

# Regulatory Dilemma in Southeast Asia

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## INTRODUCTION

Before the outbreak of the recent and on-going currency turmoil, Southeast Asia was considered the fastest-growing region in the world. Its growth was driven mainly by a surge in exports of manufactured products as these countries embraced a relatively open trade regime. The booming industrial sector is in stark contrast with a relatively backward service sector where government presence is prevalent and where competition is only a recent phenomenon. Following the liberalizing waves that hit Western and Eastern Europe and other developed countries elsewhere, the Association of South East Asian Nations (ASEAN) countries have taken similar steps to introduce private sector-led dynamism into the sluggish, government-dominated service markets.

In the recent conclusion of negotiations under the direction of the Group on Basic Telecommunications, ASEAN-5 countries<sup>1</sup> all committed to guarantee market access to international and satellite services and facilities at varying dates.<sup>2</sup> With the exception of Singapore, however, none is committed to allow foreign control of local telecommunications enterprise. This indicates that while ASEAN countries are ready to open their service markets to competition, foreign companies are to be kept at arm's length from these markets.

With a long history of government dominance in the provision of services, be it utilities, telecommunication or transportation, ASEAN countries have very little experience with regulation. Many state enterprises have been and remain more or less self-regulated. A separation of operation from regulation has yet to be realized for many state-operated services. The need for an efficient regulatory system—i.e., an effective, transparent and impartial system—is most urgent and wanting in this region.

Regulation used to be viewed as a purely domestic matter as it represents a set of rules governing the domestic market. The presence of multinationals in the domestic market indicates that this view no longer holds true. Globalization of the production process has blurred national boundaries. As foreign companies will have to operate under local rules, an effective, impartial and transparent regulatory regime can provide an investment and business environment that is conducive to the foreign investment that is much needed during the current economic crisis.

It should be noted that at the AEBF II (Asia-Europe Business Forum) meeting in Bangkok on November 14-15, 1997, the report of the Infrastructure Working Group attributed the relatively low foreign investment in infrastructure development in Asia to a lack of sound projects rather than a lack of capital. Opaque and unpredictable government regulation was found to be the major obstacle to foreign investment as it leads to excessive project risks.

While ambiguous regulations may pose business uncertainties, over-regulation can also stifle the industry. Overly restrictive financial regulation can easily chase away the relatively foot-loose "portfolio investment." In such a market, regulatory "arbitrage" can easily occur. For example, regulation inefficiency in the Japanese financial system has led to a "hollowing out" of the Tokyo financial market against other financial centers (OECD 1997).

Information technology plays an important role in facilitating "regulatory arbitrage." For example, the prospect of electronic money and EDI (Electronic Data Interchange) will make cross-border financial services more readily available. Similarly, the emergence of "call-back" technology has made by-passing a global phenomenon. The emergence of "electronic commerce" has opened up an entirely new regulatory framework dealing with the conduct of cross-border electronic business transactions. As the global economy becomes increasingly integrated, the governing laws and regulations should also become more integrated. Thus, regulation is undeniably an international issue.

Most ASEAN countries recognize the need for a regulatory body. The establishment of such a body is essential to ensure fair competition for firms and to guarantee consumers their share of gains from liberalization. Recent attempts

at strengthening regulatory capacity have focused on separating regulatory work from service provision among state enterprises and setting up regulatory bodies. Unfortunately, having a regulatory body is no magic pill. The bigger question is how to regulate efficiently. Most ASEAN countries are inexperienced in this area and hence are unlikely to be able to deal with the potential regulatory pitfalls. It is this point that I would like to elaborate in this paper.

## **THE REGULATORY PITFALLS**

At one time, regulation was believed to be the cure-all for various forms of "market failure" inherent in many industries, such as natural monopolies, externalities and information asymmetries. However, years of regulatory experience in many developed countries reveal that regulations, like markets, can also "fail." Let us review what constitutes a "regulatory failure," which was the root cause of waves of deregulation world-wide. Regulatory failure may occur for two reasons. The first is associated with the "capture theory." The theory posits that because the regulated companies are likely to have superior information, they can easily manipulate the regulator to their own advantage. Alternatively, these firms can easily form themselves into a formidable lobbying group that may influence government policies. The second reason for a regulatory failure arises from the fact that the regulator itself is not perfect. We must not forget that by creating a regulator, we entrust an enormous amount of responsibility and power unto a single body. This resembles an autocratic government. We all hope for a benevolent and an efficient regulator, but there are both up-side and down-side risks involved when power is concentrated on a single entity.

The following are major regulatory dilemmas that I am aware of in the case of Thailand, and to some extent, ASEAN countries.

