

Working Paper No 70/02

**China's Telecommunications Industry
-- The Forbidden City in the Information Age?**

by

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SNF project no 1302
"Political and Economic Structural Changes in Asia"

The project is financed by the Research Council of Norway and
The Norwegian Shipowners' Association

SIØS - Centre for International Economics and Shipping

INSTITUTE FOR RESEARCH IN ECONOMICS AND BUSINESS ADMINISTRATION

BERGEN, DECEMBER 2002

ISSN 0803 - 4028

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China's Telecommunications Industry

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Abstract

China's telecommunications market has developed enormously over the past two decades. With the industry growing 30% faster than the economy as a whole, plenty of players are eager to grab a piece of the action. In light of the recent WTO membership, China is radically restructuring its telecommunications sector and hastily forging a regulatory framework for the impending foreign competition. However, doing business in China is never as simple as it appears. Due to a weak legislation environment combined with traditional, cultural and political factors, many tangible and intangible hurdles remain to trap intended foreign investors. This paper aims to draw a general picture of both golden opportunities and hidden risks facing would-be entrants.

CONTENTS

PREFACE.....	4
INTRODUCTION.....	6
CHAPTER 1 INDUSTRY DEVELOPMENT AND MARKET ANALYSIS	8
.....	8
1.1 A VIGOROUSLY GROWING ECONOMY.....	8
1.2 DEVELOPMENT OF CHINA’S TELECOMMUNICATIONS MARKET	11
1.3 REGIONAL INEQUALITIES	15
1.4 A HIGHLY POLICY-PROMOTED MARKET.....	16
SUMMARY	18
CHAPTER 2 THE MINISTRY OF ARBITRARY POWER	19
2.1 THE FORMER MPT.....	19
2.2 EARLY REFORMS IN THE MPT	20
2.3 THE NEW AUTHORITY: THE MII	21
<i>Power range of the MII.....</i>	<i>22</i>
<i>An independent regulator?.....</i>	<i>23</i>
SUMMARY	24
CHAPTER 3 MARKET REFORMS AND DOMESTIC PLAYERS	25
3.1 PREPARATION FOR COMPETITION.....	25
<i>Before1994 – the monopoly world.....</i>	<i>25</i>
<i>The creation of China Unicom and Jitong Network Communications</i> <i>(hereinafter “Jitong”)</i>	<i>26</i>
3.2 LIMITS AND DILEMMA FOR INDUSTRY REFORM.....	27
3.3 AN EVER-CHANGING WORLD: 1999-2001	28
<i>The break-up of China Telecom.....</i>	<i>28</i>
<i>The North-South restructuring.....</i>	<i>29</i>
3.4 THE TARIFF SYSTEM OF CHINA’S TELECOMMUNICATIONS	31
SUMMARY	32
CHAPTER 4 A THEORETIC REVIEW AND CHINA’S INDUSTRY	
POLICIES.....	33
4.1 A BRIEF REVIEW OF FDI THEORIES.....	33
<i>Industrial analysis of telecommunications.....</i>	<i>33</i>

<i>Limits of existing FDI theories</i>	34
4.2 THE PREVIOUS PROHIBITIVE ATTITUDE	34
4.3 THE SUBSEQUENCE OF JOINING WTO.....	37
<i>BTA principles</i>	37
<i>China's WTO commitments</i>	38
4.4 TOWARDS A TELECOMMUNICATIONS LAW.....	39
<i>The Telecommunications Regulations</i>	39
<i>Investment Regulations Governing Foreigners</i>	41
4.5 THE MISSING LAW	43
SUMMARY	44
CHAPTER 5 HIDDEN DIFFICULTIES AND RISKS FOR FOREIGN	
INVESTORS.....	44
5.1 CULTURAL LEGACY	45
5.2 A UNIQUE POLITICAL REGIME.....	46
5.3 A WEAK LEGAL FRAMEWORK.....	47
<i>A confusing legislation network</i>	47
<i>Instrumental characteristics</i>	48
<i>Gap between "letters" and reality</i>	49
SUMMARY	50
CHAPTER 6 CONCLUSION	51
REFERENCES.....	53
APPENDIX: ACRONYMS & ABBREVIATIONS	55

Preface

In the Far East, there is a city within the city, called the Forbidden City. The Forbidden City or, now named the Palace Museum, lies in central Beijing, the capital of People's Republic of China. Serving as the seat for 24 Ming and Qing dynasty emperors (1420-1911), for centuries the Forbidden City remained a mystery and was off limits for common people and foreigners until it was opened to the public as a museum in 1950 by the new Chinese government.

Tourists come, and so do investors, along with the opening policies in the 1970's. After the formation of the People's Republic of China on October 1st, 1949, China shut its door to the outside world and for three decades remained dormant on the international economic arena. But in 1979, the sleeping giant awoke when it voluntarily opened its door to foreign investment and foreign trade by adopting an opening-up policy. Foreigners had tried for a long, long time to knock on the door of ancient China and now they were finally answered. China is no longer considered a forbidden place and is now embracing the world. While the West hailed the dramatic changes taking place in the big economy, they sadly realized before long that they are not allowed a piece of a particular pie, the telecommunications industry. Not only foreign investors but also Chinese domestic private investors are kept out of the game.

China's total ban on foreign ownership and operation in telecommunications sector is unique. Moreover, it is increasingly at odds with trends in the rest of the developing world. The service markets of Eastern Europe and Russia, India, and Latin America now all allow for substantial foreign participation. Thailand, Malaysia, Japan, Taiwan, and South Korea protect their service markets from competition of foreign investment in various ways, but none of them adheres to a complete ban. Nowadays large multinational information and networking companies routinely look upon their competitive arena in global terms. However, China still remains the last significant holdout against the trend toward globalized, privatised, and competitive telecommunications and information sectors (Mueller & Tan, 1997, p105-106). People wonder, will telecommunications be the hardest Forbidden City to crack in China? Meanwhile, there is little doubt that the opening-up of this market is only a matter of time. But when will the protections be lifted up? And how?

November 10, 2001 is a special date for many sore eyes: China's membership of the World Trade Organization (hereinafter "WTO") was officially announced at the

Doha ministerial meeting in the gulf state of Qatar, after a fifteen-year long battle of heated debate and hard talks. Long-awaiting foreign investors are excited by the news and consider it a milestone of the upcoming of a golden age. It seems that the "socialist market economy" finally agrees to integrate with the world trend. However, things may not always be as they appear. First of all, things will not change over night. Secondly, the trickiest part of doing business in China is not the tangible regulations and rules, but its complex social environment, - melted with cultural, historic, political, economic and traditional factors, which presents the biggest obstacle. China will remain a special business arena and is still a dangerous, losing field for many in-rushers. Thirdly, for a most sensitive industry like telecommunications, the risk odds are bigger and trickier for foreigners. It will continue to be a "forbidden city" because of a traditional intangible protective network and complicated bureaucratic issues.

Introduction

This paper discusses the perspectives of foreign direct investment (hereinafter “FDI”) in telecommunications industry of mainland China in light of China's accession to WTO, but only touches upon parts of the basic telecommunications services, such as, domestic and international long-distance and local telephone services on fixed-line networks, telephone and data services on mobile networks, satellite communications and mobile satellite communications, etc. It focuses on two aspects: market analysis and investment pitfalls. The aim of the paper is to draw a general picture of the potential opportunities and risks for intended foreign investors.

The majority of supporting sources come from published literature, Internet data, and official reports. The biggest problem encountered is to find trustworthy and updated data. It is extremely hard to find consistent information since there are no universal statistical standards even in governmental reports. Besides, electronic data before 1995 are almost impossible to trace, since the Internet was only introduced to China in mid-1995 and is still a new arrival in this ancient land. Many of initially planned issues, therefore, are left untouched because of lack of data. For instance, an overall layout showing provincial disparity in GDP, population and telephone penetration rate is aborted due to incomplete information; the intent of comparing operation development of major domestic players becomes meaningless since they are in frequent process of merger or split. The second challenge is the constantly shifting market situation and frequently changing policies, which add to the difficulty of data collection and force the article to be restructured several times. Finally, the third hard part is the translation work, which involves a large amount of special terms and expressions.

The paper is made up by six chapters: chapter 1, Industry Development and Market Analysis, generally pictures the industry growth path and then focuses on market analysis in both macro and micro terms; chapter 2, The Ministry of Arbitrary Power, introduces the powerful authority of telecommunications in China; chapter 3, Market Reforms and Domestic Players, depicts the telecommunications market reforms and the domestic operators in China; chapter 4, A Theoretic Review and China's Industry Policies, undertakes a brief industrial and theoretical analysis and discusses China's general industrial legal system, especially the two newly released regulatory documents; chapter 5, Hidden Difficulties and Risks for Foreign Investors,

talks about the tricks and traps for would-be foreign entrants; chapter 6, a concluding part, summarises the investment perspectives and gives some suggestions.

Chapter 1 Industry Development and Market Analysis

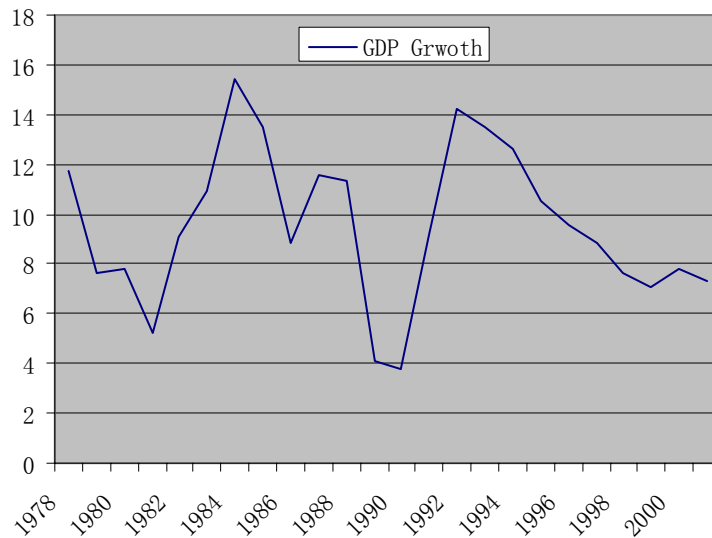
Over the last two decades China's telecommunications sector has grown to be one of its pillar industries. In 1978 China's teledensity (the ratio expressing the number of telephones per 100 people) was as low as 0.4, and in 1995 it was still only 4.66, however, by the end of 2001 it is almost 26 and still increasing. By 2000, China had built one of the largest public telecommunications networks in the world, including the world's second largest fixed-line network and the largest mobile network. Recent government and privately administered surveys estimate that China has 179 million fixed line users and 145 million mobile phone users or about 13.9 fixed line telephones per 100 people and 11.3 mobile phones per 100 people. Though the per capita number of phone users in China remains low in comparison with world telecommunications leaders like Finland and Sweden, China's absolute number of cellular phone users is already second only to the US. With over one billion people who have yet to subscribe for fixed line or mobile services, significant room exists for further expansion. According to the estimation of Wu JiChuan, China's minister of information industry, by 2005, fixed line phone figure will jump to No.1 of the world as well, with total phone users reaching 500 million, and a total teledensity 40.

1.1 A Vigorously Growing Economy

Any analysis of China's telecommunications must begin with the environment of rapid economic development in which it finds itself.

Since 1978, after introducing an open-door policy, the Chinese have set off on a rocky road to build their economy at astonishing speed. In terms of Gross Domestic Product (hereinafter "GDP"), China's economy grew at an average rate of almost 10 percent during the past two decades, one of the highest rates in the world (Figure 1.1). Nowadays, in the general climate of global economic recession, China remains a healthily growing economy among developing countries.

