

China's Telecoms: Law, Policy, Regulations and Characteristics

Telecommunications InfoTechnology Forum
The Mandarin Oriental Hotel
Hong Kong, 28 October 1996

Peter Lovelock and John Ure

Telecommunications policy in China is quite well defined. That this is so stands in contradiction to the widespread belief among foreign companies eager to penetrate the market who seem to believe that China is groping its way towards an opening to foreign direct investment but is held back by the lack of a clearly formulated policy, an absence of a telecommunications law and a failure to establish a regulator independent of the Ministry of Posts and Telecommunications (MPT) which is also, through the Directorate-General of Telecommunications or China Telecom, the dominant player. In our view this is a wrong reading of the situation because it places too much presumption on the Western way of doing things, and pays insufficient attention to Chinese 'characteristics'. This is *not* to say that we think it is impossible to apply generic models in thinking about China. On the contrary, we share the view of China scholars who would apply a bargaining model to China, who would argue that game theoretic can be usefully applied, but to adopt such an approach requires an understanding of the local characteristics which mediate the games to be played and the rules by which they are to be played.

The Model

The model consists of the players (and their interests) and 'externalities', those outside factors beyond the determination of any of the players. Externalities can arise from truly external events, such as trade wars or WTO negotiations, or from the domestic outcomes, or lack of outcomes, of the collective bargaining process. For example, the normal¹ Chinese way of doing things, that is one of the local rules of the game, is to seek consensus before moving ahead with a policy shift and implementation. This is undoubtedly a product of the vastness of the bureaucratic structure and mindset in China. If the interests of powerful players, such as ministries or provincial governments, or departments of the Party, are not catered for policy shift will simply be undermined by its lack of implementation. An issue such as state enterprise reform will just not make progress because the centre of political and administrative power in Beijing does not have the resources to force through changes that will serious damage established

¹ In this sense, the Cultural Revolution would be considered an abnormal rift away from consensus seeking. Indeed, genuine revolution implies as much, and in that sense Mao's efforts to go outside the established organs of political and bureaucratic power to destroy them up to the point where they could no longer oppose him, *but no further than that*, was a half-baked revolution.

local interests across the country. Only two instruments for such enforcement exist. One is the Party which since its virtual extinction during the Cultural Revolution has never fully recovered its role and has lost the legitimacy which was born out of the nationalist struggles and revolutionary changes of the 1940s.

The other is the army, and although the Central Military Command (CMC) unifies the PLA, under the leadership of Deng army commanders were regularly rotated to prevent the rise of local fiefdoms. Despite this, factions clearly exist within the PLA. In the last resort the state, any state, is as strong as its armed forces, but the use of armed force to implement civil policies, such as economic or industrial reforms, is clearly contradictory and doomed to failure. So the key is the inability - and, outside of the revolutionary situation that brought it to power, the inappropriateness - of the Party to perform this role. Since China is still a long way from developing a modern state apparatus with an independent civil service, let alone encouraging the development of a genuine civil society, consensus among powerful interest groups is the only effective way to achieve and implement policy shifts.

The interests groups involved include first the various ministries which have telecommunications networks which could be used to supplement (the consensus word) or compete with (a real option in the implementation of policy) the MPT's national China Telecom network which handles long-distance and all international traffic, and the provincial-level networks of the Post and Telecommunications Administrations, or PTAs. These include the Ministry of Railways, of Electric Power, Aeronautics and the PLA itself. (For greater details see TIF papers January 1996). Second, are those ministries which have manufacturing interests which potentially compete with those of the MPT, principally the Ministry of Electronic Industries, MEI and the Ministry of Defense, MOD. Third, the LianTong (China Unicom) and JiTong corporations which have been authorized by the State Council to provide 'supplementary' networks and services in public telephony and non-public data communications respectively. Fourth, many China state enterprises which have an interest to become players themselves through investment, for example through lease-back arrangements, or by becoming value-added service providers, such as paging, Internet, audiotex information providers, and so on. Fifth, another potential source of entry into the increasingly borderless telecommunications industry, are the growing number of database networking entities in China, for example the state information centres, the Xinhua news bureau, and the Census and Statistics bureau. Sixth, the Ministry of Radio, Film and Television, MRFT, has an interest in the economies of scope that cable television offers, whether it is telephony or cable modem access to Internet. This list can go on, but we may conclude with a seventh, the State Council or government itself, and eighth, the Party. These latter two entities clearly are not themselves monolithic in terms of interest groups and bargaining.