### ***1. Misconception of the role of a regulatory body***

As growth in ASEAN economies has been driven by the success of the industrial sector, it is not surprising that the survival and prosperity of producers, rather than the welfare of consumers, constitutes the focus of public policies. Thus, regulation is seen as a process to protect producers (by limiting competition) rather than consumers. While such a view would represent "regulatory capture" in the conventional regulatory literature in the West, for many developing countries that strive ceaselessly for economic prosperity, protection of producers is a widely accepted norm. For example, the new Draft Competition Law of Thailand currently pending Cabinet approval explicitly states that collusion and behavior that may limit competition may be allowed if such moves are essential for the survival of the business. Producer-oriented regulation is also evident in the cost-based price regulations that are used widely in many service industries including transport, telecommunications and energy. As consumer groups in developing countries are usually weak, their voices are unheard.

Misconception with regard to the role of regulation is probably the most fundamental and serious regulatory pitfall among ASEAN countries. With such misconception, regulations are prone to become nothing more than a rent-seeking device of private profiteers.

### ***2. Too much discretion***

As ASEAN countries rush or are rushed to open up their service markets, liberalization is handled haphazardly; little preparation is put into drawing up appropriate rules and regulations. In the case of Thailand, the draft law on setting up a National Telecommunications Commission (NTC) merely outlines its mandate, authority and the qualifications of committee members. The principles, the method and the means with which the body is to regulate are left to the discretion of the committee-to-be. There are indeed pros and cons concerning the tightness of laws and regulations. Too detailed a law can leave regulations too rigid, while too lax a law may open the system to the peril of abuse of power and may lead to inconsistency, unpredictability and an unclear decision-making process.

Where the mandate of the regulator is unclear and where regulatory procedures are ad hoc, the regulatory authority is likely to wield a lot of discretionary power. Moreover, in the absence of an effective competition law and a comprehensive consumer protection law, the regulator will have to assume the enormous task of setting its own set of principles, measures and procedures concerning these matters. The absence of general sets of laws or rules that can be referred to, makes the task of regulation significantly more complicated and at the same time, prone to arbitrariness and inconsistencies.

### ***3. Too little transparency***

While too much discretion may arise from the ad hoc approach taken with respect to regulation, there are ways to limit

the potential adverse results associated with discretion. Regulatory procedure can be made more transparent through public hearings, appeals provision, and notification and publication requirements. Therefore, in a country where the rules and the laws are weak, transparency is the soul of efficient regulation. Unfortunately, regulations in Thailand are neither clear nor transparent, leaving the system highly susceptible to all the ills of regulatory failure.

When a regulatory body wields a lot of discretionary power and its regulatory procedures are not transparent, effectiveness depends ultimately on the relative competence of the committee members who set the rules under which they operate. As a result, success stories, or unsuccessful ones for that matter, are closely associated with a certain individual, or a group of individuals, who exercise authority.

Given that the regulatory performance in such countries relies heavily on the competence of individual committee members, can these countries then find highly qualified personnel to ensure effective regulation?

#### ***4. Lack of qualified personnel***

A qualified committee member would have to be impartial and competent. Impartiality demands that a regulatory commissioner not have any direct or indirect vested interest in the business which he regulates, nor hold a political position. Competence requires an exceptional technical and operational knowledge of the business. After all, a regulator should know more about the business than the companies he regulates. With these parallel qualifications, this person will have to be a technocrat or a veteran businessperson who no longer holds a stake in the regulated business. Such an individual could prove non-existent in a developing country. First, the civil servant pay scale is generally too low to attract and maintain qualified personnel. Thus, the chance of finding a competent regulator from the public sector is remote. Secondly, in a fast-growing service sector, the persons who best understand the business are those involved in the business themselves. It is therefore not surprising that half of the committee members of the recently-established Taiwan Telecommunications Regulatory Board are former employees of the State Telecommunications Monopoly, Chung Hwa Telecom. The presence of former operators on the regulatory board may render the impartiality of the regulatory body questionable. The lack of qualified personnel poses a serious problem for most ASEAN countries.

#### ***5. Insufficient Autonomy***

Assuming that competent and well-qualified commissioners can be found, this still does not guarantee efficient regulation. For the regulator to be able to perform its task effectively, a certain degree of independence from the government is required. Autonomy is determined not only by the institutional structure, but also the extent of financial independence. An independent source of financing, either from a guaranteed line in the national budget, licensing fees, or excise taxes, can certainly promote not only autonomy, but impartiality. Particularly in countries where corruption is rife and patronage is a way of life, financial independence is a requisite for an efficient regulatory body.

#### ***What can be done?***

At the initial stage where markets become more open to competition and state enterprises are replaced by private operators, the regulatory burden will become overwhelming. The prospect of strengthening the regulatory authorities within the bureaucratic setting is bleak. Low pay-scale, political meddling and red tape are guarantees that the current inefficiencies will prevail. The establishment of an independent regulatory body, such as those in the United States, can lessen the severity of the mentioned problems. And to ensure its effectiveness and impartiality, let transparency be the soul of its design.

## **REFERENCE**

Organisation for Economic Co-operation and Development (OECD). 1997. *The OECD Report on Regulatory Reform, Volume 2: Thematic Studies*. Paris: OECD.