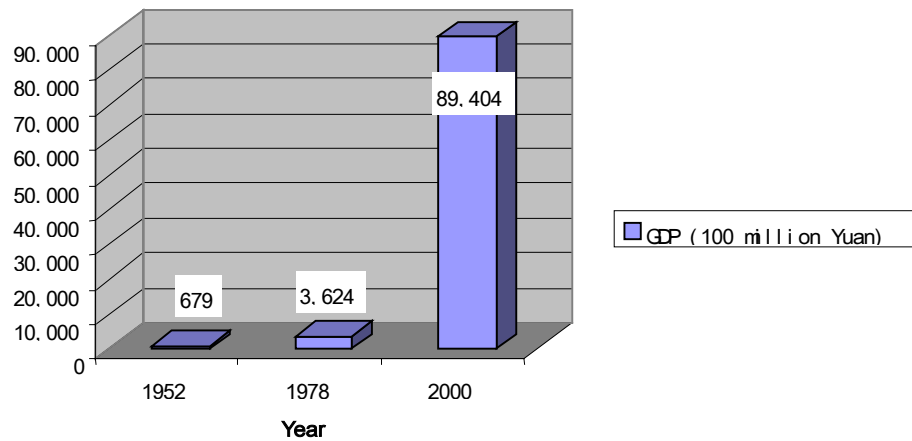
Figure 1.1 China's GDP Growth Rates, 1978-2001



Source: China Statistical Yearbook, 2000, National Bureau of Statistics of China, edited by the author

China's economic achievement is eye-catching. As Figure 1.2 shows, in 1952, three years after new China's birth, its GDP was only 67.9 billion Chinese Yuan (US\$8.21 billion). At the eve of China's opening, in 1978, the figure was only 362.4 billion Yuan (US\$43.82 billion), however, after about two decades, by 2000, China's GDP had grown to be as high as 8,940.4 billion Yuan (US\$1081.06 billion). Discounted by price factors, the actual GDP had increased by 6.4 times between 1978 and 2000, with an actual annual growth rate of 9.9 percent. According to the latest official release, the GDP estimate for 2001 is 9,593.3 billion Yuan (US\$1160.01 billion), which, in sharp comparison with the general depressing situation worldwide, represents a gross growth of 7.3 percent over 2000.

Figure 1.2 Change of GDP in 50 Years

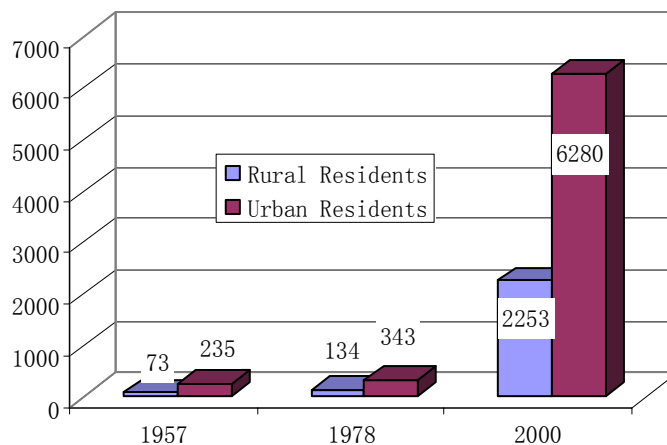


Source: Data from <http://www.stats.gov.cn>, drawn by the author

Note: Figures calculated at the prices of the indicated years; 1 US Dollar = 8.27 Chinese Yuan

As reforms and economic development are gathering strength, one direct consequence is that household income is dramatically increased, pushing up the consumption level to an unprecedented height in the fifty-year history of new China.

Figure 1.3 Changes in Residential Income (Yuan)



Source: <http://www.stats.gov.cn/ztxw/szhh/200107030012.htm>

Note: Figures calculated at the prices of the indicated years; 1 US Dollar = 8.27 Chinese Yuan

We can see from Figure 1.3 that disposable income per capita for urban residents increased by 25.7 times between 1957 and 2000, from 235 Yuan (US\$28.4) in 1957 to

6280 Yuan (US\$759.4) in 2000, while figures for rural residents grew by 29.8 times, from 73 Yuan (US\$8.83) in 1957 to 2253 Yuan (US\$272.4) in

2000. As far as average consumption level is concerned, it in fact realizes an increase of over 6 times after discounted by price indices. What is more striking, beyond the picture, is the consumption structural changes taking place over the years. Fifty years ago, Chinese people spent almost 87 percent of their income on such basic subsistence items as food and clothes. However, by 2000, the weight of expenditure on food and clothes out of the total consumption had dropped to a level of about 53 percent.

Most Chinese are very satisfied with the material improvement in their lives as a result of the reform policies by the government. At the same time, they are optimistic and feel confident about China's economic prospects. During January and February of 2002, China's Monitoring Center For Economic Health and China's Central TV Station co-hosted a household survey on anticipation of China's economy in 2002 among six big cities. The result shows that most Chinese hold great faith in China's economic performance in the coming year (Table 1.1). This outcome is especially promising against the background of a recessionary global climate and dropping consumer confidence in major developed countries.

Table 1.1 Anticipation of China's Economic Condition in 2002 over 2001
(As percent of the total residents interviewed)

	Total	Beijing	Shanghai	Guangzhou	Wuhan	Chongqing
Better	61.3	82.7	45.4	82.1	46.5	47.0
About the same	30.7	16.3	44.6	15.5	40.5	34.0
Worse	7.8	0.7	9.8	2.0	13.0	19.0
No answer	0.2	0.3	0.2	0.4	0	0

Source: Translated from the article of Feb. 26 2002 by Monitoring Center for Economic Health of China

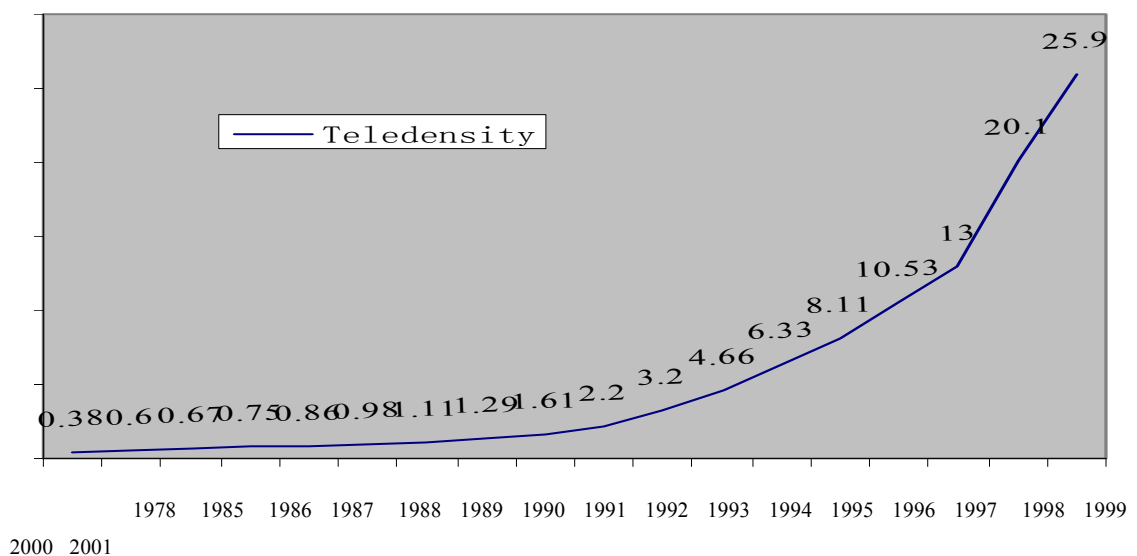
1.2 Development of China's Telecommunications Market

The success of China's market economy powerfully stimulated supply and demand in the telecommunications market, making telephone services affordable to more people.

During the past two decades, China's telecommunications market has experienced enormous growth. At the eve of China's opening up in 1978, there were

only 1.925 million fixed-line telephone users, and telephone line was considered a luxury, beyond the reach of ordinary Chinese residents. In 1980, the number of telephones owned by Chinese was only about the same as that owned by Americans in 1905. However, by the end of 2001, China had built up the world's largest mobile market and the second largest fixed-line network, only behind the United States. Now, out of every hundred Chinese people, 26 people enjoy a telephone (Figure 1.4), and telecommunications has become the biggest service industry in China. Although the teledensity is still low compared to that of developed countries, the sheer size and growth potential already make China a very attractive market in the world. Table 1.2 gives a comprehensive picture of the achievements of China's telecommunications industry during the period from 1978 to 2000. According to the government official annual economic report on March 1, 2002, the fixed-line subscribers were 179 million, of which 111 million were urban subscribers and 68 million rural subscribers. By the end of 2001, the total number of mobile phone users had reached 144.8 million, the No.1 market in the world.

Figure 1.4 Teledensity of China, 1978-2001



Source: Reproduced from <http://www.mii.gov.cn/mii/hyzw/tongji/nb/2000nb/page200203.htm>

Table 1.2 Statistics of China's Telecommunications Sector, 1978-2000

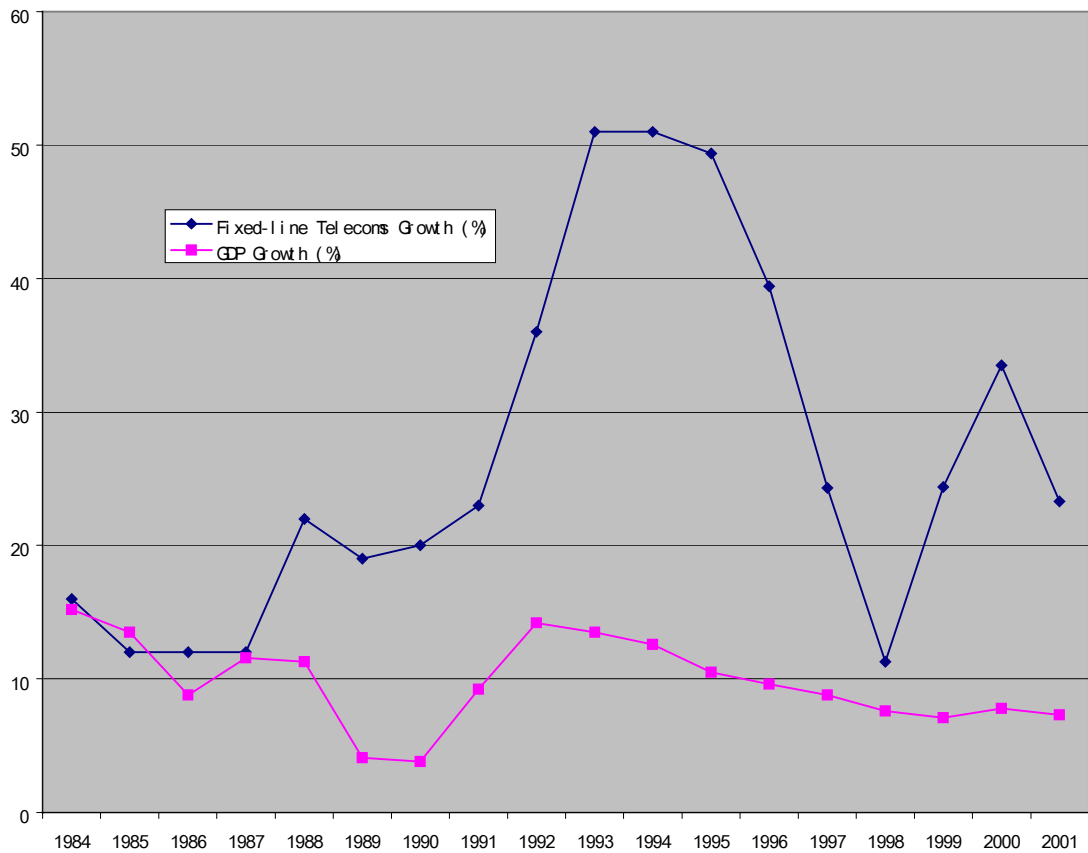
Year	Telecoms operating revenues (100 mill Yuan)	Long-distance calls (No. in 10 thousand)	Mobile subscribers (No. in 10 thousand)	Year-end fixed-line phone users (10 thousand)	Urban phone users	#Residence	Rural phone users	# Residence
1978		18574		192.54	119.15		73.39	
1980		21404		214.08	134.17		79.90	
1985		38254		312.03	218.96	4.08	93.07	2.05
1986		42303		350.38	250.51	7.36	99.87	3.61
1987		51525		390.72	293.04	17.17	97.68	6.91
1988		64617	0.32	472.70	362.30	37.83	110.39	12.69
1989		78462	0.98	568.04	439.62	89.56	128.42	21.34
1990		116292	1.83	685.03	538.45	152.72	146.58	30.66
1991	151.63	172921	4.75	845.06	670.83	239.00	174.23	49.55
1992	226.57	287380	17.69	1146.91	920.57	415.41	226.34	79.01
1993	382.45	506853	63.93	1733.16	1407.37	800.38	325.79	139.55
1994	592.30	757639	156.78	2729.53	2246.78	1489.40	482.75	274.86
1995	875.51	1013966	362.94	4070.57	3263.56	2358.40	807.00	551.37
1996	1208.75	1273951	685.28	5494.74	4277.82	3224.62	1216.92	907.27
1997	1628.95	1554026	1323.29	7031.04	5244.40	4057.16	1786.63	1406.56
1998	2264.94	1825941	2386.29	8742.09	6259.81	4911.08	2482.28	2070.75
1999	3132.38	1782532	4329.60	10871.60	7463.30	5894.40	3408.40	2949.20
2000	4494.00	2050000	8526.00	14512.20	9297.00		5183.00	

Source: Edited from <http://www.stats.gov.cn/sjjw/ndsj/zgnj/2000/O41c.htm>

Note: Figures calculated at the prices of the indicated years; 1 US Dollar = 8.27 Chinese Yuan

For the past two years, China's fixed-line market has actually been growing at an average annual rate of almost 40 percent, leaving the high GDP growth dwarfed by this speed (Figure 1.5).

