systems are characterised by wide-ranging codification of legal rules, whereas common law systems are distinguished by their reliance on incremental change through the accumulation of judicial precedent. It may be that this ability to shape the law on a case-by-case basis helps to render legal regulation more adaptable to changed circumstances. In contrast, civilian legal systems may suffer from excessive rigidity, as changes may only be made infrequently through legislation. Associated with this is a difference in 'regulatory style' (Botero *et al*, 2004): common law systems favour market solutions—contract and private litigation—over 'top down' regulation and enforcement through government agencies in civilian systems.

A second hypothesis (the 'political' claim) posits that judges in common law systems have greater power (as lawmakers) and independence from the other branches of government, and consequently may be expected to do a better job in protecting private property rights from encroachment by the state (Hayek, 1978; Mahoney, 2001; Dam, 2006). In contrast in civilian jurisdictions, the legislature has greater control over legal institutions, including judicial appointment, selection and tenure, which means that the judiciary are less able to protect individual property rights against rent-seeking by the state. This focuses on the protection of investors' property rights, and the ability of a state or system to commit credibly to do this over time.

Both of these claims have been criticised as being based upon overly reductionist characterisations of the difference between civil and common law systems. On the one hand, it is clear that judges *do* make law in civilian systems (Mattei, 1997; Pistor and Xu, 2003); on the other hand, commercial and corporate laws are subject to a relatively high degree of codification in common law systems (Funken, 2003; Armour, 2008). What is more, if the legal origins claim is accurate, it implies the existence of extremely strong path dependencies, which must have crystallised at around the time a country's legal origin was determined—for most developing countries, at around the time of their colonisation by England or France—and never have been susceptible to change since. However, it is unclear why the legal system should produce such strong lock-in effects.

Alternative, 'political' explanations assert that the structure of corporate and commercial law is better explained by political economy than by legal origins (Roe, 2003; Gourevich and Shinn, 2005). In relation to developed nations, Roe (2003) argues that social democratic governments enact laws favouring labour. Strong labour groups prompt concentrated share ownership as a means ensuring shareholders are able to coordinate in bargaining with employees over corporate rents. However to date, less work has been done in this vein in relation to developing countries, save to show that political instability is negatively associated with economic development (Roe and Siegel, 2007).

A related claim discerns a link between economic and financial structure (Hall and Soskice, 2001; Carlin and Mayer, 2002). Certain forms of financial contract complement more effectively particular types of industry: debt is suited to manufacturing, where there are hard assets to pledge as collateral; whereas equity is more appropriate for high-growth sectors where assets are less tangible. Allen *et al* (2006a) present results from cross-country regressions indicating that bank (debt) finance is more prevalent in countries dominated by physical-asset intensive industries. This literature might readily be linked with the 'political' account canvassed above, in that dominant industrial structures are likely to be reflected in powerful interest groups who may be expected to influence the course of law reform. Industrial structure, therefore, may be expected to be an input to law reform.

The foregoing survey of the literature leaves many questions unanswered. Case study research, which is particularly useful for identifying mechanisms, may be able to shed some light upon these. India, a developing country with a common law system, approximately one-sixth of the world's population,[4] and one of the world's fastest-growing economies,[5] is undoubtedly a significant case to understand. In the rest of this paper, we explore the way in which its recent spurt of economic development has been linked to legal and political institutions. In particular, we focus on whether (i) 'adaptable' legal rules framed by the judiciary and/or (ii) a politically independent judiciary have assisted economic development; and (iii) the extent to which, if at all, the current configuration of Indian corporate governance is a consequence of its political and economic, as opposed to legal, history.

3. The Indian pattern of corporate governance and finance

In this section, we give an overview of India's current pattern of corporate governance and finance. We then explore how this is related to its corporate and bankruptcy laws.

3.1 The pattern of India's industrial development

India is, compared to similarly-situated developing countries, said to be relatively weak in labour-intensive manufacturing, strong in skill-intensive manufacturing, and strong in services and high-tech sectors (Topalova, 2004;

Kochhar et al, 2006). To a large extent, this flows from policies adopted during the socialist era of central planning, following independence in 1947 until the early 1980s. In particular, planners pursued policies seeking (i) to develop self-sufficiency through import substitution and restrictions on capital flows; (ii) to channel scarce domestic capital into large-scale, capital-intensive 'national champion' firms; (iii) to deter the formation of large-scale private sector firms--which might compete for such capital--by discriminating in favour of small-scale private enterprise; and (iv) to foster the development of home-grown human capital through investment in education. Under this regime, manufacturing firms were subject to a plethora of regulatory controls over their operations which were nicknamed the 'licence Raj' on account of their similarity to the arbitrary power formerly wielded by the British.

Kochhar et al (2006) argue that this distinctive policy mix resulted in a relative underdevelopment of private sector large-scale manufacturing industry in India by the early 1980s, and a comparatively high degree of specialisation in private-sector services, which required less capital investment. As the manufacturing sector struggled to develop, the heavy state investments in tertiary education had produced by the 1980s many more qualified engineers than there were jobs (Athreye, 2005). At the same time, however, services and software firms were starting to grow rapidly. The licence Raj extended only to firms manufacturing tangible assets, leaving services firms and software manufacturers outside its ambit (Khanna and Papelu, 2005; Athreye, 2005) and giving them greater freedom to innovate. When constraints on the private sector were relaxed from the early 1990s onwards, there were therefore relatively many highly-skilled workers and an emerging specialisation in services. Seemingly as a result, India's subsequent pattern of development has seen dramatic growth fuelled by the services sector and skill-intensive manufacturing, whilst the country still remains relatively under-developed—as compared with other countries at a similar stage of development—in terms of labour-intensive manufacturing.

3.2 The structure of India's financial markets

The availability of outside finance is particularly important from the point of view of growth. If external finance is unavailable, firms are forced to rely on internal funds. Yet firms which are new entrants to global markets will struggle to generate the profits necessary to fund projects from retained earnings (Shirai, 2004). Thus constraints on outside finance may retard growth. The role of institutions which support and facilitate the provision of outside finance is therefore particularly salient. By developed country standards, Indian firms tend to be highly reliant on retained earnings and informal networks of family and friends as sources of finance, implying that there are indeed limitations in the supply of external finance (Allen et al, 2006b). Yet as we shall see, relative to similarly situated *developing* countries, India's equity markets are highly developed. As regards debt finance, overall private lending is slightly below the level in comparable developing countries, and markets for publicly-traded corporate debt (bonds) are virtually non-existent..

Table 1 lists certain key indicators for stock markets in various countries around the world, both developed and developing. As can be seen, India has an extraordinarily high number of listed companies—second only to the US. However, their average market capitalisation is relatively small. Moreover, the 'depth' of India's equity markets—as measured by the ratio of market capitalisation to GDP--is higher than that for comparable developing countries such as China, or indeed for many developed countries, including Germany.

Table 1: Selected stock market indicators, 2005

	US	**UK**	**Japan**	**Germany**	**Singapore**	**Hong Kong**	**China**	**India**
Listed companies	5,143	2,759	3,279	648	557	1,126	1,387	4,763
Market capitalisation ($bn)	16,998	3,058	4,737	1,221	208	1,006	781	553
Market capitalisation ratio (%)	139.7	151.9	100.0	48.2	198.4	548.3	40.3	82.2
Turnover ($bn)	21,510	4,167	4,997	1,763	120	460	586	443
Turnover ratio (%)	129.1	141.9	118.8	146.0	63.1	49.3	82.5	94.2

Source: National Stock Exchange of India (2006).

Table 2 shows the rapid development of India's stock markets during the 1990s. It presents data on the evolution of equity market depth—as measured by the ratio of stock market capitalisation to GDP—for India as compared to high, middle and lower income countries around the world. As can be seen, India's equity markets were relatively thin at the start of the period, having only a slightly higher ratio than that for low income countries generally. However, there was rapid growth during the 1990s, with the result that by 2002, India's market capitalisation ratio exceeded that of middle income countries generally, where it has since remained.

Table 2: Market capitalisation ratio of world stock markets, 1990-2005

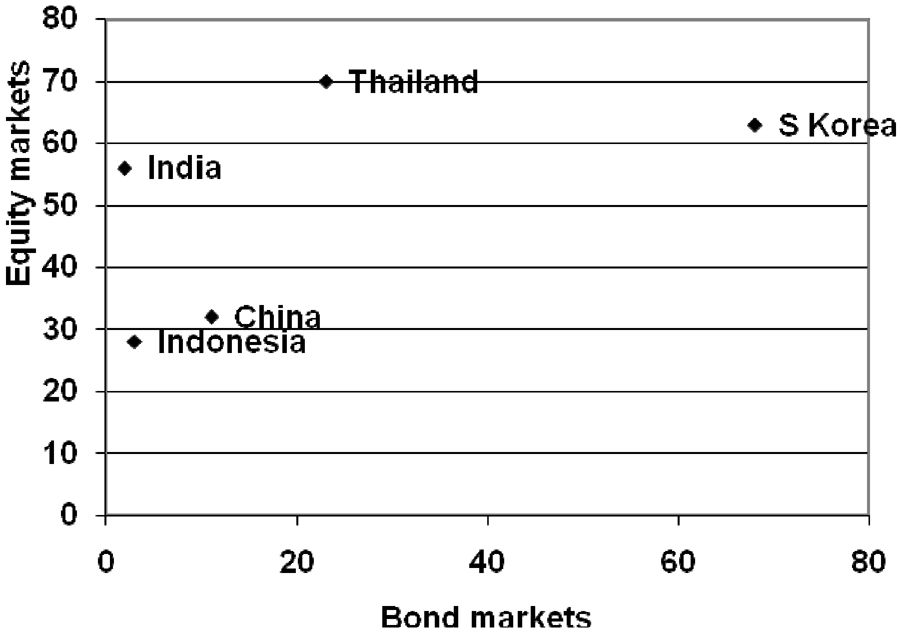
Markets	**Market capitalisation/ % GDP**					
	1990	**2000**	**2002**	**2003**	**2004**	**2005**
High income	51.6	120.6	83.4	100.1	108.9	112.9
Middle income	19.4	41.2	35.3	44.5	43.7	49.5
Low & Middle income	18.8	38.7	33.3	43.5	43.8	50.1
Low income	9.8	23.6	22.6	37.3	44.5	54.2
India	12.2	32.4	25.7	46.5	56.1	68.6
World	48.0	105.1	74.6	89.7	96.3	99.6

Source: World Bank, World Development Indicators (2006).