Domestic Players

Using these players, we can understand how the Leading Group for the Revitalization of the Electronics Industry, established in 1984 under the leadership of then Vice-Premier Li Peng, would have been a drawn-out process of negotiations and bargaining until agreement was reached on a policy shift towards this strategic sector. The priority assigned to the modernization and spread of telecommunications arose from this initiative, and we may assume that it was less to facilitate the growth or widen the scope of civil society, than to foster a research and development capability in digital technologies, and a manufacturing capability in telecoms components and equipment. The PLA and the MEI were as much players in this process as the MPT. Telecommunications also emerged as one of seven priorities listed in Project 863 (drafted March 1986, hence its name) otherwise known as the Chinese High-Technology Research and Development Programme, an opportunity the MPT lost no time in exploiting. In 1988 it won the concession of the “three 90 per cents”: 90 per cent of central government loans need not be paid back, PTAs could keep 90 per cent of their taxable profits, and the MPT could retain 9 per cent of its foreign currency earnings from incoming international traffic.² These changes were accompanied by a reorganization within the MPT to grant greater autonomy to the PTAs in procurement policy, in investment decisions, in local planning and accounting for financial performance. For example, staff bonuses could be offered where traffic targets were exceeded, and limited local levies could be added to MPT prices to raise additional local finance. Of course, as the PTAs have gained greater control over their own resources they, in turn, become stronger bargainers within the MPT network, but the MPT maintains a strong hand over what it considered the essential issues. The planning process for telecoms remains very much an iterative one, top down and then bottom-up until plan reconciliation takes place.

The MEI was not outdone. In 1988 the Science and Technology Commission (STC) launched the Torch Programme to encourage the commercialization of science-based industries. After a difficult bargaining process and false starts³ the MEI gained leadership of the Torch Programme, and a more flexible attitude towards foreign partnerships was adopted to pursue the objective of technology transfer, an essential ingredient of the learning curve in how to market the results of basic and applied R&D. Cutbacks in the PLA's budget towards the end of the 1980s placed additional pressure on the MEI to find alternative markets for its manufacturing establishments. It also propelled the PLA into a greater commercial frame of mind. Today the PLA is a major producer of locally manufactured telephone switches and of the software that operates them, and a major supplier to the MPT. Switch costs were down to

² (See Ure ed. *Telecommunications in Asia: Policy, Planning and Development*, HongKong University Press, 1995, p.16)

³ See Saiman Hui and Hillary B. McKown ‘China Computes’ The China Business Review, Sept-Oct 1993)

US\$80 per circuit by 1995. By 1996 they had fallen to around US\$60 per circuit.

The PLA also emerged successful in 1993 when Order 128 was issued jointly by the State Council and the Central Military Command. The Order reaffirmed the PLA's right to manage radio spectrum allocated for military purposes, but the Order effectively gave the PLA the right to free-up spectrum in the 800 MHz range from military use and operate it for commercial purposes. This began as a series of non-public cellular networks - in addition to numerous paging networks already operated by the PLA, often in joint ventures with Chinese, Hong Kong and other companies who put in the capital and management expertise - but escalated by early 1996 into joint public operations with the MPT, using CDMA technology. This has achieved publicity in Hong Kong because of the involvement of Star Telecom. As far as can be known, the arrangement with Star follows the usual pattern in China of non-China companies revenue-sharing and offering 'management consultancy' but having no formal operational role and no equity ownership in the operating entity. It is an arrangement with high commercial risk in the conventional Western sense as property rights are weak to non-existent, returns on investment impossible to guarantee, certainly not possible to manage and are highly dependent upon the goodwill and ongoing co-operation of the China partners. But for local, often family owned or sole or joint proprietorship Asian companies which rely closely upon networks of guanxi, such arrangements are manageable and the risks acceptable.