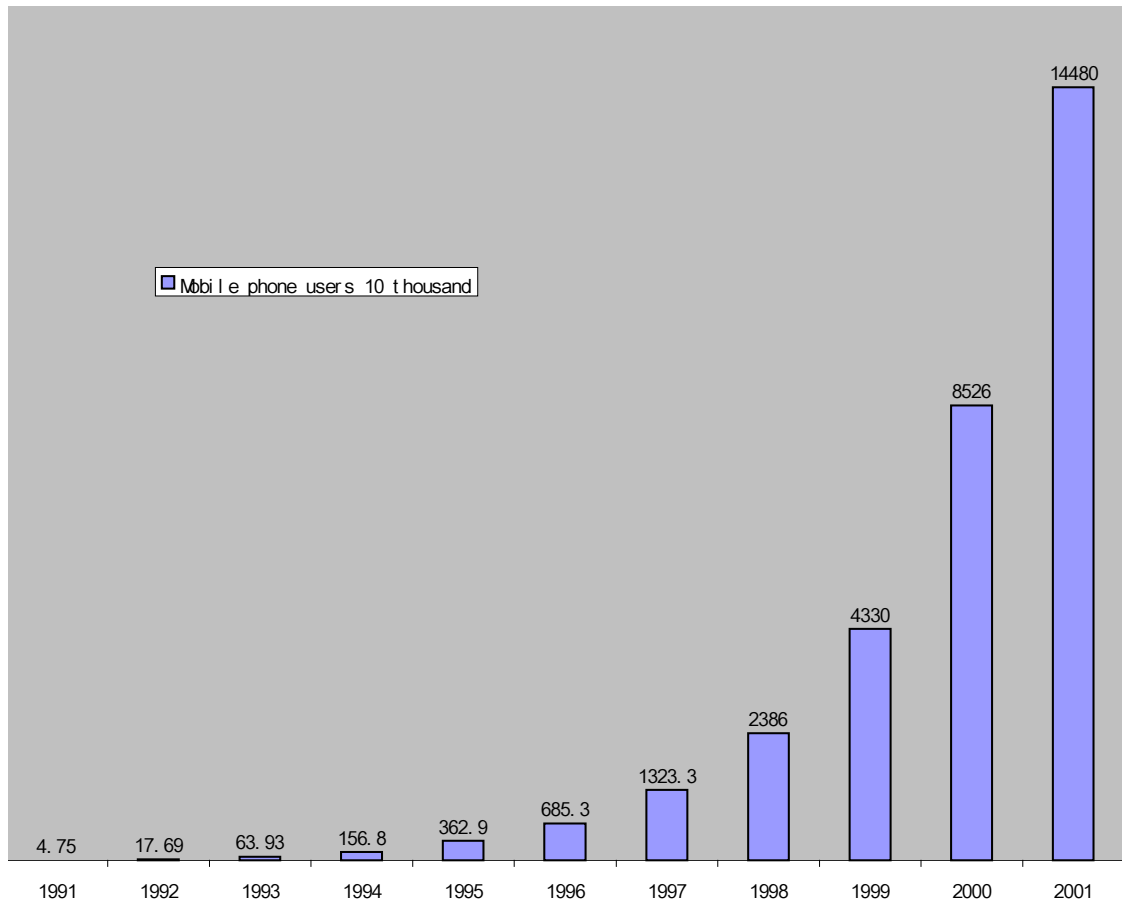
Figure 1.5 China's Growth in Telecommunications and GDP, 1984-2001



Source: <http://www.mii.gov.cn> and <http://www.stats.gov.cn>, edited by the author

The pace of growth in mobile phone service is even faster. Indeed, it is in the mobile market investors see the biggest pots of gold. The mobile phone was introduced to China as late as in 1988. At that time, the Chinese called mobile phones “Dageda”, which means “big man”, or “BigBrotherBigs”, because until recently only successful businessmen or entrepreneurs (those elites are usually called “Big Brothers” in China) could afford them. Though the mobile sector had a very late start, it has picked up an amazing speed. During the past decade, it has grown at a rate of 200 percent. It took ten years for the Chinese mobile industry to reach its first 10 million subscribers, but only one year to reach another 10 million. Today, nearly 145 million Chinese are “Big Brothers” (Figure 1.6). In ten years, the mobile phone market achieved a volume that it had taken the fixed-line sector 110 years to build. By 2005 the number of mobile subscribers could reach 240 million, according to official estimates.

Figure 1.6 Developments of Mobile Telecommunications, 1991-2001



Source: Data from <http://www.mii.gov.cn>, drawn by the author

1.3 Regional Inequalities

China's telephone penetration rate is still not high for the country as a whole. This low nationwide average reflects the predominance of undeveloped rural areas in China. In terms of economic development, there are sharp differences between eastern and western regions, and between urban and rural areas in China.

In big cities such as Beijing, Shanghai, Tianjin, Nanjing, Hangzhou, Fuzhou, Wuhan, Guangzhou, Haikou, Kunming and other provincial capitals, the telephone penetration was already over 40 percent in the market for fixed-line phones as early as in 1998, while the national penetration rate was just 10.53. Take the example of the capital city, Beijing: by mid-2001, one out of every two Beijing residents had a telephone; the number of fixed-line telephone users exceeded 5 million, and nearly 80 percent of these, 3.66 million, were residential; the fixed-line teledensity among urban residents was 66.4, and the mobile penetration rate was as high as nearly 50 percent. In

sharp contrast is the low rate in western regions. For instance in 2000, the teledensities in inner provinces like Guizhou and Shaanxi were just 6.3 and 6.96 respectively, far behind the national level of 26. There is also a sharp inequality between urban and rural areas. In penetration terms, in 2000, fixed-line penetrated 39 percent of urban households but just 20.1 percent of rural households. Imbalance exists in mobile telecommunications as well: in 2001 the mobile phone users of five coastal provinces, Guangdong, Jiangsu, Zhejiang, Fujian and Shandong, took up a share of 35 percent of the whole national market.

But in recent years the pattern of market growth shows significant signs of new trends, that is, telecommunications development of western regions and rural areas has picked up accelerating speeds. In fact, since 1992, the growth rate of rural lines has matched that of urban lines. The telecommunications growth rates in many of the interior provinces now equal or exceed the coastal provinces. This phenomenon suggests both an acceleration of the urbanization/industrialization process in interior provinces, and a growth of connectivity in the rural areas.

In the meantime, the Chinese government is determined to change the situation of spatial disparities. It stated that telecommunications construction in western areas must proceed ahead of other factors in order to provide the requisite services for local economic development, and the state will establish a general service fund to coordinate the development of telecommunications between various regions.

1.4 A Highly Policy-promoted Market

The impressive growth in China's telecommunications industry is an outcome of combined factors. Besides the economic and technological development, one important contributor is a series of governmental supporting policies for the telecommunications industry.

Prior to 1980, due to stringent price control by the state, the telecommunications industry basically was making no money, or even losing money despite the fact that the telecommunications operator was a legal monopoly. To change this situation, as well as to improve China's telecommunications services, the government relaxed its price control and adopted several encouraging policies.

One of the measures was to allow telecommunications companies to charge an installation fee or connection fee towards residential phones. Thus the Chinese subscribers were in fact financing their own installation and connection. In 1990 the

State Council approved the recommended standard for installation fees to be between 3,000 (US\$363) and 5,000 (US\$605) Yuan. Since the mid-1980s, China's local telephone companies have charged subscribers advance payments of between 1,000 (US\$121) and 5,000 (US\$605) Yuan to be connected to the network; an amount which in fact exceeded the annual income level of most Chinese. For over fifteen years, installation fees acted as a major important source of telecommunications investment funds. At the same time, the government allowed local governments and banks to help finance the industry (Table 1.3). In the process, telecommunications companies forged strong ties with local banks, local governments, and foreign corporations. By the end of 2000 the installation fee at the national level had fallen below 500 Yuan (US\$60), and on July 1st, 2001, the telecommunications authority announced cancellation of installation fees all over China.

Table 1.3 Sources of Telecommunications Investment Funds, 1983 –1995

Year/Period	Total investment (billion Yuan)	As a percentage of the total funds (%)				
		State fund	Loans	Foreign Investment	Self-financing	Ministry fund
1983	9.5					86.0
1984	13.5					84.3
1985	19.3					80.2
1981~1985	58.6	24.4	4.3	0.6	51.9	
1986~1990	201.9	27.7	10.6	8.4	61.4	56.6
1991~1995	2380.6	27.7	8.7	16.9	70.6	25.6

Source: Translated from Reference for Economic Research, Shi & Zhou, Nov. 28 1999, Issue. 1350, p35

Note: Figures calculated at the prices of the indicated years; 1 US Dollar = 8.27 Chinese Yuan

Then, after experiments in several provinces in 1983-1984, a western accounting system, Accrual Accounting Model, was implemented nationwide in 1985. Unlike the old income-expenditure accounting model learnt from the former Soviet Union, the new accounting system treats corporations as independent economic entities and interprets their business performance more accurately. Therefore, telecommunications companies enjoyed relatively independent economic interests, which in turn greatly

encouraged them to improve telecommunications investment and service performance. The new accounting system also made notable contributions to the coordinated development among different regions. Furthermore, as opposed to the general 33 percent rate for corporation income tax, a lower rate (10 percent) was applied that year to telecommunications enterprises in order to promote industry development. The growth of China's telecommunications sector in excess of GDP growth began at this time (Figure 1.5). The 10 percent taxation treatment was terminated in 1995.

All these favorable measures greatly spurred the expansion of China's telecommunications industry. Even today, government intervention still plays a major role in forming market structure. For instance, price control is still in place for the purpose of encouraging competition and nurturing minor players. (The tariff system will be discussed in more details in 3.4 of chapter 3).

Summary

In the past two decades, China has built up the biggest mobile phone market and the second largest fixed-line network in the world and the markets are still growing. The growth pace is impressive. Compared with the 50-plus percent fixed-line penetration and more than 30 percent wireless penetration in most advanced economies, as a strong market economy and a nation with 1.3 billion people but only a 26 phone penetration rate, China holds massive growth potential. The numbers have sparked the keen interest of nearly all of the world's major telecom service providers, many of whom consider China "the market of the next century." Yet behind the glorious figures, there exist several problems: the regional inequality, urban-rural disparities, policy-directed nature, lagging traffic growth, etc. However, as has been proved by recent market performance and as predicated by official analysts, it is safe to conclude that five development trends have materialized. In the future major industry improvements will be taking place in five areas: western regions, rural areas, residential telephone sector, telecommunications traffic, and value-added services.