Figure 1 plots the relationship between outside equity and outside debt markets for selected Asian countries in 2004. It shows that whilst India's equity markets are comparable with the stronger economies in the region, its outside debt markets (that is, markets for corporate bonds) are considerably more shallow. Whilst external debt finance is generally underdeveloped in India, relative to comparable economies, India's bond markets are particularly weak (Farrell et al, 2006; Asuncion-Mund, 2007).[6]

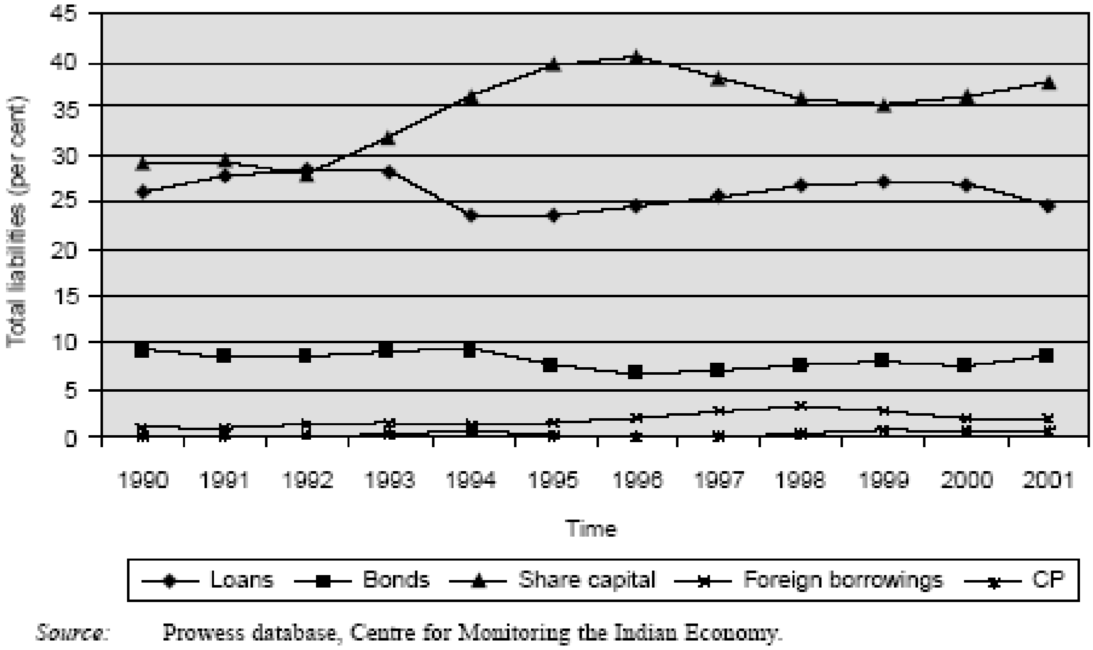
Aggregate debt-to-equity levels in India's corporate sector have decreased during the period since liberalisation, in line with the relative development of stock markets, as compared with markets for debt finance (Topalova, 2004). This trend is also evidenced in firm-level data. Figure 2 shows the liabilities (as indicated by historic cost measures on balance sheets) of Indian firms during the period 1990-2001. As can be seen, the proportion represented by equity funds have grown during this period, with a corresponding decline in that representing bank loans and bonds.[7]

Figure 1: Debt and Equity Market capitalisation (% GDP), 2004



Source: Farrell et al, 2006

Figure 2: Balance Sheet Liabilities of Indian Firms, 1990-2001



Source: Shirai (2004)

Similarly, as regards flow-of-funds measures, Table 3 indicates that Indian firms relied heavily on internal sources (retained earnings and current liabilities) when raising new finance during the 1990s and early 2000s (see Shirai, 2002; Allen et al, 2006). When external finance is raised, the principal sources were (in order): bank loans, outside equity, and bond issues. However, for smaller firms, whilst the external finance raised was relatively greater, less use was made of debt finance. Moreover, amongst smaller firms, those in the services sector rely less on debt finance (particularly bank finance) than do manufacturing firms. This greater reliance on equity finance is also pronounced for software firms (see Shirai, 2002; Love and Peria, 2004).

Table 3: Sources of New Funds for Non-Financial Indian Firms (% total funding, 1990-2004)

	All firms	Public sector firms	Private sector firms				
			Overall	Listed firms	Unlisted firms	Small scale firms	
						Manufacturing	Services
Retained earnings	36.3	42.0	33.1	35.0	28.8	6.4	12.5
Equity	13.3	8.5	16.1	15.7	16.6	29.2	27.7
Bonds	4.5	4.1	4.8	4.3	5.8	2.0	0.9
Banks/FIs	15.9	11.5	19.0	19.7	17.3	9.4	-8.7
Groups/Insiders/Directors	0.9	1.2	0.6	0.3	1.3	2.1	1.0
Liabilities & provisions	29.1	32.7	26.3	25.0	30.0	50.9	66.6

Source: Allen *et al* (2006b).

As might be expected, riskier firms—as proxied by age and size—appear to raise less outside finance than average (Shirai, 2002; Love and Peria, 2004). However, Shirai (2002) reports that the use of outside equity by riskier firms has increased significantly since 1990, indicating that developments in the stock markets have assisted such firms in raising finance. A similar pattern of development has not, however, been present in credit markets. Whilst banks have become more willing to extend credit, this appears to have been across the spectrum of borrower types (Shirai, 2002), with the result that access to credit by the more risky firms has not proportionately increased. Moreover, India's bond markets appear to be underdeveloped, with there being relatively few issues, most of which take the form of private placements (Asuncion-Mund, 2007).[8]

It is interesting to note that the relative strengths of India's financial markets complement the areas of comparative advantage in industry. Firms without tangible assets—such as the service industry firms in which India is specialising—do not have assets to offer as collateral, and so do not lend themselves to raising debt finance. Rather, equity is a more appropriate source of outside finance. India's peculiarly high level of corporate access to outside equity therefore complements the emphasis on tertiary industries.

This claim bears further elaboration. To be sure, the 'pecking order' theory of corporate finance suggests that debt is likely to be the outside financial contract of choice for entrepreneurs. This is because, unlike outside equity, debt does not involve an immediate allocation of control rights to outsiders, and the entrepreneur therefore remains in control of their firm. However, debt is not well suited to high-tech manufacturing or services firms, in which much of the value is likely to be tied up in growth opportunities (see Armour, 2003). Firms developing new technologies or client bases commonly do not generate steady cash flows that can be used to make interest payments, and lack liquid assets that could be used as collateral. Instead, the value (if any) of such a firm will inhere in the ideas and 'human capital' of the entrepreneur and opportunities for growth. This makes such firms unsuitable candidates for debt investment (Berger and Udell, 1998; Carpenter and Petersen, 2002). Rather, there is a strong complementarity between 'soft' assets and concentrated equity finance, in the form of venture capital. Empirical findings confirm that equity financing, and not debt, predominates in privately-held firms in technology-intensive industries (Freear and Wetzel, 1990; Carpenter and Petersen, 2002).

Much of the outside equity raised by high-tech firms in the US and UK is sourced from private equity funds—in the form of venture capital—rather than raised directly from stock markets. However, the success of venture capital markets is in turn thought to be associated with the existence of deep and liquid stock markets (Black and Gilson, 1998; Jeng and Wells, 2000). The intuition is that entrepreneurs are more willing to enter into a contract ceding control to an outside investor (private equity) if they have the 'carrot' of the possibility of their regaining (effective) control of the firm after an IPO. However, many Indian firms simply go direct to the capital markets, without going through a VC stage, as is evidenced by the extraordinarily high number of listed companies in India.

3.3 India’s legal system and investor protection laws

3.3.1 General background

Although India is described as a common law country, having inherited a common law legal system from the British, many of its laws were in fact codified during British rule.[9] This was then overlaid with further legislation when, in post-independence India, the government implemented a socialist reform agenda in encompassing all areas of commercial activity, including corporate finance.

Table 4 elaborates the principal legislation in the sphere of company law and investor protection prior to India’s liberalisation in 1991. Together, these measures established a tightly-controlled regime covering almost all aspects of corporate management, including the raising of outside finance. Controls on finance took effect both through the nationalisation of banks and controls on the raising of debt and equity finance on public markets, with additional restrictions on trading in secondary markets. Moreover, both the public-sector banks and the remaining privately-owned banks were required to lend at subsidised interest rates to ‘national champion’ industries.

In an environment in which banks are used as a means of channelling subsidies to firms favoured by central planning policies, debt does not impose a hard budget constraint on borrower firms. It is therefore not surprising that the pre-liberalisation environment lacked an effective means of enforcing debt contracts. For the recovery of unpaid debts, and even the enforcement of security interests, there were few options other than filing a suit before the courts. However, the very long delays typical in the Indian courts significantly undermined the legal protection of creditors.[10] Moreover, India’s corporate insolvency laws were also notoriously weak. On the one hand, the Companies Act 1956 contains no effective procedure for corporate restructuring allowing renegotiations whilst the firm continues to trade (see Batra, 2003). Coupling an inadequate substantive law with the delays associated with litigation in Indian courts resulted in winding-ups typically taking upwards of ten years to complete, with delays of over 50 years being not unheard-of (Goswami, 2002).

Table 4: Principal Components of the Regulatory Framework for Indian Corporations Prior to Liberalisation

Capital Issues Control Act 1947 ('CICA')	Established a legal regime requiring Government permission for issuing capital and regulating the price of new issues of equity by private companies (through the office of Controller of Capital Issues).
Companies Act 1956 ('CA 1956')	The main legislation governing the establishment, operation and management of companies. Confers a variety of powers on the central government (exercised through the Department of Companies Affairs via the Company Law Board or the Registrar of Companies) and the judicial system (the High Courts) to monitor and regulate companies.
Securities Contract (Regulation) Act 1956 ('SCRA')	Provides for control of virtually all aspects of securities trading, including the running of stock exchanges with an aim to prevent undesirable transactions in securities. Gives Central Government regulatory jurisdiction over stock exchanges through a process of recognition and continued supervision, contracts in securities, and listing of securities on stock exchanges. Stock exchanges can frame their own listing regulations within the consonance with minimum listing criteria set out in the rules.
Monopolies and Restrictive Trade Practices Act 1969 ('MRTP')	Enacted to prevent concentration of economic power in the hands of private companies; to provide for the control of monopolies and prohibit monopolistic and restrictive trade practices. Amongst other things, it has been said to be one of the main barriers preventing Indian (private) companies from realising economies of scale.
Foreign Exchange Regulation Act 1973 ('FERA')	A controversial law regulating dealings and transactions involving foreign exchange - any contravention amounted to a criminal offence, punishable with imprisonment and severe fines (up to 5x the amount involved), there was a presumption of criminal intent, and the statute contained no provision guaranteeing legal assistance to the accused. The Office of Directorate of Enforcement responsible for enforcement had wide powers for arresting, conducting search and seizure and prosecuting people under the act. There were several restrictions on dealing in foreign exchange, for instance, on drawal of foreign exchange for current account transactions and on transactions in foreign exchange on account of trade in goods and services.
Sick Industrial Companies Act 1985 ('SICA')	Enacted to protect financially distressed, or 'sick' companies. Imposes a moratorium on the payment of creditors and control of the company passes to an administrative agency, the BFIR. The focus of the regime is on preserving employment and it is widely perceived that failing firms are kept open unnecessarily long in order to avoid immediate job losses.