The State as a player has the dual role of promoting policy shifts as a development issue and maintaining cohesiveness among its constituents. The 1980s saw policy shifts being promoted as outlined above, but each policy shift required a process of negotiation with the interested ministries. Perhaps the most dramatic policy shift however arose when Deng made his now-famous 'tour of inspection' to the South in 1992. In the aftermath of Tiananmen Square the political situation temporally threatened to go beyond a bargaining process into an acute process of political maneuvering. Heads did role, notably that of Party General Secretary Zhao Ziyang and close associates, and Deng was faced with the choice of reasserting his authority or falling hostage to the conservative camp. His 'tour of inspection' proclaimed his leadership through a vigorous public alignment with the powerful provincial interests of the South - especially in Guangdong - who favoured continued economic liberalization and a commitment to unrestrained economic growth. He consolidated this play with his promotion of the other great centre of economic power, Shanghai, and of the Shanghai faction in the Party leadership. His personal role as chairman of the powerful Central Military Command simultaneously reinforced his position, but to make absolutely sure he moved against the Yang brothers who by the early 1990s held the Presidency and significance influence in the armed forces between them.

This determined action by Deng, apart from confirming the seriousness with which he viewed the potential threat to the unity of the state under his leadership, and that politics remains very firmly in command in China, also confirmed just how far policy issues, such as the role of telecommunications, remained first and foremost issues of the state. Overnight the telephone penetration targets for 2000 were doubled, from around 50 to nearly 100 million. This was indefatigable commitment to economic growth which would not only stamp Deng's authority over policy-making but would win friends among important revenue ministries like the MPT and politically influential ministries like the MOD and MEI.

Externalities and FDI

Besides the domestic players, there are outside players trying to influence China's telecommunications policy direction. The obvious ones are foreign companies eager to undertake FDI, country governments - and by extension organizations such as the European Union - eager to assist their companies gain market access and possibly willing to offer soft loans, multilateral lending agencies such as The World Bank and the International Finance Corporation, the trade organizations, such as the WTO. Here it is interesting to note that when China was involved in negotiations to join GATT, or the WTO as a founding member, China let it be known that it would consider opening its telecoms market in some fashion. As early as 1993 Chinese representatives were publicly but enigmatically alluding to a greater opening of China telecoms markets. In a much publicized visit to New York the major of Shanghai, Huang Ju, was quoted as saying that "We would like to designate a place to experiment with more foreign participation in the telephone network." This was interpreted by some analysts as "the first big crack in the wall preventing foreign investment" " (*South China Morning Post* 12 November 1993, p.B2) on the assumption that the major was suggesting that Shanghai would like to experiment with some form of FDI, such as a Build-Transfer-Operate or even a Build-Operate-Transfer arrangement. Two months later, Professor Li Yinning, head of the department of economics and management at Beijing University and member of the National People's Congress, was writing that the ban on FDI in China's telecoms networks "should not be interpreted as a long-term policy." He mentioned that tariff reform was one of the policy issues that required solving before an opening could be contemplated, and added that "There are also some misunderstandings about the Government's recent move to exercise control over satellite television signal reception. But this policy should be seen as separate to the ban on the provision of telecommunications services by foreigners... after the 'misunderstandings' have been removed there will be closer Sino-foreign co-operation in China's telecommunications industry." (*South China Morning Post* 24 January 1994, p.B5). Four months later the *China Daily*, under the headline 'Service trades are opening up' was quoting the State Administration for Industry and Commerce "that it would give a 'green light' for foreign investors to join in the development of China's service industry." Among the

list of service industries referred to was “communications” (*China Daily* 1-7 May 1994).