Chapter 2 The Ministry of Arbitrary Power

Economic development has generated an enormous appetite for information services in China. Sitting atop of the telecommunications field is a virtual national monopoly power – first, the Ministry of Posts and Telecommunications (hereinafter “MPT”), and later, the Ministry of Information Industry (hereinafter “MII”).

As a functional organ of the State Council, the MPT, the forerunner, was in charge of the combination of postal services with local and long-distance telecommunications services throughout China. It was also the administrator of China’s telecommunications equipment manufacturers. In other words, the MPT was a pure example of the kinds of state-owned postal, telephone, and telegraph monopolies that have dominated the telecommunications landscape in most of the world for the past 100 years. The MII, the MPT’s successor, was constructed in an effort to create a more specific telecommunications regulator independent of the telecommunications industry.

2.1 The Former MPT

The MPT had all the characteristics of a stated-owned monopoly. It controlled a universal nationwide telecommunications network. It formulated key policies and plans, such as the ban on foreign direct investment in service provision or the formula for redistributing long-distance revenues. It set and enforced some (not all) technical standards. The MPT and its provincial-level branches also had an extensive network of newsletters and journals that defined and reinforced the viewpoints of the telecommunications monopoly on matters of policy and administration. No other telecommunications interest in China could match its scope and power.

For the MPT, five guiding principles had contributed to maintaining its strength:

- ❑ *Rapid expansion.* The MPT must keep up with the growth of the economy as far as possible. It could not afford to leave any significant aspect of the telecommunications sector unaddressed.
- ❑ *National coverage.* The MPT must serve all of China, not just parts of it, if it were to maintain its status as a national industry governor.
- ❑ *Self-preservation.* When expanding, it must maintain organizational integrity. Some change in structure was unavoidable as the MPT grew in scale, but it

must oppose divestitures, privatization, and any other ruptures that might undermine its integrated control of the sector.

- *Exclusion of foreigners.* The MPT must hold foreign providers at bay. Although it recognized its need for foreign capital and technology, it had to protect its underdeveloped, and therefore vulnerable, service markets. Equally important, keeping out foreigners prevented domestic competition from gaining powerful allies.
- *Preempting the competition.* The MPT must stay ahead of domestic competition and marginalize it whenever possible.

Another factor that accounted for the cohesiveness of the MPT was its elaborate system of revenue redistribution. In the MPT era, all revenues collected for international, inter-provincial, and even intercity telephone calls, were handed over to the MPT and then the MPT redistributed the local level's share of long-distance revenues according to a formula that did not reflect costs. A substantial part of this revenue was retained by the MPT. Some provinces benefited from distribution of the revenues more than others. Revenue redistribution fulfilled important political functions – promoting the development of a ubiquitous national network and mollifying political tensions among provinces. On the other hand, it helped the MPT to raise enough funds to finance the industry expansion without depending on foreign capital sources.

Thus, the MPT could be considered as a model of the socialist market economy. It preserved a state-owned, centralized organization with an essentially monopolistic hold on an industry sustaining a blistering pace of growth.

2.2 Early Reforms in the MPT

For the first 30 years after New China's birth, its communication development focused upon the mass media such as radio diffusion. From 1978, the Chinese government shifted its priorities to economic development and gradually recognized the significance of telecommunications infrastructure. This change of attitude brought about incremental reforms in the governmental division responsible for telecommunications – the MPT.

The reform precedents set by developed countries often started with restructuring and /or privatizing the MPT. However, this procedure in China took

place very slowly and quite differently, because China's legal and institutional infrastructure is not developed well enough to quickly restructure such a large and multi-layered organization on a national scale.

From the beginning, the goal of the reform process had been to infuse China's planned economy with market forces and rational economic incentives without moving all the way to privatization. In practice, this had meant decentralizing administrative power and forging a closer link between rewards (profits, promotion) and performance.

In 1988, a major state enterprise reform initiative took place at the national level. Its object was to further separate government functions from business management. The MPT was partially affected. The separation order was applied to the MPT's manufacturing entities but not to its service-providing entities. However, the 1988 reforms did shift more decision-making authority regarding procurement, operations, network development, and financing from the MPT headquarters to the local municipal and county level.

In 1994, the State Council required the MPT to further its management system reform. The General Posts Bureau and the General Telecommunications Bureau were transformed into enterprises adopting business accounting principles. Post and telecommunications sectors continued to be under the dual leadership of both the MPT and the provincial/municipal governments. In April 1995 when the General Telecommunications Bureau was registered as an enterprise entity, the separation of government functions from enterprise functions in the telecommunications sector made a big step forward, but it was still largely unfinished.

In January 1997, the MPT made a decision to split the post business from the telecommunications business, a move that eliminated cross-subsidization among different business lines. After experiments in Chongqing and Hainan, this process was carried out nationally in 1998 and was completed in January 1999 by the MII.

2.3 The New Authority: the MII

In preparation for its accession to the WTO, China took up further meaningful reforms in its telecommunications regulatory organization. To this end, in March 1998, the State Council merged selected functions of the MPT, the Ministry of Electronics Industry, and the Ministry of Radio, Film and Television into a new senior telecommunications authority, the MII.

As the new regulatory authority under the State Council, the MII has been given responsibilities for supervision and management in such information industries as telecommunications, multimedia, broadcasting, satellite and the Internet, at the central and provincial levels, without any mandate for engaging in telecommunications business directly. The MII so far seems to be successfully making its case for an overall supervisory authority.

13 divisions of the MII have been established in accordance with its new functions:

- ❑ Administrative Office
- ❑ Automation Promotion Section (National Automation Office)
- ❑ Economic Regulation and Communications Liquidation Section
- ❑ Economic System Reform Economic Operation Section
- ❑ Electronic Information Product Administration Section
- ❑ Foreign Affairs Section
- ❑ General Planning Section
- ❑ Personnel Section
- ❑ Policy and Regulations Section
- ❑ Radio Administration Bureau (National Radio Office)
- ❑ Science and Technology Section
- ❑ Specialized Electronic Equipment Bureau
- ❑ Telecommunications Administration Bureau

Power range of the MII

The MII is in charge of supervising and administering China's telecommunications industry as a whole. It is responsible for the overall planning of the construction and administration of public telecommunications networks, specialized telecommunications networks and broadcast and television transmission networks. The telecommunications administrative authorities (hereinafter "TAAs") of the provinces, autonomous regions and municipalities under the direct administration of the central government are responsible for supervising and administering the telecommunications industry within their respective areas of administration.

A brief description of the MII's functions may help understand its unmatched role and significance in China's telecommunications industry. Main duties of the MII are: to draft laws and regulations, and to issue administrative rules for the industry; to

organize and implement any related strategies, policies and plans; to administrate and supervise law enforcement; to formulate industry guidelines and set industry standards; to compose policies concerning telecommunications service charges and confirm basic payment standards; to provide guidance for the adjustment of the industry, product, and enterprise structure, etc. Most notably, it also takes the tasks of “safeguarding the security of the nation’s communications and information” and “supporting national industries.”

An independent regulator?

After the birth of the MII, the government took a more decisive step. It forced the telecommunications regulator, the MII, to give up operating China Telecom so that the ministry could play a more neutral role. By the end of 1998, the goal of separation of government functions from enterprise functions at the organizational level was largely achieved. But much remains to be clarified.

An independent regulator should treat domestic and foreign carriers equally, and is not accountable to either side. First, the regulator should be exempted from undue political intervention. However, the MII’s top priority is to faithfully implement the policies of the Chinese Communist Party and the government. Therefore its independence can only be viewed in a comparative rather than absolute sense. The MII’s real independence will be contingent upon wider political reforms, the outcome of which is uncertain. Second, independence means that the regulator has no interests in the regulated industry and does not favor national players at the expense of consumer interests. Unfortunately, given the fact that China’s domestic carriers are state-owned rather than private, the MII still has strong structural, political, and economic incentives to favor Chinese companies.

Zhu Rongji, China’s prime minister and its most principled reformer, has long been fed up with the slow reform progress. He was the advocate of opening up the telecommunications market, but the MII opposed it. Though Zhu won the battle, he has not won the war. The MII is in charge of crafting the new rules. Mr. Wu Jichuan, chief of the ministry, represents broad segments of China’s bureaucracy. The extreme protectionist, the MII, is working swiftly to build up competitive edges of domestic players in the telecommunications sector so that they will be ready for foreign competition. What is more unfortunate, is that Mr. Wu Jichuan is reported to be a quite arbitrary protectionist, as the following citation depicts,

“... Mr. Wu seemed to relish this confirmation that he was the most powerful man in what is likely to become the world’s biggest telecoms market. ... One brave reporter wondered whether some transparency in the ministry’s decision-making process might help. ... “There are many opinions,” he said, “but what matters is mine.” ... In 1997 he told America’s commerce secretary that China would not open its telecoms market for at least 20 years. ...” – The Economist, Dec. 9 2000, page 76

Later, under the pressure of inevitable opening up of the market, Mr. Wu seems to have surrendered to reality. Speaking at a recent conference in Hawaii in January 2002, Mr. Wu was at pains to stress that the Chinese telecommunications market was open for business. “The Chinese government is taking a positive and pragmatic approach to development,” he says, “it won’t designate who can compete and who can’t. It will provide conditions that everyone can compete on that basis and increase revenues for themselves (Raffray, 2002).” But, can we trust his words this time?

Summary

The MII now has the mightiest power regulating various aspects of China’s lucrative telecommunications industry. How is it to utilize its power and when will it become a truly independent regulator are the biggest concerns among various investors, observers and analysts. Given the close financial and operational relationship between the MPT and China Telecom in the past, and the perceived continuing association between the MII and the new telecommunications companies as well as the MII’s powerful role in price-setting, network construction and other matters, it remains to be seen whether the MII will in practice be truly impartial to all telecommunications operators (including new entrants, private investors and foreign investors) in executing its regulatory powers. In fact, it may take a considerable period of time, even with the help of WTO membership, before the MII becomes a truly independent telecommunications regulator.

Chapter 3 Market Reforms and Domestic Players

With the telecommunications industry growing 30% faster than the economy as a whole, plenty of players – from powerful government ministries to cash-rich Western multinationals – are eager to grab a piece of the big cake. But to be successful, new entrants must first understand the changing context of the Chinese telecommunications market.

China's leaders recognize the rich opportunities and what is at stake: telecommunications, perhaps more than any other industry, holds the key to China's economic future. Leaders have come to realize that no single player could build the massive, efficient telecommunications infrastructure needed for China to be a global economic power in the coming century. Therefore, from 1994, China embarked on a tough journey of restructuring its telecommunications market by introducing market rules.

3.1 Preparation for Competition

The problem with China's telecommunications market is a legacy of central planning. The regulator, either the MPT or the MII, is not an impartial referee but intervenes on behalf of its favorites. Until recently, the monopoly service provider, China Telecom, was an arm of the ministry. However, telecommunications is considered the crown jewel of China's industries, and for the industry's sake the government is keen to introduce the concept of competition.

Before 1994 – the monopoly world

Prior to 1994, China's telecommunications industry was a monopoly market dominated by the state-run China Telecom. For decades, the government entrusted the task of building up China's telecommunications infrastructure largely to China Telecom. Funded by massive state investment, China Telecom made fast progress. In 1985, by capacity, China had the 17th largest telephone network in the world; in 1997, it had the second largest, made up largely of a million kilometers of state-of-the-art fiber-optic cable.

But monopoly also had produced inefficiency, poor service and high prices. For instance, in Beijing, the installation fee for residential phone lines was increased arbitrarily by the local operator from 200 Yuan (US\$24) in 1980s to 5000 Yuan

(US\$605) in 1996. The connection fee for mobile phones was once even as high as 28,000 Yuan (US\$3386). However, despite the flying charges, the service quality remained largely unchanged. To have a phone line connected, for example, the subscriber had to wait as long as half a year in 1994.