The Sick Industrial Companies Act (SICA) was enacted in 1985 to provide an improved means for the reconstruction and rehabilitation of distressed ('sick') firms.[11] Its innovation was to institute a general stay of creditors' claims, but at the same time to transfer control of a distressed firm not to the courts, but to a new administrative agency, the Board for Industrial Financial Reconstruction (BIFR). However, the BIFR seems to have performed little better than the courts, has itself generated considerable delay and expense, with relatively few successful recoveries of distressed firms.[12]

The liberalising New Economic Policy of 1991 lead to a dramatic reconfiguration of the economy. The motivating idea was to move from an economy controlled and planned by the state to one in which the private sector was to have a significant role, competition was to be encouraged, market-oriented mechanisms were to be developed and government intervention was to be limited to the extent justifiably required (Bhagwati 1993; Panagria 2004: 10). Widespread legal reforms were associated with this shift, including in the field of investor protection.[13] In the financial sector, the reforms were particularly wide-ranging in relation to equity markets. In contrast, reforms relating to creditor rights, insolvency and debt markets have been either delayed or insignificant.

The first significant aspect of the reforms has been the relaxation of the restrictive legislation that formed the legal basis for state control during the pre-liberalisation era. Thus, of the five pieces of legislation described in Table 4, one (CICA) was repealed outright, another (FERA) was entirely replaced by a more liberal statutory regime (the Foreign Exchange Management Act 1999 or 'FEMA'),[14] and three others (SCRA MRTP, and SICA)[15] have been amended with a view to reducing governmental control of the activities on the securities markets and increasing competition. Finally, whilst the Companies Act 1956 remains the primary legislation governing the establishment, operation and management of companies and also winding up or liquidation,[16] several changes have also been made to this Act, mostly with a view to relaxing government controls and giving more freedom to companies to manage their own affairs.[17]

3.3.2 Reforms relating to equity finance

Rapid and wide-ranging legislative efforts were made after liberalisation to foster the development of Indian securities markets (Shah and Thomas, 2001; Thomas, 2006). Principal amongst these was the replacement of central government control over stock exchanges with an SEC-style independent regulator, the Securities and Exchange Board of India ('SEBI'). With the repeal of the CICA in May 1992 and with it the abolition of requirement of Government permission for companies issuing capital and Government control over the pricing of new issues of equity, a market oriented independent entity to regulate the securities market was deemed necessary. SEBI had initially been established in 1988 as an advisory body; in 1992 the Securities and Exchange Board of India (SEBI) Act conferred statutory authority upon it as a unified securities regulator. Following SEBI's establishment as an independent statutory authority, the focus shifted to establishing a regulatory framework to ensure transparency of trading practices, speedy settlement procedures, enforcement of prudential norms and full disclosure for investor protection, rather than the prior emphasis Government intervention and control (Ahluwalia, 1995). Crucially, SEBI's constitutive statute gave it power to produce binding regulations, which power it has exercised in a number of fields, including disclosure requirements,[18] the introduction of corporate governance rules (the so-called "Clause 49" of the Listing Agreement),[19] a takeover law,[20] and the prohibition of insider trading.[21]

The establishment of SEBI was the single most influential event in the reforms of the securities market. It was soon followed by the establishment of a new securities exchange, the National Stock Exchange ('NSE') in 1992,[22] the first clearing corporation–National Securities Clearing Corporation Ltd ('NSCCL')—in 1995,[23] and an independent depository called National Securities Depository Limited ('NSDL') in 1996, following the passage of the Depositories Act in 1996.[24] These new and independent institutions provide the necessary modern infrastructure for the now fast-growing Indian stock markets. Moreover, the advent of competition between stock exchanges lead to the rapid adoption of a number of innovative technologies. For instance, the NSE introduced a nation-wide on-line fully-automated screen based trading system, and in its first year of operation became the leading stock exchange in the country.[25] The incumbent Bombay Stock Exchange ('BSE'), which had previously enjoyed a comfortable monopoly, was forced to follow suit shortly afterwards, resulting in the disappearance from India of the old open outcry trading system. The NSE has introduced a number of other technological innovations, which the BSE has subsequently adopted (Shah and Thomas, 1996, 1999).[26]

Another important development has been the increase in market participants. Following liberalisation, Indian stock markets have been opened to investment by foreign institutional investors ('FIIs'), Overseas Corporate Bodies ('OCBs') and non-resident Indians ('NRIs'), who have been allowed to invest extensively in Indian companies. Moreover, FIIs have been permitted to invest in all types of Indian securities–including Government securities—and enjoy full capital convertibility (Mohan, 2004).

3.3.3 Reforms relating to debt finance

On the other hand, reforms affecting the banking sector and creditor protection have achieved comparatively limited success. A range of banking sector reforms initiated in 1992 were designed to liberalise the sector, to increase the financial stability of banks, and to increase competition in the sector—which up to that point had been subject to a near-monopoly from the public sector (Khatkhate, 2002; Ahluwalia, 2002; Mohan 2004, 2006) To be sure, these reforms have resulted in some increase in market participants and associated competition from private and foreign banks now permitted to operate in India. However, it is still difficult to obtain permissions to start a bank; moreover it is necessary for both foreign and domestic banks to obtain permission from the Reserve Bank of India ('RBI') to open a branch, and a patchwork of rules persist that favour public sector and domestic banks over foreign entrants (Thomas, 2006). Nevertheless, the pre-liberalisation legal framework for credit agreements, which made it difficult for creditors to enforce their claims, and prioritised the interests of distressed companies over those of their creditors, has not changed with anything like the speed, or to the extent, that has occurred in relation to the legal institutions underpinning equity markets. (Ahluwalia, 2002).

The first step to improve the situation was the passage of the Recovery of Debts Due to Banks and Financial Institutions Act 1993 (the 'RDDB Act'). Pursuant to the RDDB Act, the Government could set up Debt Recovery Tribunals ('DRTs') for recovery of debts due to banks or financial institutions of not less than Rs1m. But the RDDB Act was subject to legal challenge on constitutional grounds, forcing the DRTs to cease activities.[27] Whilst an interim order of the Supreme Court allowed the DRTs to resume functions from March 1996, it was not until 2002 that the RDDB Act was finally approved in a form compatible with the Court's requirements. Whilst the Supreme Court of India has commented in a recent decision on the 'limited success' of the DRTs,[28] Visaria (2006) reports empirical findings that their introduction has been associated with a reduction in loan delinquency rates.

A second major legal reform relating to creditor rights was the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002 ('SARFAESI'). In a bid to bypass the delays associated with enforcement through Indian courts, this legislation empowered banks and financial institutions to enforce security interests extra-judicially.[29] In particular, such creditors are thereby permitted to seize and sell collateral without recourse to courts if a default is not remedied within 60 days. In a pattern that echoed the experience in relation to the RDDB Act, certain aspects of the extra-judicial enforcement regime introduced by SARFAESI were challenged on constitutional grounds.[30] After a judicial review by the Supreme Court, the Act's constitutional validity was generally upheld in 2004, save for certain parts that were accordingly amended in 2005.[31]

It appears that SARFAESI's grant to banks of a right of enforcement without court intervention has had a significant impact on lending practices. Anecdotal evidence suggests that, as might be expected, it has reduced the time involved in enforcing collateral and has strengthened the bargaining power of banks and FIs in negotiations over defaults (World Bank, 2007).[32] Moreover, Vig (2007) reports that SARFAESI's introduction is associated with a decrease in the average amount of collateral offered by firms. This is consistent with studies from developed countries that find stronger creditor rights to be associated with lower levels of collateralisation (Davydenko and Franks, 2008): inframarginal firms need offer less security, whereas at the margin additional borrowers are able to obtain access to secured credit.

SARFAESI also established a regime regulating the securitisation and reconstruction of financial assets.[33] This has given lenders and alternative exit route from distressed loans—sale to an investment entity specialising in distressed debt, as opposed to enforcement. In July 2005, the RBI authorised the sale or purchase of non-performing assets by banks and other financial institutions in return for cash consideration. From November 2005, it also paved way for foreign investment in such assets by allowing foreign direct investment to comprise up to 49% of the equity capital of asset reconstruction companies or securitisation companies set up to purchase non-performing loans from banks. These have enabled such companies to finance the acquisition distressed debt afford a clean exit to the sellers. According to our interviewees, this innovation has had a positive impact on the provision of debt finance in India, by freeing up bank capital for fresh loans.

Thus, with respect to the enforcement of bank debt and security interests, the RDDB Act and SARFAESI represent limited but positive steps forward. However, these statutory provisions apply only to debts due to banks and financial institutions, and are not available to ordinary creditors. Thus, an ordinary creditor wishing to enforce a debt has no option but to pursue the debtor before ordinary civil courts, with the associated long delays. The RDDB

Act and SARFAESI may therefore be expected to have had little or no impact on bond markets, where investors need not be banks or financial institutions.

Insolvency law is the aspect of creditor rights in relation to which least progress has been achieved to date: according to World Bank measures, Indian insolvency law continues to be amongst the least effective in the world (World Bank, 2007).[34] Following the recommendations of an expert committee,[35] the government passed the Companies (Second Amendment) Act, 2002 (the 'Second Amendment') which amongst others things sought to introduce new provisions to the Companies Act 1956 scheme pertaining to corporate reorganisation (Batra, 2003) Concomitantly, the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 was passed to repeal the SICA regime. Whilst the new provisions of the Second Amendment for reorganisation are modelled on the provisions of SICA, and the powers of the BIFR transferred to new tribunals called the National Company Law Tribunal ('NCLT'), the Second Amendment has made an effort to avoid the most obvious shortcomings of SICA. For instance, it does not contain the much abused statutory moratorium under SICA, the definition of 'sick'ness has been improved under the new provisions, and the NCLTs will be constituted of qualified people to preside over rehabilitation and liquidation matters. Yet it is doubtful whether the change is sufficiently significant for the Second Amendment to make a significant impact on corporate debt markets. Not only is the Second Amendment far from perfect (see Batra, 2003; World Bank, 2007), but a range of other legal rules--such as labour laws,[36] industrial relations, and even certain land laws,[37] also impede the restructuring or closure of distressed undertakings (see also Joshi and Little, 1996: 208-217).

The Second Amendment has also faced constitutional legal challenge. The Madras High Court ruled some of its provisions unconstitutional in 2004, and stayed the operation of the Amendment until suitable changes were made.[38] The central government filed a special leave petition to the Supreme Court against this decision. We were informed by the Ministry of Company Affairs that the Supreme Court has not given a judgment in the matter, as the Government has agreed to take the issues raised in the Madras High Court's decision into account and make appropriate amendments. Therefore, amendments to the Act are expected to be brought forth but in the meanwhile, the NCLT tribunals have not yet been established and neither has the SICA been repealed.

3.3.4 Summary

The restrictive legal regime imposed on companies during the central planning era has been deregulated following liberalisation, and new legal institutions have been introduced to facilitate the raising of corporate finance. However, India's pattern of legal reforms has, to date, been more successful as regards shareholders than as regards creditors. The early establishment of a new independent securities regulator, SEBI, with power to pass delegated legislation, has seen a rapid and responsive development of a regulatory regime for shareholder protection. In contrast, however, the reform strategy for creditor rights has depended largely upon primary legislation, which has seen lengthy delays owing first to the cross-currents of coalition politics, and then to constitutional challenges before the courts by affected interest groups.

3.4 Complementarities between law and finance

Three issues have been discussed in this section: the pattern of India's industrial development; the pattern of financing for Indian firms, and the development of legal institutions supporting external finance. It seems plausible to suggest that there are complementarities between the three patterns. Stronger legal institutions for equity investors are associated with, by comparison with similarly situated countries, relatively high levels of equity investment; this in turn complements a pattern of industrial development specialising in services, software and high-tech manufacturing, sectors naturally complemented by equity, rather than debt, finance. The identification of this configuration poses obvious questions about the links between legal institutions and industrial development. The difficulty with looking for direct links between the quality of investor protection laws, corporate financing patterns and the pattern of industrial specialisation is that there are likely to be significant feedback effects, with each factor being endogenous. Accepting this problem, the literature has sought to look for exogenous (possibly instrumental) variables. On the one hand, the 'legal origins' claim asserts that the civil or common law status of a country's legal system influences the quality of its laws and hence, development; on the other, a range of 'political' claims assert that the structure of government and configuration of interest groups are determinants of the quality of substantive legal rules. The next two sections explore the applicability of these theories, respectively, to the case of India.

4. What role did India's 'legal origin' play?

As discussed in section 2, the 'legal origins' view asserts that the historically-determined structure of a country's legal system—into one of the civil or common law 'legal origins'—is a determinant of the quality of micro-level legal institutions that facilitate corporate finance. Common law legal origins are thought to lead to superior legal institutions through two particular channels: first, the relative 'adaptability' of judge-made, as opposed to codified, private law; and secondly, the relative independence of common law judges from politics, resulting in a reduced tendency towards rent-seeking behaviour on their part. We now examine whether, and to what extent, India's status as a common law country affected matters through each of these two channels.

4.1.1 Judicial law-making and 'adaptability'

The 'adaptability' thesis, it will be recalled, asserts that common law systems derive a comparative advantage in innovating legal rules (to respond to changed environmental or technological circumstances) through the use of judge-made, as opposed to codified, laws. Judicial law-making results in an emergent, rather than a planned, system of rules, in which one aspect may change at a time without implications for the coherence of the body of rules as a whole. If this were an accurate account, we would expect to see rapid development of judicial rules following significant environmental or technological changes. Post-liberalisation India therefore makes a good test case, as the relaxation of government controls on finance from 1991 onwards created scope for significant financial innovation. However, as we shall see, judicial law-making had little or no part to play in this process in India.

The defining feature of the Indian court system is the staggering delays involved in resolving a case by trial, which typically would take up to 20 years (Debroy, 2000).[39] As of February 2007, there were over 41,000 cases pending before the Supreme Court,[40] and as of August 2006, nearly 4 million before all the High Courts, and approximately 25.5 million before all the District Courts.[41] Tables 5 and 6, respectively, give figures for pendency of cases before the various High Courts and District Courts.[42] With a backlog of this magnitude, it is simply not possible for India's judges, even if they are activist and willing to update the legal rules in response to changes in the real economy, to act as agents of legal change in a way that responds anything like quickly enough to keep up with the galloping pace of economic change.

Table 5 Pendency in High Courts updated on 7.8.2006

SI. No.	Name of the High Court	As on	Civil cases	Criminal cases	Total
1	Allahabad	30.6.06	584499	207651	792150
2	A.P.	30.6.06	216433	21239	237672
3	Bombay	31.5.06	320840	37191	358031
4	Calcutta	30.6.06	227485	37887	265372
5	Delhi	30.5.06	95589	30923	126512
6	Gujarat	31.12.05	100488	30897	131385
7	Gauhati	30.6.06	52418	6900	59318
8	H.P.	30.6.06	10934	5993	25027
9	Jammu & Kashmir	31.12.05	39529	2444	41973
10	Karnataka	30.6.06	77697	13732	91429
11	Kerala	30.6.06	101374	24677	126051
12	Madras	30.6.06	339157	31754	370911
13	M.P.	31.12.05	130259	55759	186018
14	Orissa	30.6.06	193186	17254	210440
15	Patna	31.12.05	66549	25033	91582
16	Punjab & Haryana	31.12.05	201151	42320	243471
17	Rajasthan	31.12.05	158318	47867	206185
18	Sikkim	30.6.06	47	11	58
19	Uttaranchal	30.6.06	31518	7422	38940
20	Chattisgarh	30.6.06	52355	24038	76393
21	Jharkhand	30.6.06	47066	231032	278098
	Total		**3054992**	**902024**	**3957016**

Source: Indian Ministry of Home Affairs, Department of Justice, available at http://mha.nic.in/rtijustice1.pdf

Table 6: Pendency in the District Courts, as of 7.8.2006

SI. No.	Name of States/UTs.	As on	Civil cases	Criminal Cases	Total pendency
1	Andhra Pradesh	30.6.06	501335	474843	976178
2	Arunachal Pradesh	31.12.05	847	6410	7257
3	Assam	31.12.05	49633	141195	190828
4	Bihar	30.6.05	230159	1047533	1277692
5	Chhartisgarh	30.6.05	49557	210045	259602
6	Goa	31.12.05	20644	13671	34315
7	Gujarat	30.6.06	783662	3152284	3935946
8	Haryana	31.12.05	202525	304323	506848
9	H.P.	31.12.05	64336	113080	177416
10	J & K	31.12.04	48132	83812	131944
11	Jharkhand	30.6.05	52709	243316	296025
12	Karnataka	30.6.06	569322	516736	1086058
13	Kerala	30.6.06	420549	506746	927295
14	M.P.	31.12.05	194240	758738	952978
15	Maharashtra	31.12.05	748760	2579121	3327881
16	Manipur	31.12.05	3304	1812	5116
17	Meghalaya	31.12.05	4193	6979	11172
18	Mizoram	30.6.05	1935	5952	7887
19	Nagaland	31.12.05	1018	3076	4094
20	Orissa	30.6.05	180632	799404	980036
21	Punjab	31.12.05	247927	312529	560456
22	Rajasthan	31.12.05	293220	757154	1050374
23	Sikkim	30.6.06	187	437	624
24	Tamil Nadu	30.6.06	438488	436450	874938
25	Tripura	31.12.05	6983	25899	32882
26	Uttah Pradesh	31.12.05	1188440	3552101	4740541
27	Uttaranchal	31.12.05	26222	99634	125856
28	West Bengal	31.12.05	512947	1428280	1941227
29	A & N Island	31.12.05	1291	46385	47676
30	Chandigarh	31.12.05	20472	59522	79994
31	D & N Haveli	30.6.04	550	2457	3007
32	Daman & Diu	30.6.04	752	860	1612
33	Delhi	30.6.06	140462	788064	928526
34	Lakshadweep	30.6.04	75	45	120
35	Pondicherry	30.6.06	12827	7698	20525
	Total		**7018335**	**18486591**	**25504926**

Source: Indian Ministry of Home Affairs, Department of Justice, available at http://mha.nic.in/rtijustice1.pdf

Several factors contribute to these extraordinary figures (see Krishnan, 2003; Narayan, undated). First, India has relatively few judges per capita, as illustrated by Table 7. Although these figures date principally from the mid-1990s, there is no reason to believe that the picture has changed significantly. Not only are there relatively few judicial posts in India, but the posts which do exist often remain unoccupied (Debroy, 2000; Hazra and Micevska, 2004).

Table 7: International Variation in Judges per Capita

	Year	Judges	Judges per 100,000 capita
Common Law Countries			
USA	1998	28049	10.4
England & Wales	2001	3518	6.6
Canada	1991	1817	6.5
Malaysia	1990	274	1.6
India	1995	9564	1.0
Civil Law Countries			
Germany	1995	22134	27.1
Denmark	1997	653	12.4
France	1997	6287	10.7
Taiwan	1995	1252	5.7
S. Korea	1995	1212	2.7
Japan	1999	2949	2.3

Source: Galanter and Krishnan (2002).

Secondly, procedural laws in India--particularly with respect to civil litigation– facilitate delays and are often abused to frustrate genuine litigants. For instance, they readily allow 'interim applications', 'ad-interim applications' and adjournments, which readily permits a party wishing to prolong the proceedings to do so almost indefinitely (Debroy, 2000; Krishnan, 2003).[43] Furthermore, they create layers of rights to appeals and revision – another major cause of delay.[44] As one of our interviewees observed--'it's a defendant's court'. These procedural laws generate negative synergies with the fee structure of litigation lawyers, who are paid by appearance, and so have an incentive to prolong the duration of cases for as long as possible. Long delays and low settlement rates are the result.[45]

With a typical delay of 10 years or more until a lawsuit is resolved, it seems hardly likely that judicial innovation in lawmaking can have been the main channel through which India's substantive laws regarding investor protection were developed in the post-liberalisation era. This is not, of course, to say that no judicially-lead legal developments occurred; rather, it implies that those that did occur would have played, at best, a subsidiary role. One example where such innovation has occurred concerns the protection of minority shareholders under the Companies Act 1956. Under the 1956 Act minority shareholders are given statutory entitlements to protection against 'oppression',[46] and also against 'mismanagement', a very open-ended term.[47] Since the provisions were enacted in 1956, the Indian courts have developed a rich body of case law precedents interpreting and applying these provisions.[48] However, the timescale is much longer, and the changes much more incremental, than the developments that have occurred since 1991.

These findings challenge the notion that common law systems' alleged advantages in terms of adaptability give them an inherent advantage for economic development. Where courts are chronically overworked—as is likely to be the case in many developing countries—then it is hard to see that they can be motors of legal reform. In contrast, the most successful mechanism for producing new laws in India has been delegation to regulators with quasi-legislative power. Passing the mantle to technocratic committeeshas deflected political attention which would have been received had the rules been promulgated by primary legislation. The real engines for development of the legal framework of corporate finance in India have rather been specialist regulatory bodies such as SEBI, and, to a lesser extent, the Reserve Bank of India (RBI). This casts considerable doubt on the ideas underlining the adaptability hypothesis.