Cheap, fast telecommunications will be vital in the new digital era, and China's leaders do not want to be left behind, so finally they tried to create real competition to the old monopoly, China Telecom. The government made a marked move to introduce competition back in 1994, when it authorized the creation of a second telecommunications operator, the China Unicom.

The creation of China Unicom and Jitong Network Communications (hereinafter "Jitong")

In 1994, in an effort to liberalize China's telecommunications market, China Unicom was licensed to break China Telecom's monopoly on domestic fixed-line and cellular telephony. China Unicom has extensive political relationships with various ministries in the government. Three government ministries, the former Ministry of Electronic Industry (hereinafter "MEI"; the MEI is now a part of the MII), the former Ministry of Power Industry, and the Ministry of Railways, are significant shareholders of China Unicom (Chuang, 2000). China Unicom was allowed to conduct local phone services, long-distance services, and mobile services, and was granted an exclusive operational license to build a nationwide Code Division Access network, - an advanced wireless system.

China Telecom generally has not welcomed its domestic challenger, China Unicom, and used its clout to keep the new company on the margins. The MII has had to make some efforts to enable China Unicom to mount a credible challenge to the leading carrier, China Telecom. Meanwhile, China Unicom has the backing of other powerful ministries. Thus a managed duopoly in the telecommunications market was temporarily formed. This was regulated by politics rather than by market forces.

In terms of market structure, in the end of 1998, China Telecom in fact still monopolized the fixed-line sector while China Unicom took up only a negligible share; in the wireless service market, China Telecom and its state-designated competitor, China Unicom, constitute a duopoly, controlling 94 percent and 6 percent of the market, respectively.

In the same year as China Unicom's birth, Jitong was established by the MEI to provide primarily Internet protocol (hereinafter "IP") telephone and broadband network services. It also runs China Golden Bridge Information Network, one of the few enterprises authorized to offer commercial Internet networking to Internet service providers.

3.2 Limits and Dilemma for Industry Reform

As early as in 1993, an unusually widespread debate on the reforms of telecommunications industry took place in China. However, despite strong advocacy for liberalization from outside observers, incumbent players and consumers, the reform process has been slow. Many existing hurdles, ranging from top-level power fighting and political bureaucracy to depressing reality of underdevelopment and unfinished enterprise reform, tend to obstruct liberalization process. Even with the stimulation of WTO membership, a truly fair, effective and pro-competitive market will take a long time to form.

First, both the previous MPT and the current MII hold a conservative and protective position in the debate. They argued that liberalization sacrifices economies of scale in telephone services and undermines the goal of achieving universal service. They also claimed that a centrally controlled telecommunications market was essential to national security. Additionally, the MII is not a truly independent regulator yet, and there are no clear lines defining ownership of assets between the provincial/ municipal administrative bureaus and the MII.

Secondly, the overall framework concerning competition policy is inconsistent and lacks transparency. The telecommunications industry has long been governed by fragmented administrative decrees mainly dealing with technical standards and service tariffs, while many basic issues such as state-owned enterprise reforms, private participation in telecommunications, antitrust, and property rights remain unresolved. Therefore, the MII is still incapable of preventing domestic carriers from engaging in anti-competitive behavior such as cross-subsidization and concealment of technical information and network and service specifications.

Thirdly, the fact that the national market is unevenly developed among different regions hinders the applicability of market forces. Even by 1998, about 33 percent of rural villages, mostly in western China, still had no access to phone services. In addition, the operational costs in western China are believed to be

exceptionally high because of the harsher natural conditions and the smaller and poorer population. Under such circumstances, cross-subsidization from eastern areas to western areas and from wireless and long-distance services to local phone services (also due to lack of independent accounting systems for separate services) is not only necessary but also unavoidable in order to achieve universal services nationwide.

3.3 An Ever-changing World: 1999-2001

From early 1999, the transformation process of China's telecommunications market has taken on a swift pace. The market situation is changing so frequently that over a period of just a few months things could take on an unrecognizable look. Basically there are two major actions, the demerger of China Telecom in 1999 and the North-South splitting of China Fixed-line Telephony Company (hereinafter "China Telecom-f") in 2001, with some minor players coming up and being mingled out during the process.

The break-up of China Telecom

The Chinese government instituted liberalization in its telecommunications market in February 1999 when the State Council approved a new restructuring plan for the state-run monopoly, China Telecom. The government broke up the China Telecom into three separate companies, each operating a different service sector – China Telecom-f, China Mobile Communications Company (hereinafter "China Mobile"), and China Satellite Communications Company (hereinafter "China Satellite"). Meanwhile, the detached paging business operator, China Paging Company, was merged into China Unicom, which remained a full-service operator for both fixed-line and wireless businesses. Later, a new telecommunications operator was created, China Network Communications (hereinafter "China Netcom"), with approval to operate broadband networks.

In 2000, another telecommunications operator, the Railway Communications and Information Company (hereinafter "China Railcom"), was licensed. Backed by the Ministry of Railways and using the 120,000 km fixed-line network linking 500 cities which it already had in place, China Railcom has the huge advantage of having the exclusive right to lay network along the country's railway lines, which represents China's second biggest fixed-line network after China Telecom-f.

After this restructuring, by the end of 2000, a fledgling competition situation was basically created in the basic telecommunications service market, with each business line having at least two state-run competitors (Table 3.1).

Table 3.1 Summary of Telecommunications Licenses in China (by the end of 2000)

Provider	Domestic/ Int'l distance	Wireless long- distance	IP telephony	Satellite -related business	Data communications	Internet
China Telecom-f	√		√		√	√
China Mobile			√	√		√
China Satellite					√	
China Unicom	√	√	√		√	√
China Netcom			√		√	√
Jitong			√		√	√
China Railcom	√				√	√

Source: Various sources, collected by the author

Nevertheless, China Telecom-f is still recognized as China's de facto telecommunications monopoly in every business line except for mobile communications. Its fixed-line network is still the largest in the country. According to the MII, by the end of 2001, China Telecom-f accounted for 53 percent of all telecommunications revenues in China and over 90 percent of non-mobile telecommunications revenues. In the mobile phone market, in terms of subscriber number, China Mobile held 71.7 percent of the market share, and China Unicom a share of 28.3 percent, by the end of 2001.

The North-South restructuring

In December 2001, the government split the largest operator, China Telecom-f, into two, one part for the north (covering 10 municipalities/provinces, that is, Beijing, Tianjin, Hebei, Shanxi, Inner Mongolia, Liaoning, Jilin, Heilongjiang, Henan and Shandong), and another focusing on the south (covering the rest of China). To help competition, both China Netcom and Jitong joined the northern interests of the old

China Telecom-f, with the new body to be known as the New China Netcom Group. It will control 10 municipalities/provinces and own 30 percent of the national backbone. In the south, China Telecom-f will take 21 southern municipalities/provinces and keep 70 percent of the national backbone while retaining its name as “China Telecom (hereinafter “China Telecom-s”).”

The two entities will be competing head to head in the battlefield of fixed-line telecommunications, and are allowed to build up local networks and to operate fixed-line business in each other’s domain. Both entities are also entitled to compete for later mobile licenses. Not long after, the newly established China Railcom was mingled with China Unicom. So, after this hustle-and-bustle restructuring, the market pattern of China’s telecommunications is initially set as shown in Table 3.2.

Table 3.2 Market Players in China’s Telecommunications Sector (after December 2001)

Operator	Fixed-line services	Mobile services	Satellite-related services	Data communications	Internet
New China Tetcom	√			√	√
China Telecom-s	√			√	√
China Mobile		√			√
China Unicom	√	√		√	√
China Satellite			√		

Source: The author

Table 3.3 Towards A Competitive Market

Milestones in Liberalizing China’s Telecommunications Industry (1994-2001)	
Jan. 1994	Creation of Jitong
Jul. 1994	Creation of China Unicom
Feb. 1999	Break-up of China Telecom: China Telecom-f (Dec.1999), China Mobile (Jan. 2000), China Satellite (Jun. 2000)
Apr. 1999	Creation of China Netcom
Mar. 1999	China Paging →China Unicom
Dec. 2000	Creation of China Railcom
Dec. 2001	Splitting of China Telecom-f: New China Netcom & China Telecom-s China Netcom & Jitong →New China Netcom China Railcom →China Unicom

Source: Edited by the author

The engine behind all those reforms in China's telecommunications industry has been the impending international competition pressure as a result of China's WTO accession. From the birth of China Unicom in 1994, China's telecommunications industry has undergone a complicated liberalization process (Table 3.3) and this process will continue until a true competition pattern has been created. The government is making great efforts to help domestic player learn market competition rules so that they are able to create a competitive edge against fierce future wrestling.

3.4 The Tariff System of China's Telecommunications

Chinese telecommunications users had long been subject to the high charges and poor service quality associated with China Telecom's monopoly of telecommunications business. More recently, telecommunications charges (e.g. initial connection charges and rates for long distance and international calls) have been greatly reduced and service quality has been improved in light of more competition among domestic telecommunications operators. However, due to lack of an effective regulatory framework, some operators have resorted to unfair practices, such as price cutting, false or misleading advertisements and cross-subsidies among different types of services, in order to gain a larger market share.

Currently, there are three types of telecommunications charges: market prices, government-guided prices, and government-fixed prices (Table 3.4). Government-fixed rates only apply to basic telecommunications business and they allow a floating zone in special cases. For example, prior to July 1st 2001 when China eliminated the installation fee for fixed-line phones and network connection fees for mobile phones, the government allowed China Unicom and China Railcom to charge tariffs that were 10 to 20 percent lower than the government-fixed rates applied to all other carriers. The government felt that such a double standard was justified to allow these two weaker players to become viable competitors to China Telecom-f before the entry of foreign competition.

Table 3.4 Current Price Regime in China's Telecommunications Market

Government-fixed Price	Government-guided Price	Market Price
<p>Applicable for fixed-line services (including local, domestic and international long-distance) and mobile services, set by the state and can not be changed</p> <p>* Exemption: China Unicom & China Railcom can fluctuate by $\pm 10\%$</p>	<p>Applicable when introducing new services, decided by operating enterprises and based upon the guiding standards of the state</p>	<p>Applicable for value-added services of IP telephony, paging, and data communications, and must be reported to the state</p>

Source: The author

The Chinese authorities have promised to move to a complete market tariff system on a step-by-step basis when market conditions are mature. The general principles guiding the price reform are “that rates for telecommunications will be determined on a cost basis, taking into account the requirements of the national economy, the development of the telecommunications sector and the affordability of users (the Telecommunications Regulations, see 4.3 of chapter 4).”

Summary

Recognizing the need to prepare for the inevitable arrival of foreign competitors after WTO accession, China's telecommunications industry has undergone fundamental changes over the past few years. In the process, the MII has had to use administrative means to create a more level playing field. However, the recent market restructuring and the impending foreign competition in the post-WTO era in basic phone services, represent a new challenge for the MII. The new challenge will force the MII to reconsider how to allocate universal service obligations fairly among different service providers. The critical questions for interested foreign companies and would-be participants are whether the current domestic players are likely to embrace even more competition and, if not, how will the MII behave in its dealings with foreign entrants.

Chapter 4 A Theoretic Review and China's Industry Policies

Traditionally, many service sectors, such as telecommunications, electricity and transportation, were considered as natural monopolies and hence were strongly regulated and protected. However, rapid development of technology and information has greatly altered the look of those once-privileged industries. Deregulation and liberalization have become the themes of development trends. Global trade organizations like WTO never stop their efforts to seek global solutions for further liberalization. Then how should we look at the cautious, and even resistant attitude of the Chinese government towards opening-up of its market if FDI means increased economic efficiency? And what progress has it achieved in losing its investment environment?

4.1 A Brief Review of FDI Theories

There are several theories explaining the phenomenon of FDI, such as Enterprise Advantage Theory (Hymer, 1960), Internalization Approach (Gray, 1978, 1982), Location Theory, Eclectic Theory of International Production (Dunning, 1977) as the combination of the former three and the dynamic Product Life-cycle Theory (Vernon, 1966). But none of them observes the FDI activity from the angle of the host countries and thus their applicability is somehow limited.