4.1.2 Political independence and the protection of property rights

We now turn to an alternative claim about the importance of 'legal origins', namely the 'political' thesis. This asserts that common law systems grant relatively greater political independence to their judiciary, who are thus better positioned than their civilian brethren to protect citizens' property rights from encroachment by the state.

There is some support in India's constitutional history for the idea that a politically independent judiciary can assist financial development. A politically independent judiciary, with the Supreme Court at its apex, has been a key feature of India's democracy throughout the 57 years of its existence.[49] The role of the Supreme Court as the protector of individual rights guaranteed under the Constitution of India as 'fundamental rights',[50] and its extensive powers of judicial review of legislative and executive actions, have been distinguishing features of the constitutional system in India. Indeed, scholars of constitutional law regard the Indian Supreme Court as having been exceptionally activist in responding to government intervention (see e.g., Allen, 2000).The judiciary--through the Supreme Court—did, during the era of central planning, play an important role in protecting individual property rights from encroachment by the state. The Constitution of India, as originally drafted following independence in 1947, provided for the protection of individual property as a fundamental right.[51] However, the newly independent government of India was keen to carry out drastic land reforms and redistribution of property in order to further social justice. This quickly led to tension between the government and the judiciary over the extent to which the legislature had power to engage in such redistribution of property rights.

The saga began with the 1951 case of *Kameshwar Singh v. State of Bihar*,[52] in which the Patna High Court held that legislation that provided for the abolition of an age-old hierarchical system of 'zamindari' rights was unconstitutional.[53] The legislature's response was to pre-empt the Supreme Court from considering the issue by introducing the First Amendment to the Constitution of India, which provided that certain laws listed in a new (and now notorious) Schedule IX to the Constitution were deemed to be beyond challenge on the ground of interference with fundamental rights.[54]

After the First Amendment, the next point of contest became the 'compensation' payable on the compulsory acquisition of property by the state for public purposes. In the case of *Bela Banerjee*,[55] the Supreme Court adopted a creative approach, reading the word 'compensation' appearing in what was then Art 31(2) of the Constitution as meaning compensation which was a 'just equivalent to the property acquired', even in the absence of adjectives like 'just' or 'adequate'. The legislature responded by amending the constitution again, this time to make the question of 'adequacy of compensation' non-justiciable.[56]

Despite this amendment and in reaction to other expansionary legislative amendments of 1964,[57] the Supreme Court nevertheless subsequently came up with further ingenious ways to protect private property from public takings. For instance, in *Vajravelu*,[58] the Court held that whilst the question of *adequacy* of compensation was not justiciable; if the law made *no* provision for compensation, or if the compensation was *illusory*, the Court could nevertheless declare the law invalid. Moreover, in the case of *Bank Nationalization* in 1969,[59] the Court declared the relevant law unconstitutional on the basis that it, 'failed to provide expropriated banks with compensation determined in accordance with the relevant principles provided by the law.'

This constitutional back-and-forth continued into the 1970s, with further constitutional amendment by the legislature being met by correspondingly expansive interpretation of the remaining provisions by the Supreme Court. An endgame appeared to have been reached during the Emergency period of 1975-77, which was the height of the arrogation of executive power. During this period the Court acceded to the government's wish to suspend the protection of fundamental constitutional rights. Furthermore, when the Emergency suspension of rights ended in 1978, the legislature comprehensively amended the constitution so as to remove entirely the 'right to property' from the category of fundamental rights.[60]

Although ultimately the legislature succeeded in putting the protection of property rights beyond justiciability, it seems clear that the independent and activist judiciary delayed this process for some time. Moreover, the Supreme Court became, if anything, even *more* activist in its interpretation of the Constitution of India following the end of the Emergency. It did so through a very liberal interpretation of its standing rules, The Court's innovation was to relax standing requirements so as to permit any citizen to bring a petition alleging that a piece of legislation is unconstitutional, or that the government is failing to protect the fundamental rights of citizens, regardless of whether the citizen has any personal interest in the outcome (Desai and Muralidhar, 2000; Jain, 2000; Messay, 2000; Datar, 2001; Thiruvengadam, 2006).[61] Actions of this type, where the plaintiff has no personal interest in the matter, came to be known as 'public interest litigation' ('PIL'). As might be expected, this engendered a great deal of litigation, and the extensive constitutional jurisprudence that has consequently been developed by the Court in response to PIL actions has led some to refer to the Indian Supreme Court as the 'most powerful court in the world' (Cunningham, 2003).

Thus it seems likely that the political independence of India's judiciary has played a meaningful role in protecting property rights in the years since independence. Despite the problems of backlog, the Supreme Court has been willing to go to great lengths to ensure that cases involving issues of expropriation or other violation of fundamental rights are heard. Yet whilst a powerful independent judiciary can clearly act as a constraint on rent-seeking legislative measures, this works as a double-edged sword—following liberalisation in 1991, strong judicial protection has acted as a brake on the rapid transformation of credit markets, owing to constitutional challenges to reforms to debt enforcement and insolvency laws.[62]

4.1.3 Summary

To what extent, then, are the 'adaptability' and 'political' theories regarding the influence of a country's legal system on financial development borne out by the case of India? Since liberalisation, there has been widespread reform of regulatory mechanisms governing equity markets; reforms have also been attempted as regards credit markets, but these have proceeded at a slower pace and to date appear to have been less successful. The regulatory adaptability that has been shown in relation to stock markets has emphatically not been a function of judicial law-making, as posited by the 'legal origins' literature. Rather, the lesson from Indian stock markets is that rapid regulatory innovation has been successfully achieved by delegation to technocratic regulatory agencies.

In contrast, there does appear to be support for the idea that the political independence of the judiciary in India helped to protect property rights from encroachment by the state. However, it seems unclear to what extent this is a function of India's *common law*, as opposed to its *constitutional*, status. In the UK, where the 'common law' approach to lawmaking originated, there was until very recently no constitutional protection for fundamental rights,[63] and the judiciary would have no legal basis for objecting to encroachments on property rights of the variety disputed in India during the pre-liberalisation period.[64]

The Indian case study also illustrates a significant tension between the desiderata reflected in the adaptability and political accounts. Adaptability involves rapid change to accommodate developments in the real economy; political independence on the other hand implies conservatism in respecting property rights. To the extent that the reforms required for adaptation to changed circumstances are those affecting property rights, a strong judiciary will act as a check on efficiency-enhancing, as well as rent-seeking reforms. The delays following PIL challenges to the implementation of credit market reforms such as the Debt Recovery Tribunals, SARFAESI and the reform of insolvency law all flowed from the activism of India's Supreme Court. To some extent, therefore, the retardation of credit market reforms—as compared with stock market reforms—may be a consequence of their greater impact on property rights.

We have seen that two aspects of the 'legal origins' claim at best only partly explain the pattern which the development of India's investor protection has followed since liberalisation. And to the extent that it does—through the 'political' channel—the implications are at least partly contrary to the manner predicted by the theorists: India illustrates that a politically independent judiciary may be a check on beneficial adaptation, as well as rent-seeking. Entirely unexplained by theories focusing purely on legal institutions, however, are the apparent complementarities between industrial structure and the relative success of equity markets. To understand these better, we now turn to political explanations.

5. Politics and India's pattern of legal and industrial development

'Political' theories of the development of corporate financing patterns assert that both financing patterns and legal institutions are determined by the preferences of dominant interest groups, as mediated through the political system (see, e.g., Roe, 2003; Gourevitch and Shinn, 2005). In this section, we first explore the role of interest groups in the process of law reform. The most important interest groups influencing the law reform agenda appear to be industry lobby groups, whose agenda therefore reflects and reinforces the pattern of India's industrial development. This in turn implies that legal institutions were not determinative of India's distinctive pattern of development. We then suggest that both India's pattern of economic development and the quality of her financial laws have in fact been strongly influenced path dependencies from first, the legacy of colonial rule and, secondly, the central planning policies adopted following independence in 1947.

5.1 Interest groups and financial law reform

In order to explore the role of interest groups in Indian law reform, we spoke to various people involved in the process—in particular, senior civil servants in the Ministries responsible for legislative reform affecting corporate finance; regulators from SEBI and the RBI, and various lawyers, investment bankers and industry groups. A similar pattern emerged from both the Ministries charged with drafting primary legislation,[65] and the regulators empowered to draft delegated legislation.[66] We were told that most changes were either initiated following lobbying from business interest groups or market participants, or, where they were not so initiated, at the very least involved meaningful consultation, at a later stage in the process with such groups.

5.1.1. Consultation processes

There are, however, subtle differences between the Ministries and the regulators and even as between the two regulators, both as regards the conduct of the consultative process itself, and in the extent to which interest groups are influential in affecting the reforms agenda. Although the Ministries view drafting a new piece of legislation as very much an internal exercise, there is now typically public consultation and involvement of interest groups. This often includes the setting up of expert committees with representatives from different interest groups like business personalities, bankers, professional bodies, regulators, and corporate lawyers.[67]

The regulators also typically set up committees comprised of experts from the relevant field, including industry interest groups and lawyers, to consider reforms. The SEBI committees are usually chaired by well-known business personalities and involve consultation with a larger number of interest groups.[68] The RBI committees on the other hand are typically chaired by RBI officials or public bankers or officials from other government bodies or public financial institutions, rather than industrialists.[69]

As between the two regulators (the RBI and the SEBI), we were told that the RBI is said to adopt a more bureaucratic approach to the consultative process than is the SEBI. Conversely, industry groups are said to lead or influence the setting of the reform agenda of the SEBI to a greater extent than that of the RBI. Thus, some of the recent changes in the field of investor protection on securities market, like the corporate governance norms introduced in the form of Clause 49 of the Listing Agreement have been a result of initiatives of industry associations – mainly the voluntary code for 'Desirable Corporate Governance' by the Confederation of Indian Industries ('CII'), an influential industry interest group.

5.1.2 Nature and extent of interaction

The involvement of interest groups, and the extent to which the government was willing to interact with them, has increased significantly over the past 20 years. Prior to liberalisation, consultation with industry participants was limited to pre-budget discussions over provisions in the budget. Our interviewees spoke of a marked difference in the attitude of the government following the onset of liberalisation, now being more open to interacting with interest groups. It appears that the most influential interest groups are business or industry groups, corporate lawyers, professional bodies, and in the case of reforms affecting the banking sector also the public and private banks and public financial institutions.[70]

The level of involvement of different interest groups varies. For instance, corporate lawyers are involved at all stages of legal or regulatory change, ranging from participation in wider consultation, to being part of expert committees to a more direct involvement in assisting the ministries or regulators (mostly the SEBI) in the drafting of legislation or subordinate legislation (on a *pro bono* basis).[71]

Indian industry, represented by various interest groups, appears to be the principal constituency influencing the reform agenda in the production of new laws at both ministerial and regulatory levels. Publicly-traded firms in India typically have controlling interests concentrated in the hands of family blockholders (Khanna and Palepu, 2005). The powerful networks and high concentration of wealth of leading business families enables them to act as an effective interest group in seeking regulatory reform. Indian industry exerts influence through well-established and organised channels of trade and industry associations. Umbrella organisations like the Federation of Indian Chambers of Commerce of Industry ('FICCI') and the Confederation of Indian Industry ('CII') are amongst the most active, followed by the several local chambers of commerce and a range of industry-specific associations. All these bodies generally follow an 'events-based system' in which seminars, round-tables and workshops are regularly organised to provide a common platform for discussion and consensus-building on topical issues by involving government representatives (even ministerial delegated), representatives of the regulators, as well as experts and industry representatives.

As far as banks are concerned, the Indian Banks Association ('IBA') provides a formal channel for the exchange of ideas and for influencing policies.[72] However, it was suggested to us that in practice the voices of private and foreign banks, although formally part of the RBI's consultation process, may not be heard as clearly as those of the large publicly-owned banks. There is a concern that the RBI, which itself holds stakes in a number of the public banks, may be subject to conflicts of interest leading it to focus on the interests of public rather than private concerns (Thomas, 2006).[73] However, the increase in competition in the banking sector has been responsible for creating new interest groups representing private banks and foreign banks, which have been able to exert some influence at the ministry level in the reforms agenda. For instance, we were informed by some of our interviewees that a significant part of the impetus for SARFAESI came from the systematic, and ultimately successful, lobbying efforts of the largest private bank in India.

Labour unions, we were told, do not tend to get directly involved in affecting the reform agenda with regard to investor protection, especially in relation to regulations introduced by SEBI or the RBI. However, they have been involved in political lobbying regarding changes to corporate insolvency law, seeking (successfully to date) to avoid reforms which might diminish the pro-employee features of the current insolvency laws (Umerji, 2004). Moreover, labour unions and groups representing small businesses have been amongst those that have used the wide standing rules available for public interest litigation to challenge the introduction of legislative reforms such as the Second Amendment to the Companies Act 1956.

The general picture that emerges may be summed up by three observations. First, reforms that have taken the form of delegated legislation promulgated by technocratic regulators such as the SEBI and the RBI have proceeded more quickly, and with less political hold-up, than have reforms that have depended on the passage of primary legislation. Secondly, as between SEBI and the RBI, the former has been more effective in implementing reforms and developing new institutions, perhaps in part because of its absence of ties with interest groups aligned with the pre-liberalisation era. Thirdly, it is the needs of businesses in raising capital, as opposed to investors—whether foreign or domestic—and employees, that have been catered to by those responsible for reform, and by SEBI in particular. The relevant reforms appear to have been driven in large part by business' desire for greater access to finance. These points help to explain several aspects of the pattern of Indian law and finance set out in Section 3. Within this framework, the voice of industries in which India has been particularly successful—software, hi-tech manufacturing and services—may have dominated the law-reform agenda. These types of business, lacking hard assets which may be seized by creditors on default, are better complemented by equity, rather than debt, finance. Hence interest groups lead from industry may be expected to exert greater pressure for reforms in relation to equity, rather than debt, finance.

5.2 Path dependencies

We conclude this section by suggesting that many of the key features of the pattern of legal and financial development in India since liberalisation have been strongly influenced by historically contingent choices made during the era of central planning.

Under the socialist regimes that governed India from 1947 until 1991, a series of plans were instituted for the development of India's industry (Rothermund,

1988; Lal, 2005; Kochhar et al 2006). These focused on (i) developing capital-intensive infrastructure projects; (ii) 'prestige' industries. The way in which the 'flagship' industries were supported was through mandatory loans from state-owned banks. Moreover, a certain proportion of funds had to be loaned to particular industries so as to foster their development. Thus firms in such industries lacked hard budget constraints. The result of these policies, when coupled with import substitution, was that neither capital nor product markets exerted meaningful discipline on firms operating in these sectors. As a result, many Indian firms (mostly public sector) were inefficient, and development did not occur as fast as it might have. Indeed, the chronic overstaffing of many large (public) firms was recognised by the government as a means of disguising unemployment. Powerful labour protection under labour laws,[74] coupled with protection of employment in the public sector,[75] made these consequences difficult to reverse.
The small but significant private sector, although efficient, worked subject to a range of restrictions, including lack of access to finance, , multiple licensing requirements, extensive labour regulations, import restrictions, and heavy taxation.

Another central tenet of post-independence policy was investment in higher education. The combination of inefficient public sector manufacturing and high quality higher education meant that India generated a large pool of well-qualified individuals who had relatively limited opportunities. By the 1980s, more technology-oriented firms started to flourish. On the one hand, they were outside the framework established by the central planning regime; without such subsidies (and without the interference imposed by the 'licence Raj'), they were forced to be efficient. On the other hand, they were able to draw upon a large pool of human capital, with relatively low wage costs. As a result, India's software, telecoms and high-tech manufacturing industries have grown dramatically since the early 80s. They are now the most successful sectors by far, with the result that India's overall pattern of development might be understood as going straight to high-tech, without passing low-tech manufacturing (Kochhar et al, 2006). [76]

Few areas of the Indian economy were as dominated by the State as was finance (Thomas 2006). Although at independence India had a fairly well-developed banking system,[77] post-independence–like many other developing countries--its banking sector exhibits a significant degree of public ownership. Public ownership of banks in India began with the government ownership of the Reserve Bank of India in 1949.[78] The subsequent nationalization of significant private banks operating in India established a state monopoly in the sector. [79]

Under the Banking Regulation Act, 1949, the RBI was invested with wide ranging powers for supervision and control of banks coupled with licensing powers and the authority to conduct inspections. The RBI also controlled interest rates (fixed deposits and lending rates) and thereby controlled financial transactions. There were entry barriers for new private banks, foreign banks were not allowed to be set up and the regulations inter alia ensured that banks invested heavily in government securities as their primary investments and all banks public as well as private had to lend (as much as 40%) to priority sector that too at lower rates of interest.

We are now in a position to see contingent links between the ways in which socialist policies were implemented prior to 1991 and the development of law and finance in India since then. On the one hand, planning and education policies appear to have affected the development of Indian industry, resulting in under-representation in heavy industry and in an emphasis on services and high-tech manufacturing. In turn, the financing needs of these sectors—primarily oriented towards equity, rather than debt—are heard most vocally by regulators and legislators in the post-liberalisation law reform process. At the same time, the very regulators involved in reforming credit markets—namely, the RBI—have been historically involved in the use of credit as an instrument of state industrial policy, rather than a hard budget constraint. In contrast to SEBI, which was set up from scratch following liberalisation, the RBI's personnel and culture have been influenced by its former role. This may be at least as significant an explanation for the lack of effective credit market reforms as was industrial structure. Both, however, share the feature of having been contingent consequences of India's particular political history.

6. Conclusion

In recent years, India has undergone spectacular economic and financial development. This makes it an interesting and important case study for the investigation of claims asserting links between legal institutions, corporate finance, and—more tentatively—economic development. India's economy is heavily biased, relative to comparable developing nations, towards services. This is complemented by a relatively high use of equity finance and—again in relative terms—less use of debt finance, especially bonds. We show that these complementarities are, further, associated with a particular pattern of legal institutions: an effective regulator, and much new regulation, for equity markets; conversely reforms which might stimulate debt markets have been slower in coming and only partially implemented.

We investigated the extent to which these links between law, finance, and the economy in India may have flowed from the nature of India's legal system, in particular its 'regulatory style' as a common law country. One mechanism sometimes said to underpin such a link is the idea that judge-made law is more readily 'adapted' to changes in circumstances. We find no evidence at all that this mechanism played any role in transforming India's investor protection laws since liberalisation in 1991. Judge-made law, in the form of precedents, can only emerge at the speed at which judgments are in fact given. Indian courts are typically overwhelmed by delays—a typical dispute taking 10 years to resolve—and so it is impossible for the judiciary to act as an agent of rapid legal change.

An alternative claim asserts that common law systems have an advantage over their civil law counterparts owing to relatively greater judicial independence, which can act as a constraint on rent-extraction by the state. We find some evidence that India's independent judiciary played a meaningful role in protecting individual property rights from state expropriation during the era of central planning. Moreover, whilst a highly independent judiciary may assist in preventing adverse economic outcomes at some points in history, the Indian experience with public interest litigation being used to delay the passage of creditor-oriented reforms in the past 15 years suggests that it may also act as a brake on positive legal change under some circumstances too.

Together, these findings imply a significantly more modest role for law than is commonly understood in the 'law and finance' literature, which accords much weight to the civil or common law nature of a country's legal system. Indeed, the pattern of complementarities between India's legal, financial and economic structure do not appear to have been determined by the country's legal origin. Rather, we find more support for the claim that economic structure is a determinant of financial structure. Moreover, this in turn appears to have been influential in the relative success of reforms fostering equity markets, as opposed to bond markets. Indian industry provides significant interest groups influencing the reform process, and so it is perhaps not surprising that the regulation of equity markets should fare better than debt. The pattern of India's (relatively) service-oriented economy appears to be an unintended consequence of the policies pursued during the pre-liberalisation period. These too have also had an independent influence on legal reform, as the development of credit markets appears to have been delayed by the need to re-orient regulators and institutions from their former role in industrial policy to simply imposing a hard budget constraint. It seems that it may be easier to create new institutions from scratch (SEBI) than to reorient the culture and interest groups associated with an existing institution designed for a different purpose (RBI).

All in all, then, we conclude that legal origins played at best a supporting role in bringing about India's characteristic pattern of legal, financial and economic development. Political theories, and in particular those focusing on the identity and influence of interest groups associated with industry, allow us to explain a greater part of the links observed between service-oriented economy, equity-oriented finance, rapid regulatory developments for equity markets and lack of legal change in relation to credit markets.

Notes

[1] This literature connects with other recent work on the relationship between financial system and economic development (see Levine, 1997; Beck et al., 2003a, 2003b; Berkovitz et al., 2003; Pistor and Xu, 2003; Pistor *et al*, 2003, Claessens and Laeven, 2003; Milhaupt and Pistor, 2008).

[2] These include: "antidirector rights" and creditor rights; (La Porta *et al*, 1997, 1998); regulations governing firm start-up; (Djankov *et al*, 2002); contract enforcement; (Djankov *et al*, 2003); securities regulation; (La Porta *et al*, 2006); labour regulation; (Botero *et al*, 2003); self-dealing rules (overlapping with the earlier "antidirector rights") (Djankov *et al*, 2005) and bankruptcy procedures (Djankov *et al*, 2006).