Industrial analysis of telecommunications

Is telecommunications an industry for internationalization? As a service sector, telecommunications has its distinctive characteristics. First, it involves high sunk costs in physical networks and high expenditure in research and development. "Knowledge-capital", that is high-tech products and rapid innovations, reputation, management, patents and trademarks, is vital in determining a company's competitive advantage. According to Hymer's theory of Enterprise Advantage, multinational firms tend to be important in industries with high levels of intangible assets, because knowledge-based assets can be transferred easily back and forth across space at very low costs. Secondly, there are significant network externalities in the telecommunications industry, where the benefit that consumers derive from any good or service depends on the number of other users. In this sense, economies of scale matters. Therefore, it calls

for industry concentration and overseas expansion. The larger the market size, the better.

Limits of existing FDI theories

FDI is the international economic activity jointly participated in by the investors and the host countries. The investing behavior of the investors and the actions taken by the host countries to attract investment are the two sides of this activity. Current FDI theories all observe FDI in the perspective of investors, or rather, individual investors, instead of taking both parties into account. Focus of their analysis is whether enterprises are competent enough to invest overseas, why invest overseas and which countries to go to. Attitudes and reactions of the host countries are not put into the analytic framework. The host country is always regarded as a passive recipient of foreign investment, unable to either influence investment selection and decision, or change investors' behavior. Therefore, the existing FDI theories are not only a kind of microanalysis, but are basically supply-determinative as well. Such theories are incomplete and their explanatory capability is very limited.

In fact, the host country plays a very active, and even decisive role in the FDI activity. By using regulatory power, it can decide whether foreigners are welcomed, in which sector they can invest, and in what way and at what scale they can participate. With regard to the host country, the most important thing is how to get more benefit from the process by improving its own bargaining power. Policies and regulations are, therefore, often employed by the host country government as powerful tools to guide or limit foreign investors' behavior. The viability of industry regulation has actually been verified by nations during the natural-monopoly times. Even with today's liberalization trend, governmental policies and regulations still have significant influence on the investment activities of foreign investors.

4.2 The Previous Prohibitive Attitude

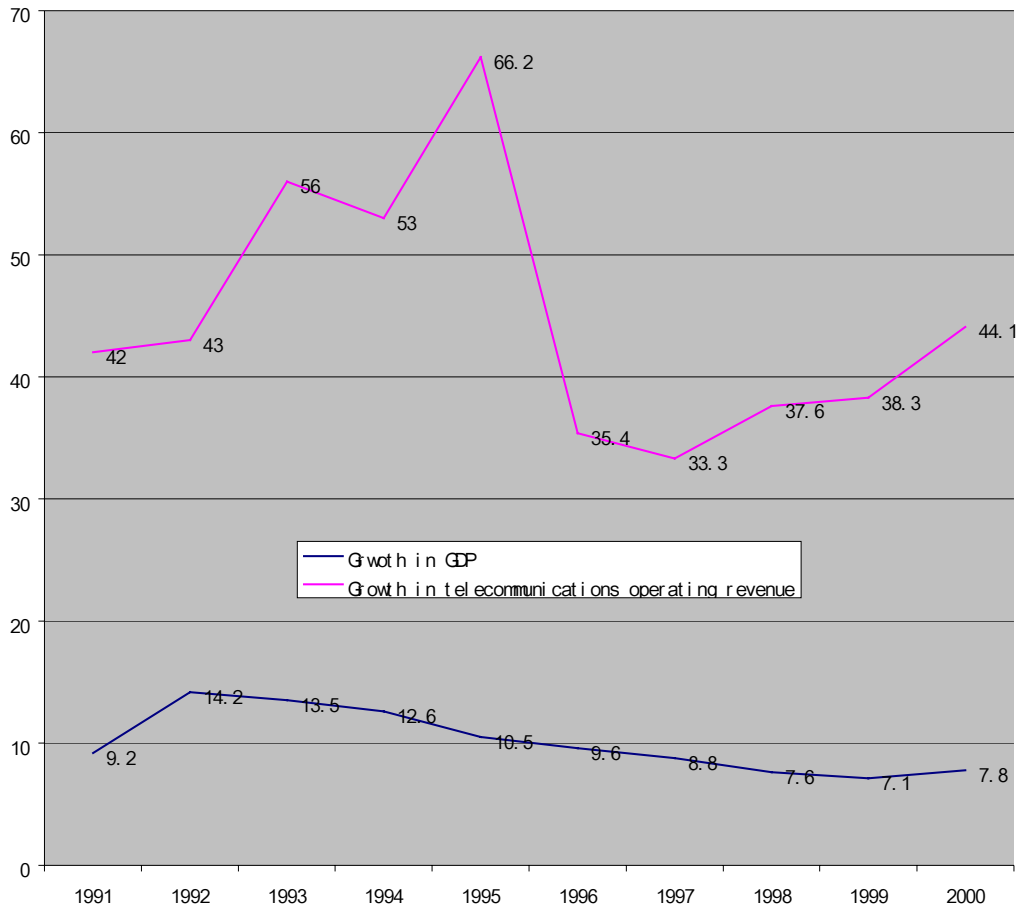
For decades, China has not permitted direct equity investment in or operation of telecommunications business by foreign individuals or corporations. A June 1993 State Council licensing order (the bulk of which was drafted by the MPT) reiterated this prohibition in the strongest terms. This occurred after the Deng Xiaoping-inspired pushes for foreign investment. China's restriction on foreign involvement is based on many considerations.

First, it is for the sake of state security. For decades, China's policy makers have been very cautious about information and communications. They maintain that telecommunications concerns the nation's security and sovereignty; therefore, it cannot be opened up to the outside world. They believed that centralization of telecommunications management in a single, state-owned operating entity makes it easier to use the network as an extension of the state's surveillance and security apparatus. This consideration is strengthened by the older leadership's military background and the association in Chinese history between telecommunications, transport, and sovereignty.

Second, telecommunications is universally perceived as a fast-growing, highly profitable business. Both the former MPT and the present MII would like to reserve as much as possible of this market for themselves. Historically, the Chinese telecommunications monopoly overcharges long-distance and international calls, where demand is inelastic and users are wealthier, while undercharging basic local calls. According to the official release by the MPT a couple of years ago, the profit margin on local services was only two to three percent; on long-distance calls 25 percent; and on international calls 75 percent. During the past decade, the total telecommunications revenues have been growing at a speed of 40 percent a year (Figure 4.1). In fact, with a total operating revenue of 449.4 billion Yuan (US\$53.34 billion) in 2000 (Table 4.1), telecommunications had become the No.1 service industry within China's tertiary sector.

Thirdly, the monopoly operator, China Telecom, was not competitive enough against its foreign counterparts. Years of monopoly privilege without competition pressure resulted in high charges, low efficiency and poor service in China's telecommunications sector. Given the relative underdevelopment of the Chinese market and the advanced technological and management expertise of foreign companies, both the MPT and the MII view foreign competition as a great danger to nationals. Therefore, in order to nurture national industry, they are very unwilling to allow them in.

Figure 4.1 China's Growth in GDP and Telecommunications Operating Revenues



Source: The author

Table 4.1 China's Telecommunications Total Operating Revenues, 1990-2000

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Billions of Yuan	13.92	15.16	22.66	38.25	59.23	87.55	120.88	162.90	226.49	313.24	449.40
Growth (%)		42	43	56	53	66.2	38.4	33.3	37.6	11.9	44.1

Source: Edited from <http://www.stats.gov.cn/sjjw/ndsj/zgnj/2000/O41c.htm>

4.3 The Consequences of Joining WTO

In light of China's official accession to WTO in November 2001, China is obliged for the first time to allow gradual foreign involvement in its telecommunications business. In addition, China also automatically becomes a party to the Basic Telecommunications Agreement (hereinafter "BTA"), an agreement that governs the liberalization of basic telecommunications services among WTO members, and that is committed to imposing pro-competitive regulatory principles on all WTO parties (Xu & Yip, 2001). China's membership of both WTO and BTA will bring significant impact and changes to this socialist market economy.

BTA principles

Being a BTA signatory, China should adopt the core regulatory principles set out in the Reference Paper, which forms part of the BTA (Xu & Yip, 2001). In essence, the BTA requires member states to comply with the following six regulatory principles:

- a) to establish a regulator independent from any service supplier;
- b) to utilize transparent criteria in licensing;
- c) to establish terms and conditions for non-discriminatory interconnection;
- d) to adopt cost-based pricing and safeguards to protect against anti-competitive behaviors;
- e) to utilize "objective, timely, transparent and non-discriminatory" procedures for the allocation of scarce resources; and
- f) to administer non-discriminatory universal service obligations.

As there is little WTO guidance on the practical application of the above principles, these six principles will, in fact, be implemented in accordance with the national legislation of BTA signatories. At present, none of these six areas of China's telecommunications sector seems to comply with BTA rules – although some are in better shape than others (Table 4.2). Overall, there are huge gaps between the current regulatory regime and the ideal one outlined by the BTA. These gaps will act as regulatory barriers to foreign entrants until sound regulations are in place.

Table 4.2 Current Regulatory Status of China's Telecommunications Sector

Current situation	Forecast for the next 5 years
<ul style="list-style-type: none"> • No national telecom legislation • Extensive administrative control 	<ul style="list-style-type: none"> • No timetable for a telecom law • Overall development uncertain
<ul style="list-style-type: none"> • Interconnection order issued, but limited in scope and depth 	<ul style="list-style-type: none"> • Further improvements
<ul style="list-style-type: none"> • Current telecom services not universal • Strong urge to provide services to rural, western regions 	<ul style="list-style-type: none"> • More regulations • Rules may favor incumbents and require new entrants to share more universal service burdens
<ul style="list-style-type: none"> • Applied administratively with little transparency 	<ul style="list-style-type: none"> • Improvements in opening, transparency, and nondiscrimination • Possible difficulty complying with WTO national treatment principle
<ul style="list-style-type: none"> • The MII's independent regulatory role formally established • Boundaries between the MII and state-owned carriers still unclear 	<ul style="list-style-type: none"> • Some effort to improve regulatory independence • Real independence contingent on macro political reforms
<ul style="list-style-type: none"> • Handled administratively with little transparency 	<ul style="list-style-type: none"> • More competition and transparent methods

Source: Zhang & Peng, the China Business Review, May/June 2000

China's WTO commitments

According to China's WTO telecommunications agreements, China will progressively open its telecommunications service market to foreign companies in three phases, which vary in timing over three different categories of services: value-added services (hereinafter "VAS") and paging (this category is beyond discussion in this article), mobile voice and data services, and domestic and international basic fixed-line services.

Foreigners will be able to acquire 30 percent ownership in VAS and paging in Beijing, Shanghai, and Guangzhou immediately upon China's accession and up to 50 percent ownership anywhere in China within two years of China's entry. Foreign ownership in mobile telecommunications would reportedly be permitted immediately upon China's WTO accession, with up to 49 percent ownership phased in over three years. The third category to be phased in will open three years after accession and rise to 49 percent foreign ownership anywhere in China by year six.

Beijing, Shanghai, and Guangzhou constitute China's key telecommunications service corridor, accounting for roughly 75 percent of all domestic traffic. This corridor will open to foreign investment in the three categories of telecommunications

services during the relevant Phase I. Phase I varies among the three categories: immediately for VAS and mobile and data services, and three years for basic services. Another 14 cities (Chengdu, Chongqing, Dalian, Shenyang, Fuzhou, Xiamen, Hangzhou, Ningbo, Nanjing, Qingdao, Shenzhen, Xi'an, Taiyuan, and Wuhan) will open during the relevant Phase II, that is, one year after accession for VAS, three years for mobile and data and five years for basic services. All of China will be open to foreign investment in all telecommunications services six years after China's WTO entry (Horsley, 2001).

By joining the WTO, China is committed to allow access to its vast markets with tremendous growth potential, which were previously forbidden and, just as important, to ensure that this access is fair and that the rules governing it are transparent. But many barriers remain for the successful implementation of these commitments, and this is the main topic of chapter 5.