[3] Other criticisms include: (1) The *accuracy* of the coding of legal variables has been questioned (see, e.g., Spamann, 2006); (2) the *selection* of variables to be coded has been criticised as being abritrary and misleading (see, e.g., Cools, 2005; Braendle, 2006;Lele and Siems, 2007); (3) the regression results have relatively low R-squareds, implying that the legal variables leave much of the differences in the economic variables unexplained (see, e.g., Roe and Seigel, 2007).

[4] In 2006, India's population was 1.1 billion, comprising approximately one-sixth of the world's population: see http://india.gov.in/knowindia/population.php

[5] According to World Bank data, India's economic growth during the period 2000-2005 averaged 6.89%, as compared with a global average of 2.97%: see http://devdata.worldbank.org/data-query/

[6] It is worth adding that by far the largest share of the bonds issued by Indian companies take the form of private placements, rather than issues to public markets. Indeed, it is fair to say that the Indian public bond market is still almost non-existent.
[7] Similarly, Thomas (2006) calculates a time-series for debt-equity ratios, using market values of equity, for listed Indian firms over the period 1989-2005, and concludes that there has been a significant increase in the use of equity relative to debt during this period.
[8] Such placements are made by high and low quality firms in equal proportions, implying that the bond markets have not yet developed sufficient infrastructure for distinguishing between them (Shirai, 2002).
[9] For instance, the Indian Contract Act,1872, The Indian Trusts Act, 1882, Indian Penal Code, 1860, the Indian Evidence Act, 1872, Criminal Procedure Code, 1873, Code of Civil Procedure, 1901, The General Clauses Act, 1897, The Negotiable Instruments Act, 1881, Bankers Book Evidence Act, 1891 etc.

[10] In certain circumstances, they could have the right of private sale or appointment of private receiver. But these rights are available provided they are specifically spelt out and are further subject to conditions which are so archaic that in practice these rights are of little significance and almost all cases require the intervention of courts. See S.69-69A of the Transfer of Property Act, 1882 for details. In case of debts due to State Financial Corporations (SFC), the SFCs had some special rights of enforcement without court orders. See e.g. S. 29 of the SFC Act, 1951, it gives SFCs the right to take over the management or possession of the borrower (being an industrial concern) including the right to transfer the secured property by lease or sale. But these apply naturally only to debts due to SFCs and other creditors did not possess such special rights of enforcement outside courts.

[11] It is a concept unique to India – defined in the SICA, S. 3(o) as amended in 1994 means an industrial company which has been registered for five years and to has negative net worth i.e. accumulated losses exceeding its entire net worth.

[12] BIFR records show that from 1987 to 2005, 5327 firms entered the SICA regime. Of these, only 504 have been successfully revived (http://bifr.nic.in/geninfo.htm).

[13] Other areas in which significant reforms were initiated following liberalisation included industrial policy, foreign investment, and trade and exchange rate policy. See generally Bhagwati (1993); Joshi and Little (1996); Ahluwalia (2002); and Mohan (2004, 2006).

[14] The most significant liberalisation was the replacement of criminal penalties under FERA with a regime of civil fines under FEMA. The amount of penalty

has been reduced to three times the amount involved as opposed to five times formerly prescribed. The transition from FERA to FEMA along with associated changes in foreign exchange policy have facilitated transactions and dealings in foreign exchange considerably.

[15] The SCRA has been amended on numerous occasions since liberalisation, including in 1992 (to make necessary changes to reflect the abolition of the central government-run securities supervisor and the establishment of SEBI), 1993 1994, 1995 (when legal sanction was extended to the Listing Rules), 2000 (to implement new rules relating to appeal to the securities tribunal), 2001 and 2003. The MRTP was amended by the Monopolies and Restrictive Trade Practices (Amendment) Act 1991, which made changes to the criteria of firms that would fall within the restrictions under that Act. The SICA was amended in 1991, 1993, 1994 and is now scheduled to be repealed under the Sick Industrial Companies (Special Provisions) Repeal Act 2003.

[16] Unsuccessful attempts were made in the 1990s to replace the present act with a new law.

[17] For instance, important changes to the Companies Act were made in the relevant period by the Monopolies and Restrictive Trade Practices (Amendment) Act, 1991, Depositories Act, 1996, Companies Amendment Act 1996; Depositories Related Laws (Amendment) Act, 1997, Companies Amendment Act 1999, Trade Marks Act, 1999, Companies Amendment Act 2000, Companies Amendment Act 2001, Companies Amendment Act 2002, Companies (Second) Amendment Act 2002.

[18] For example, the SEBI (Disclosure and Investor Protection) Guidelines, 2000 (DIP) lays down the disclosure requirements and minimum eligibility norms for issuers and also requirements for intermediaries designed to ensure fuller disclosure for the protection of investors.

[19] The Clause 49 corporate governance rules, introduced in 2001 were initially based on voluntary code promulgated by the Confederation of Indian Industry in 1998, which in turn drew heavily on the UK's Cadbury Code of Corporate Governance. However, since its inception Clause 49 has seen many changes introducing progressively more onerous obligations, following the influence of the U.S. Sarbanes-Oxley Act.

[20] India's takeover regime was gradually evolved by the SEBI first in the form of the SEBI Substantial Acquisition of Shares Regulations 1994, then replaced by new regulations in 1997 and subsequently amended from time to time. Whilst the take over regime in India is influenced by the UK's City Code in imposing 'mandatory bid' requirement, the way in which the principle is

implemented is wholly different. Rather than being triggered at the acquisition of 30% of the voting rights, as in the UK, it is triggered at only 15%. However the obligation imposed is much less onerous: the acquiror need only cimpulsorily acquire a further 20% of the voting rights, as opposed to their entirety. As one of our interviewees, a leading M&A and corporate finance lawyer, explained, this is intended to reduce the burden on the acquirer with a view to encourage takeovers, and represents an implementation of the mandatory bid principle that is adapted for more concentrated owbnership structures found in India (cf. Joshi and Little, 1996).

[21] SEBI (Prohibition of Insider Trading) Regulation 1992, as amended from time to time.

[22] The NSE was set up by a group of leading financial institutions at the behest of the Indian government. It started trading bonds in June 1994, and shares in November 1994 (see : http://www.nseindia.com/content/us/fact2006_sec1.pdf).

[23] National Securities Clearing Corporation Ltd. was established as a wholly owned subsidiary of NSE in August 1995 to act as a common counterparty for all trades at the NSE, and commenced clearing operations in April 1996. It was set up to bring and sustain confidence in clearing and settlement of securities; to promote and maintain, short and consistent settlement cycles; to provide counter-party risk guarantee, and to operate a tight risk containment system. See http://www.nseindia.com/ for details

[24] The NSDL was promoted by the NSE along with the Industrial Development Bank of India ('IDBI') and the Unit Trust of India ('UTI') as an independent entity. NSDL commenced operations in November 1996 and has since established a national infrastructure to handle trading and settlement in dematerialised form and thus completely eliminated the risks to investors associated with fake/bad/stolen paper securities. See http://www.nseindia.com/ for details.

[25]The NSE remains India's most liquid stock exchange. The percentage of NSE-listed companies which are regularly traded is as high as 99.05%, as compared to 34.54% on BSE (NSE, 2005:95).

[26] Indeed, according to Bhattacharya and Patel (2005: 423), a number of the practices adopted by the NSE are actually more advanced than those employed by the New York and London Stock Exchanges.

[27] Soon after the inauguration of DRTs in a number of major cities, the RDDB Act was challenged in several high courts on the basis that was 'unconstitutional'. Pending final verdicts in these matters, the operations of the DRTs were stayed. The central government brought a special leave petition

before the Supreme Court, which in March 1996 issued an interim order permitting the DRTs to resume functions. The Supreme Court also asked the central government to amend the RDDB Act to address certain legal anomalies. Following the passage of these amendments, the Supreme Court gave a final ruling in March 2002, stating that the DRT Act was now constitutional(Visaria, 2006).

[28] See *Mardia Chemicals Ltd Etc. v. Union of India and others*, JT 2004 (4) SC 308

[29] See SARFAESI ss.13-17

[30] In particular, provision was made (s 17(2)) for aggrieved debtors to appeal to a DRT against an extra-judicial enforcement, but were required to post a deposit totalling 75% of the outstanding debt. This was challenged as an inappropriate restriction on the debtor's ability to appeal.

[31] In *Mardia Chemicals* (see above n __), the Supreme Court upheld the constitutional validity of SARFAESI, with the exception of s 17(2) (see above n __). In early 2005, SARFAESI was accodingly amended to permit borrowers to contest extra-judicial enforcement under SARFAESI before a DRT without having to deposit 75% of the claim.

[32] However, some of our interviewees were quick to point to the practical problems with the SARFAESI out-of-court enforcement mechanism, e.g. finding buyers for the assets when the company owners are hostile to the sale and can easily manipulate the auction, or the problem of protecting and maintaining the property before the private sale i.e. from the time of taking possession and the time that the DRT will take to decide on the objections by borrower and the appeal/s from that decision. They conceded, however, that it provides banks and FIs with a new tool for negotiations and helps in bringing borrowers to the table.

[33] See SARFAESI Chapter IV, esp. ss.20-26.

[34] According to the World Bank survey, the completion of a corporate bankruptcy in India typically takes 10 years—a tie with Chad for the longest time in the world.

[35] The Eradi Committee conducted a comprehensive review of the law relating to reorganization and liquidation of companies, and suggested changes to the existing CA 1956, including provisions pertaining to reorganisation based on renegotiations and repeal of SICA. The RBI Advisory Group (2001) subsequently recommended a separate bankruptcy code, rather than including provisions in the CA 1956. However, the latest report touching upon the matter--that of the J.J. Irani Committee in 2005-- concluded that the appropriate way to

proceed was simply through reforms to the existing company law. In light of this, it looks unlikely that India will adopt a separate corporate bankruptcy code.

[36] For instance, with respect to provisions such as S.25 (O) of the Industrial Disputes Act, 1947 requiring government consent before the closure of firms with 100 or more workers.

[37] For instance, the Urban Land (Ceiling and Regulation) Act makes it difficult for distressed firms to sell surplus urban land.

[38] The structure of NCLT/NCLAT was challenged in the Madras High Court in the case of *Thiru. R. Gandhi President v. Union of India (UOI)* [2004] 120 CompCas510(Mad). The Madras High Court gave its ruling in April, 2004 whereby some of the provisions of the said amendment Act were held to be unconstitutional. The operation of the amendment Act was also stayed until a suitable rectification could be made. Thereafter, a special leave petition was filed by the Central Government in Supreme Court, where the matter is presently under consideration: Standing Committee on Finance (2005-06).