4.4 Towards A Telecommunications Law

While China has enacted legislation to facilitate foreign investment in general, there is still the hazardous absence of a telecommunications law. Several drafts of a telecommunications law have been prepared, but bureaucratic inertia and irreconcilable interests have stymied the process. However, spurred by the WTO and BTA commitments, the Chinese government is working hard and fast to prepare a legal environment for its telecommunications service sector and has already made some notable efforts.

The Telecommunications Regulations

The Telecommunications Regulations of the People's Republic of China (hereinafter "Telecommunications Regulations") were approved by the State Council on September 20th, 2000 and were promulgated and became effective on 25 September 2000. This is the first general administrative regulation in China's telecommunications history, signaling the beginning of legislation construction for the telecommunications industry.

The 81-article Telecommunications Regulations aim to regulate the telecommunications market in China, protect the interests of both subscribers and operators, and ensure the safety and security of telecommunications networks and information. The regulations open the field to non-state participants, including

individual and foreign investors. The regulations also establish network interconnection rights for non-dominant operators, a permit system for licensing operators, a cost-based pricing (tariffs) system, a fee-based, centralized auction system for allocating telecommunications resources (such as spectrum and satellite orbit positions), regulations of telecommunications services including universal service, centralized administration of the construction of telecommunications facilities, principles on network-access permits for telecommunications facilities, network safety and security requirements, and fines and penalties.

Within these regulations, telecommunications operations are loosely divided into two categories: basic telecommunications services (hereinafter “BTS”) and value-added telecommunications services (hereinafter “VATS”) (Table 4.3). Meanwhile, the Telecommunications Regulations set out extensive pre-requisites for the operation of BTS. While non-state-owned or private entities now for the first time are allowed to hold up to 49 percent of the equity of a BTS operator, the requirement that 51 percent of the equity of a BTS operator still must be owned by the state reflects the Chinese government’s determination to retain state control over the operation of BTS. As for the VATS, there is no requirement that a certain percentage of the equity or share capital of a VATS operator must be owned by the state. Therefore, it is possible that 100 percent of the equity or share capital of a VATS operator may be owned by non-state or private domestic entities.

Table 4.3 Classifications of Telecommunications Business

**Appendix to the Telecommunications Regulations of the People’s Republic of China:
Catalogue of the Classification of Telecommunications Business (promulgated Sep. 25th,
2000)**

1.	Basic telecommunications services:
	A. Domestic long-distance and local calls on fixed network
	B. Mobile phone networks and transmission of data
	C. Satellite communications
	D. Leasing or selling of bandwidth, optical fiber and cable
	E. International telecommunications infrastructure
	F. Wireless paging
	G. Transfer sales of basic telecommunications

-
2. Value-added telecommunications services:
 - A. E-mail
 - B. Voice mail
 - C. Online storage and retrieval of databanks
 - D. EDI
 - E. Online data processing and transaction processing
 - F. Value-added fax
 - G. Internet access
 - H. Internet information service
 - I. Video telephone conference

Source: Telecommunications Regulations of the People's Republic of China

Investment Regulations Governing Foreigners

If the Telecommunications Regulations can be thought to target domestic operators, then the promulgation of Administrative Regulations on Foreign Invested Telecommunications Enterprises (hereinafter "Administrative Regulations") on December 21st, 2001 is a long-awaited event for foreign investors. Foreign companies have every reason to be excited by these new regulations that are supposed to entitle foreign investors legal status in China's telecommunications industry. The new regulations came into effect on January 1st, 2002.

As with the Telecommunications Regulations, the Administrative Regulations conform in every aspect to China's WTO and BTS commitments. The 25-article regulations set out specific requirements for would-be foreign operators in BTS and VATS business and also stimulate application and approval procedures (Table 4.4). They also state that foreign investment in the telecommunications industry must be in the form of Sino-foreign joint ventures (which are entities composed of both Chinese and foreign partners, each investing a certain percent of capital) and that foreign operators must abide by the Telecommunications Regulations and other laws, directives and provisions of the Chinese government.

Table 4.4 Administrative Regulations for Foreign Funded Telecommunications Enterprises

Summary of the Administrative Regulations (promulgated Dec. 21 st , 2001)		
Operating areas	Nation-wide or inter-province/autonomous region/municipality	Within province/autonomous region/municipality
Entrance requirements	For BTS: minimum registered capital of 2 billion Chinese Yuan; For VATS: minimum registered capital of 10 million Chinese Yuan Sound performance and experience in the industry	For BTS: minimum registered capital of 0.2 billion Chinese Yuan; For VATS: minimum registered capital of 1 million Chinese Yuan Sound performance and experience in the industry
Equity/capital share for foreign partner	For BTS (excluding Radio paging): maximum of 49% For VATS (including Radio Paging): maximum 50%	For BTS (excluding Radio paging): maximum of 49% For VATS (including Radio Paging): maximum 50%
Censoring authority	The MII	For BTS: the MII For VATS: the TAAs*
Processing time	For BTS: 180 days For VATS: 90	For BTS: 180 days For VATS: 60 days

Source: Translated and edited by the author from Administrative Regulations on Foreign Funded Telecommunications Enterprises

* The TAAs: the telecommunications administrative authorities of the provinces, autonomous regions and municipalities

The Administrative Regulations have been made to fit in with China's WTO promise that overseas investors should be able to take up to 49 percent of the operation of BTS within five to six years of China's accession. Unless a potential foreign investor is willing to accept a minority interest of 49 percent in any proposed Sino-foreign BTS joint venture, the chances for the foreign investor to successfully partner with a private domestic entity would therefore appear to be minimal. As for the VATS, under the

terms of China's WTO agreements, foreign investment in VATS will be capped at 30 percent initially, and at 50 percent within five to six years of accession. A private domestic entity can thus hold 70 percent of the equity initially (which may be reduced to 50 percent within five or six years of accession) of any Sino-foreign VATS joint venture. For foreign investors, the possibility of establishing a Sino-foreign VATS joint venture with a private domestic entity is therefore more likely to be viable.

Thus, even with the Administrative Regulations in place, it is safe to say that the 49 and 50 percent foreign-ownership ceilings set in China's WTO commitments will be high ones that foreign carriers will find hard to touch, especially for core services such as fixed-line and mobile services. "The Chinese partner simply won't step aside and let you take control," says Robert Lewis, a partner of international lawyers Lovells, "The deck is stacked in favor of the Chinese partner (Raffray, 2002)." Without a majority ownership, foreign companies might be limited as to how they can participate in the market.

4.5 The Missing Law

China could end a lot of confusion by adopting a pro-competitive telecommunications law. Without a national law with an overarching set of regulations, procedures, and enforcement mechanisms, the legitimacy of foreign investments remains unclear, and foreign investors are left vulnerable to the MII's heavy-handed intervention.

China has been working on a telecommunications law for almost 20 years. Rapid changes in technology and market development in China, as well as bureaucratic competition among the various stakeholders in China's telecommunications industry, have stalled efforts to finalize a draft. As a result, the telecommunications industry has been governed by a patchwork of administrative regulations. China's recent WTO entry will definitely serve as an engine to prompt China to work out some basic principles and rules to bring order to an increasingly competitive and diversified market, while taking international practices and pro-competitive WTO tenets into consideration.

The MII and China's legislators should gain concrete experience through the implementation of the Telecommunications Regulations and the Administrative Regulations, which will enable the ultimate adoption of a comprehensive and workable telecommunications law by the National People's Congress. The MII minister Wu predicted in March 2001 that the law would be promulgated within two to four years.

That long-awaited law is likely to be based heavily on the Telecommunications Regulations and related regulations on the Internet, foreign investment, e-commerce, and other matters.

Summary

The Telecommunications Regulations are the first comprehensive set of regulations governing the conduct of telecommunications business in China. In many ways it appears to adhere to the principles under the BTA and therefore reflects positively on China's commitments to its WTO agreements. In particular, the Telecommunications Regulations have set out in clear items the framework for operational licensing, interconnection, the setting of telecommunications charges and standards of telecommunications services, and so on.

The latest release of the Administrative Regulations specifically covers the issue of foreign investment in the industry and it is a milestone in China's regulatory history. It sets the entry requirements for potential foreign investors and establishes the legal position for foreign investment in China's telecommunications industry. Though China still lacks a telecommunications law and there is a long way to go to build a strong regulatory system, it is expected that with improved transparency and a pro-competitive regulatory environment, the investors' confidence in China's telecommunications industry is likely to grow.

Chapter 5 Hidden Difficulties and Risks for Foreign Investors

Across the globe, telecommunications operators are becoming selective in their investments and looking for quick returns to satisfy nervous investors at a time when the combination of liberalization, competition and new technology expenses has hurt telecommunications revenues worldwide. Any investment complicated by bureaucracy may not be worth it.

China has unlimited potential to grow. Foreigners who invest in China, however, often face many difficult hurdles and tremendous setbacks. We should bear in mind that China is an ancient country with more than 5,000-years of history. Many things are just too old and too deep to be rid of instantly. Therefore, it is vitally important for foreigners to understand the risks involved in investing in China and to

be aware of the potholes created by a totally different cultural and political environment and a weak legal framework.

5.1 Cultural Legacy

Over the centuries there have been many schools of thought, ideas, some of which still color the perceptions of Chinese today. One major factor is the ideas of Confucius (about 550-479 BC). This traditional Chinese cultural legacy has played a large role in shaping the meaning of law and shaping how laws are enacted in China.

Confucian teaching has always influenced the Chinese economic and social life. Confucianism favors seeking solutions by peaceful discussion rather than by taking disputes outside the realm of the parties involved, and emphasizes the discord that already exists. In essence, anybody who brings a conflict to court is viewed as having disturbed social tranquility and as being disruptive and uncultivated. Therefore, the law has always been subordinate to traditional virtues and Confucian principles of harmony, peace, and conciliation. As a result, justice is not guided so much by the law as by reason and an individual's virtue. From a cultural standpoint, the rule of law in China is viewed in a way different from that in many western countries. Hence, there is a clash between eastern vs. western views on laws and contracts, which hampers the attempts of western companies to invest in telecommunications business in the country.

“Many investments occurred in a frenzy. Everyone thinks, ‘Well, they have such a lack of capacity; we’ll just throw money into China, ’” as described by Nicholas Howson, a partner of a Beijing law firm (Bowers, 1999). But many companies soon got caught up in the idea of investment. They did not realize that some deals were risky, that take-off agreements were badly negotiated, or that approval from all levels of governmental authorities, in writing, was important. Those investors paid dearly for their confidence in the “handshake deal,” in cases where the Chinese refused to honor takeoff payment agreements or eventually backed away from a project.

It is a culture clash not so simple as fork and knife vs. chopsticks. It is a real difference in the understanding of investments and market economy. “There were no contracts here 10 years ago. And now these poor benighted souls from New York or Houston come in and say ‘ I have a contract and you have to honor it because in my funny world I can go to court and enforce it.’ The Chinese have a different view (words of Nicholas Howson, Bowers, 1999).” China practically is starting from scratch

to build a market economy. Foreign investors cannot expect dramatic changes to take place very quickly, even in light of China's WTO membership.

5.2 A Unique Political Regime

China's economy is different from the western capitalist economy that most foreign investors are used to. One important note to make is that China is trying to build "a socialist market economy." The term means that China tries to hold on to its Communist roots. China is a one party state with "people's democratic dictatorship", which some people say is a country ruled by men, not by law. All the reforms and laws reflect the socialist influence of the Chinese Communist Party. China's leadership emphasizes its intention to maintain the socialist character of its economy and to maintain control of communications. As emphasized by China's late leader, Deng Xiaoping in his address at the National Party Congress in 1982 (Hjellum, 1996),

"We must integrate the universal truth of Marxism with the concrete realities of China, blaze a path of our own and build a socialism with Chinese characteristics – that is the basic conclusion we have reached after summing up long historical experience."

So, is China, a socialist-democracy with its own brand of market capitalism, ready to carry out its promises to the WTO and further open up its markets, or will resistance from conservative hard-liners cause continued uncertainty on the foreign investment arena? Many say that China is going to change for the better and that WTO membership will bring China in line with the rest of the world, forcing it to strengthen the rule of law and to increase transparency for foreign investors. This would, in turn, increase protection for the interests and confidence of foreign investors. But, this would mean that the Communist Party, which has always seen itself as above the law, would have to give up some of its sovereignty and power to individuals and private companies. Is it willing to do that?

China's leaders are of two minds when it comes to such critical industry as telecommunications: they want and need foreign investments, yet they are reluctant to accept game rules on any terms but their own. At the highest level, the Chinese government, and not only MII Minister Wu Jichuan, has been unwilling to loosen control over a sector that contributes so much to government coffers and to economic

growth. Meantime, China views the regulation of telecommunications and information industries as a means to control the flow of information to its people (Bowers, 1999).

Even the WTO obligations cannot do much to guarantee the interests of future foreign operators. In the minds of Chinese leaders, some government intervention and state control are necessary. They believe that it is for the benefit of the Chinese people and they are not willing to simply hand it over without looking carefully at what that means in the long term. The Chinese government, to its credit, is trying to modernize China as quickly as it can without feeling that they are going to be taken advantage of.

For this political situation to change it needs more than just a WTO membership or some kind of telecommunications laws or regulations, on the other hand, it depends on the continuation of China's political and economic reforms, - which will not happen overnight. Therefore, political risks should be deeply embedded in foreign investors' considerations when they check how China fits into their global strategy and what course of action will help them reach their strategic vision for China.

5.3 A Weak Legal Framework

China's legal framework for foreign investment reflects a "tension between encouraging foreign investment and maintaining state control over the economy". The framework is regulatory in nature and puts a large emphasis on state control of economic and social development.

Although China amended its Constitution in 1982 to explicitly protect foreign investors' "lawful rights and interests in the People's Republic of China", to this day, the legal framework for foreign investment is still not fully constructed. There are still quite a few sectors of the Chinese economy that are not governed by any formal law.

Many of the problems that foreign investors face in China stem directly from the fact that the legal framework guiding foreign investment is vague and weak. It can be partially explained by the fact that China has only had a very short period of time – 20 years – to build up a legal system compatible with its socialist market economy. A relatively young legal system, combined with a unique Chinese conception of the meaning of the rule of law, helps explain why its legal framework is so weak.

A confusing legislation network

The development of the legal system for foreign investment did not start until 1979. China's legal framework and legal institutions were practically destroyed when their

economic contact with the outside world was cut off between 1966 and 1976. Only with the adoption of the open door policy did the Chinese start to rebuild their legal system.

The highest legal authority in China is its Constitution, which was devised and put into force in 1982. Laws are enacted by the National People's Congress (hereinafter "NPC") and its various standing committees. The State Council, ministries, and administrative agencies also issue regulations, rules, provisions or measures, decisions, notices, and orders to refine the legislative purposes of the NPC or its standing committees. Until recently, fragmented administrative rules and regulations governed China's telecommunications industry and the process for issuing and implementing such rules was non-transparent and inconsistent.

Access to published Chinese legislations is difficult as there are no officially published gazettes or compilations of Chinese laws and regulations that are updated regularly. Moreover, internal rules that are applicable may not be publicly disclosed. Judicial decisions are not considered precedents and therefore, are not considered sources of law. As Chinese laws and regulations can come from many different sources, and as they are not often published, it is very hard for foreigners to be knowledgeable of all the laws and regulations that are applicable to them.

Another notable representative of China's bureaucratic practices is the complicated multi-level approval process for investment projects, especially ones involving foreign participants. The discretionary nature of hierarchical approvals in China allows the relevant authorities to have the flexibility to effectively enforce veto announcements when situations are not in their favor, even in cases where a project is initially legally permitted.

Instrumental characteristics

Once foreigners have jumped over the hurdle of finding out what laws apply to them, they face another difficulty that is even harder to overcome. Laws in China are inherently fluid and flexible. This is illustrated by the characteristics of Chinese legal drafting that are employed in formulating the law. Chinese laws are often filled with principle-like pronouncements, vagueness and ambiguity, broadly worked discretions, undefined terms, omissions, and general catchall phrases. These drafting techniques produce laws that are often subject to varied interpretations by different parties.

Instead of being a form of protection for foreign investors, these laws can create risks that are built into the investment environment and are hard to avoid.

In places where the rule of law is strong, such risks are minimized because the law is viewed as being absolute, as embodying a set of ethical norms that are embraced by the society, and as being normative. Normative law serves as a clear guide for people's actions and behavior. There are three general principles that are reflected in laws that are normative: certainty, generality, and equality (Chuang 2000). The certainty principle guarantees that the law is stable and cannot be manipulated by arbitrary power. The generality principle guarantees that the law is not particularized to policies, goals, or individuals. The equality principle guarantees that the law is applied to everyone equally. These three elements provide protection against the exercise of arbitrary power by private individuals as well as government officials. Unfortunately, those three principles are missing from China's current laws and regulations.

Gap between "letters" and reality

In China, unfortunately, there is a gap between the law on its face and the legal norms that are actually implemented. Chinese laws are not normative, but are instead instrumentalist. As a result, they are not characterized by the fundamental characteristics of normative law, that is, certainty, generality, and equality. Law in China is used as a vehicle to promulgate the policies and goals of the state. It is state policy, and not law, that stands supreme. Therefore, legislative enactments and laws do not represent norms that are applied consistently in different situations, but instead represent ways to exercise state power. As goals and policies of the state change, so will the interpretation of the law. Laws are intentionally left vague to provide room for different interpretations that may apply at different times and by different people. This characteristic of the law, along with the fact that so many different state organs can enact laws and regulations, makes it hard to determine exactly what laws are applicable and how those laws should be interpreted.

The opening-up of the telecommunications industry is a perfect example of the uncertain days that lay ahead for foreign investors. Almost immediately after the signing of the U.S. – China WTO Agreement, Wu Jichuan, chief of the MII, stated that the agreement would not dramatically impact China's information industry. This is a rather bizarre statement, considering the fact that the agreement had opened up the

telecommunications industry, an industry that previously had been completely closed to foreign investment. Wu further stated that though China's telecommunications sector would be open to foreign investment, China would not only continue to reinforce the qualification of all foreign investors, but would also facilitate orderly competition according to the relevant regulations. Wu also said that allowing foreign investors to hold a certain percentage of share capital did not mean that they must reach that figure.

As a result of this instrumental approach and lack of normative principles, the rule of law in China is often subordinate to the rule of the individual. The rule of law prevents arbitrary abuse of power by individuals and also protects enterprises and individual rights. But, in a place where it is trumped by the rule of individual and where law is subject to interpretation by government officials who have to follow government policies and directives, a shaky investment environment where there are autocratic and unpredictable rules is created. Furthermore, frequent political infighting in China often leads to policy inconsistencies that promote different interpretations of the law. As Meherro Jussawalla, an analyst of a US East-West think tank center, warns (Raffray, 2002),

“Maybe it is easier to enter [now] but it is certainly not easier to win. It is one thing to sit in Beijing, quite another going to the provinces where there are local interpretations of the rules.”

Summary

Even though China has tried to set up an environment that is friendly towards foreign investment, it appears that the unpredictability of China's regulatory environment, caused by its weak legal framework, is doing poorly to attract and protect foreign investors. China's accession to the WTO may be a catalyst for changes that will create a more protective environment for foreign investment. Foreign investors certainly hope that the WTO membership will make China's policies more transparent and less arbitrary. However, China's rule of law will not change overnight. The “people's democratic dictatorship” that Mao set up is simply too strong to be dismantled right away. Political infighting between reformist liberals and conservatives will still exist. Things will not change until the Communist Party is no longer above the law and an

open and transparent judiciary system has been put into place. It will take more than WTO membership to change China's weak legal framework.

Chapter 6 Conclusion

China has been, for much of its history, a “forbidden kingdom” from which foreigners were excluded. The sheer extent of China – its size, resources and population – led it to ignore and dismiss the outside world as irrelevant or dangerous. When China did open up, it did so voluntarily and to its advantage, for example the open-door policy of 1978 credited by Deng Xiaoping. Now comes a new change, which is not voluntary. China has succeeded in its 15-year campaign to join the WTO. For the first time in its 5000-year history, the Chinese market will be truly opening up to foreigners. The potential impact of this process of domestic opening is enormous.

The WTO membership is definitely a step in the right direction. By signing the agreement, China has shown that it is willing to consider changes that will fundamentally alter the way they have done business in the past 50 years. These changes will not come easily, but China's further integration into the global economy will enhance the ability of China's business partners to influence China's behavior. China's WTO membership will also have the potential to change China's internal politics, lending support to the liberal reformist officials who hopefully understand that there ought to be legal, social and political reforms to support the economic reforms that are being implemented.

China's telecommunications industry has long remained a “forbidden city” in this “forbidden kingdom”. Despite the many restrictions that exist, the opening promise of China's telecommunications market is a direct outcome of the WTO membership. Without the pressure to comply with WTO obligations, China probably would not have restructured its regulatory regime and telecommunications industry so quickly. However, the nationalistic, protectionist traditions among Chinese regulators and companies, combined with a weak legal system, may signify that foreign carriers will find that the lucrative telecommunications service market in China is out of reach. In other words, foreign firms may find a nominally more open telecommunications market in China after WTO accession, but one that comes with significant regulatory constraints.

The Telecommunications Regulations and the Administrative Regulations though, do represent the fruits of China's efforts up to date to create a comprehensive telecommunications law to regulate the industry. For the first time in history, China relaxes its legislation banning foreign investment in the telecommunications sector. They offer important insight into the future of foreign telecommunications investment in China. However, foreign investors must look realistically at China's past and current policies towards foreign telecommunications operators and should keep in mind that doing business in China is never as simple as it may appear.

China is *in* the information age, but it is not yet *of* it. Despite all the talks about "information superhighways" and the western-generated hype about "new ages", China is still a developing country with more than half of its population being farmers making their living on manual and animal labor. It has not been able to ignore the global revolution under way in the sector, but, as usual, China insists on going its own way.

Foreign investors brave enough to tread the murky waters of China's telecommunications industry must not overlook certain basic truths. The Chinese government is determined to protect its role in telecommunications. In addition, foreign operators in large profitable cities could probably be required to assist with infrastructure development in poor rural regions. The MII and the State Council will continue to make decisions affecting telecommunications regulations, pricing and licensing. Foreign investors must also remember that such decisions may favor the home team as usual.

What analysts call regulatory risk - never knowing who will make what policies tomorrow - remains the big downside of the world's most tempting market. Our best advice for the awaiting foreign investors is to take on a "wait, check, and see" strategy rather than a "full speed ahead" approach, as can be expressed by the vivid words of Hui Pan, chief economist for Information Gatekeepers (Luna, 2001),

"Company will probably invest selectively and maybe cautiously initially to see what the reaction is from the Chinese side, whether they are completely cooperative and if they will really abide by the rules and honor their commitments."

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Appendix: Acronyms & Abbreviations

Administrative Regulations – Administrative Regulations on Foreign Invested Telecommunications Enterprises

BTA – Basic Telecommunications Agreement

BTS – basic telecommunications services

China Mobile – China Mobile Communications Company

China Netcom – China Netcom Communications

China Railcom – China Railway Communications and Information Company

China Satellite – China Satellite Communications Company

China Telecom-f – China Fixed-line Telephony Company (after Feb. 1999)

China Telecom-s – China Telecommunications Group (after Dec. 2001)

FDI – foreign direct investment

GDP – Gross Domestic Product

IP – Internet protocol

Jitong – Jitong Network Communications

MEI – Ministry of Electronic Industry

MII – Ministry of Information Industry

MPT – Ministry of Posts and Communications

NPC – National People's Congress

TAAs – telecommunications administrative authorities

Telecommunications Regulations – Telecommunications Regulations of the People's Republic of China

VAS – value-added services

VATS – value-added telecommunications services

WTO – World Trade Organization