[39] Commercial disputes before courts in India are among the most lengthy, costly and complex in the world—resulting in a rank of 173rd in the World Bank's 'Doing Business' dataset on the 'ease of enforcing contracts'. It takes 1,420 days to enforce a contract in India, compared with 969 days on average in South Asia, 351 days on average in OECD countries, 450 days in Malaysia and only 292 days in China (World Bank, 2007).

[40] According to the monthly statement of pending cases for the month of February, 2007, see
http://www.supremecourtofindia.nic.in/new_s/pendingstat.htm

[41] Figures as of 7.8.2006, Ministry of Home Affairs, Department of Justice, available at http://mha.nic.in/rtijustice1.pdf and http://mha.nic.in/rtijustice2.pdf.

[42] The Ministry of Home Affairs, Department of Justice claims that the pendency at the Supreme Court has substantially reduced over time. However, the vast majority of private law claims are not heard in the Supreme Court but in the High Courts, where the levels of pendency have been *increasing* since liberalisation. see http://mha.nic.in/justi.htm

[43] However, amendments to the Indian Civil Procedure Code ('CPC') in 1999 and in 2002 attempted to improve the situation - besides imposing a maximum of three adjournments, these abolished the right of second appeal in money suits where the value does not exceed Rs. 25,000. Further, the general power of the courts to extend the time prescribed in the CPC is now restricted to 30 days, where previously it could have been extended without limit (Ministry of Law, Justice and Company Affairs, 2002).

[44] Looking at civil litigation, under the Civil Procedure Code 1908 ('CPC'), a first appeal can be made on fact or point of law to District Courts (s 96), a second appeal to High Courts is possible only on a point of law (s 100). If the second appeal is heard by a single judge, the appellant can pray for an additional appeal, known as a 'letters patent' appeal, to a Division Bench of the High Court. Upon certificate by the High Court, a further appeal can be made on a substantial question of law to the Supreme Court - under Article 133 of the constitution. What is more, under CPC s 115, 'revision applications' may be filed with High Courts under certain circumstances even when an appeal is not possible.

[45] Another factor sometimes said to contribute to the delays is that the Indian population has a particularly high propensity to resort to litigation to settle disputes. Empirical studies, however, belie this claim (see Moog, 1993; Wollschlager, 1998). Moreover, the incidence of new litigation has not increased significantly in the past 30 years—and indeed has decreased over the past century. Delays have rather grown owing to the legal system's increasing inability to resolve existing cases, leading to an ever-increasing backlog (Debroy, 2000; Krishnan, 2003; Galanter, 2007).

[46] When affairs of the company are conducted in a manner prejudicial to public interest or interests of the company or the shareholders or in a manner oppressive to any members: see CA 1956 s 397.

[47] When affairs of the company are conducted in a manner prejudicial to the interests of the company or to the public interest, see CA 1956 s 398.

[48] For instance, see *Needle Industries (India) Ltd v. Needle Industries Newey (India) Holding Ltd* (1981) 51 Com Cases 743 (SC); *Chander Krishan Gupta v. Pannalal Girdhari Lal Pvt. Ltd*. (1984) 55 Com Cases 702; *Re Malayalam Plantations (India) Ltd*. (1991) 5 Corpt LA 361 (Ker); *Akbar Ali A. Kalvert v. Konkan Chemicals Pvt Ltd*. (1997) 88 Com Cases 245 (CLB); *Re AIR Asiatic Ltd* (1994) 3 Comp LJ 294 (CLB).

[49] The constitutional scheme is designed to maintain the independence of the Supreme Court. A Supreme Court judge can be appointed by the President, but only after consultation with the Chief Justice of India (proviso to Art 124 (2) of the Constitution of India). Once appointed, such a judge can be removed from office only by impeachment in the Parliament with two-thirds majority (Art 124 (4)). However, following a period of excessive executive interference in judicial appointments at the Supreme Court during the 1970s, jeopardising the independence of judiciary (see Desai and Muralidhar, 2000), the Court has

developed a system of collegium by judges which operates, in effect, to rule out any executive interference whatsoever: see *Supreme Court Advocates-on-Record Association v Union of India* 1994 SC 268 and the Presidential reference made on 23rd July, 1998.

[50] Basic individual rights are given constitutional protection as the 'fundamental rights' guaranteed under Part III (Art 12-35) of the Constitution of India.

[51] Art xx.

[52] AIR 1951 Patna 91

[53] Established since the Mughal era, the system of zamindari rights granted the 'zamindars', or intermediaries, special powers over land in return for an obligation to collect and pay fixed amount of land revenue to the rulers. By the time of the British Raj, the zamindars were treated as landlords of the lands for which they collected taxes and the farmers that worked the land for crops became their tenants.

[54] Constitution (First Amendment) Act 1951, introducing new Art 31B which provided that the Acts mentioned in a new Schedule IX (listing, at the time, thirteen state land law reform statutes) would not be deemed to be void on the ground of their taking away or abridging any of the fundamental rights. As observed by Jain (2000), '…a new technique of constitutional amendment, by way of incorporating legislative acts in the constitution itself, was initiated to immunize them and make them fully unchangeable in a court against any attack under any fundamental rights'.

[55] *State of West Bengal v. Bela Banerjee*, AIR 1954 SC 170.

[56] The Constitution (Fourth Amendment) Act 1955 amended Art 31 (2) so as to make the question of 'adequacy' of compensation non-justiciable. A new clause, Art 31 (2)A was added and Art 31A, added by the First Amendment, was further expanded to include more categories of 'deprivation' of property which were to be immune from challenge on the basis of violation of fundamental rights. More Acts were also added to Schedule IX itself.

[57] The Constitution (Seventeenth Amendment) Act 1964 further expanded the scope of Art 31A and Schedule IX to widen the meaning of 'estate', thereby putting a range of new enactments beyond the possibility of judicial challenge, and by adding several further central and state Acts to Schedule IX so as to immunize them.

[58] *Vajravelu v Special Deputy Collector* AIR 1965 SC 1017; *Union of India v the Medical Corporation of India* AIR 1967 SC 637 (later overruled by the Supreme Court in *State of Gujarat v Shantilal* AIR 1969 SC 64).

[59] *R.C. Cooper v Union of India* AIR 1969 SC 1126

[60] Constitution (Forty-fourth Amendment) Act 1978, repealing Art 31 of the Constitution of India.

[61] The 'Judge's case' or *S.P. Gupta v Union of India*, AIR 1982 SC 149, is commonly regarded as the beginning of PIL in India (Jain, 2000).

[62] See above, text to nn __-__.

[63] The Human Rights Act 1998 (UK) marked a significant departure, but even this does not give the judiciary power to strike down primary legislation as unconstitutional, merely to ask Parliament to reconsider.

[64] To be sure, one should not push this point too far, as a characteristic feature of the Indian judiciary's intervention has been an expansionist interpretation of what legal bases were open to them under the constitution for checking execut

[65] Namely, the Ministry of Company Affairs, the Ministry of Law and Justice and the Finance Ministry, which are responsible for making primary legislation in the spheres of company, insolvency, and banking law.

[66] Namely, the regulators of the two major components of the financial sector, SEBI (stock markets)) and RBI (the regulator of the banking sector and various non-bank financial institutions).

[67] For instance, currently the Ministry of Company Affairs is considering a comprehensive reform of the company law – to this end, the government published a concept paper which was put on its website for comments from all interested, it then set up an expert committee chaired by well-known business person, J.J. Irani (Director of Tata Steel and Tata Sons) that prepared and submitted its report. The ministry is now involved in drafting a bill leading to major reforms along the lines of recommendations in consultation with legislative department of the Law Ministry.

[68] For instance, the corporate governance norms adopted in the form of Clause 49 (see above, n __) were the result of SEBI committee headed by well-known businessmen Mr Kumar Mangalam Birla and amended as a result of recommendations by a committee chaired by the software tycoon Mr Narayan Murthy.

[69] For instance, the High Level Expert Committee on Corporate Bonds and Securitization was headed by R H Patil, the Chairman of the Unit Trust of India. M. Narasimham, a former Governor of the RBI headed the most influential Narasimham Committee that recommended most of the first generation and even some of the second generation reforms in the banking sector. To be sure, this in no way implies any lack of independence or expertise in the RBI

committees, but merely serves to point out differences in the level of involvement of private interest groups by the two regulators.

[70] International organisations such as the World Bank and IMF were also cited by our interviewees as influential in providing the impetus for early post-liberalisation reforms, and as a continuing force behind the second generation reforms of the financial sector.

[71] Examples range from the SEBI's takeover regulations to, more recently, a draft bill to introduce a limited liability partnership business form, in which well-known corporate law firms were involved in the drafting exercise.

[72] The IBA was formed in 1946 with 22 members. By 2003 it had 147 members, comprising public and private sector domestic banks, foreign banks having offices in India, urban Cc-operative banks, developmental financial institutions, federations, merchant banks, mutual funds, housing finance corporations, and other non-bank financial institutions:see http://www.iba.org.in/brief_background.asp.

[73] The RBI holds stakes in some of the important public sector banks like the State Bank of India, the National Bank for Agricultural and Rural Development and the National Housing Bank. However, recently, the Indian Government announced its intention to acquire RBI's stakes in these entitiesin order to separate the ownership and regulatory functions of the banking regulator (see *The Hindu,* 2 February 2007: http://www.hindu.com/2007/02/02/stories/2007020203511700.htm.

[74] Indian labour laws are highly pro-worker : see Tendulkar (2004).

[75] Art 311 of the Constitution of India provides for special rules in relation to 'dismissal, removal or reduction in rank of persons employed in civil capacities under the Union or a State'. In effect, Art 311 ensures that a state employee receives the highest protection and is very difficult to remove, creating a sort of tenure for incumbents in such positions.

[76] From a development perspective, this does create problems. The successful firms tend to be capital rather than labour intensive, with the result that the gains from this trade are very unevenly distributed; some in the West and South are extremely wealthy, whereas many villages in East India lack basic amenities, and child mortality is amongst the highest in the world (see Sen, 1998).

[77] The earliest bank in India was the Bank of Hindustan, established in 1870. In the early 20th century there were the 'presidency banks' under Presidency Banks Act of 1876, namely the Bank of Calcutta, the Bank of Bombay and the Bank of Madras. In 1921, all presidency banks were amalgamated to form the

Imperial Bank of India that carried out limited central banking functions prior to establishment of Reserve Bank of India (RBI). Seehttp://www.banknetindia.com/banking/boverview.htm.

[78] Established in 1934, the RBI took over the functions of central bank from the then Government (performed by the Controller of Currency) and the Imperial Bank of India. It was originally privately owned, but since its nationalisation under the Banking Regulation Act of 1949, it has been owned by the Government of India.

[79] In 1969, the government nationalized 14 of the biggest private banks operating at the time and in 1980 took over a further 6 private banks.

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