The significance that was read into these various statements arose because of State Council Document No 55 which was announced October 1993. This listed the ‘Provisional Administrative Measures for the Examination and Approval of Applications for Undertaking Liberalized Telecommunications Services’ which separated value-added services into two categories. The first required a licence from the MPT prior to operation, and included mobile radiotelecommunications, including paging and cellular using 450 MHz and 800 MHz wavebands, and domestic Vsat. The second required only a declaration, and included messaging services, e-mail, EDI, videotex and other services as from time to time approved by the MPT. In the atmosphere of China’s possible entry into GATT, or becoming a founder member of the WTO, China was clearly dropping hints to strengthen its negotiating position. Naturally, it would find many allies among North American, European and Japanese telecommunications companies if they really thought the door on FDI, or something very close to it, was about to open. But what is so clear about the statements coming from China is that they were so undefined, so vague as to their possible meanings.

The Model’s Predictions

And this is precisely what allows China to steer a course through the bargaining model, at home and abroad. Everything is left flexible, open to interpretation. No-one player knows for sure how their bargaining position will work out. The MPT has fought a remarkably successful campaign to consolidate its regulatory powers and extend its market dominance at the same time as potential rivals such as JiTong, LianTong and the PLA have entered the arena. It does not oppose these new entrants - whose networks are their to ‘supplement’ its own - but it allows the PTAs to enforce their own delays and erect their own obstacles to Unicom in terms of interconnection and pricing. JiTong, LianTong, the PLA and others in their turn manage to edge their way in, with a little help from their friends at provincial government, municipal government or State Council level.

On the fringes of the public network ‘private’ networks operate, such as paging, trunked radio, 450 MHz and 800 MHz cellular, which interconnect with the public network under locally negotiated terms with the PTA and the PLA, the public security bureau and other bodies. These frequently involve non-China companies providing finance and equipment in revenue-sharing arrangements. The details of these and their status in law are usually veiled in secrecy. This secrecy may have to do with a dubious legal position, but it is equally likely that it is just part of the mystique that surrounds commerce in China. Closer to reality is the simple fact that if the powerful China parties involved are happy with the deal it goes ahead, and if not it runs into difficulties irrespective of its position within China’s underdeveloped commercial laws.

The MPT's direct intervention is likely only in cases which publicly challenge the MPT's authority in establishing regulations to be followed or where non-MPT and MPT non-approved bodies are breaking into the market. This situation allows for enormous flexibility in the development of different sectors of the market, for example Internet. Internet service providers require MPT approval, but cannot operate gateways. However, the MPT as regulator and operator, albeit officially at an arms length through China Telecom, has attracted far too much opposition from other ministries to permit it to regulate with impunity. One major battle over which a compromised was reached was the allocation of radio spectrum.

The MPT would dearly have liked to incorporate the functions of the State Radio Regulation Commission, but at the end of 1993 the SRRC was reformed with a membership of 22 - a reflection of multiple interest groups - chaired by Vice-Premier Zhou Jia Hua, with MPT Minister Wu Juchuan as Standing Deputy Vice Commissioner, Wei Fulin, Assistant to the General Staff of the CMC and Zhang Kezi, Deputy General Secretary of the State Council as Vice-Commissioners. Many other ministries, such as the MEI and Railways, and state commissions are represented. Although the SRRC is housed within the MPT's building its functions remain independent. What is particularly interesting about the reform of the SRRC is that it acts as a precursor of the Joint Conference on National Economic Informatization, established 1994.

The Joint Conference was set up precisely to facilitate the bargaining process in a co-ordinated, less fragmented way. The turf battles between the ministries was threatening policy implementation. The national telecommunications network, while vastly expanded from the 1980s, remains woefully inadequate. Perhaps even more important, the efforts by the State Council to build an effective national information infrastructure capable of providing the centre with economic and social data needed for state planning was lacking. The MEI was not slow to press the case for alternative resources to be made available for this urgent task which was assigned the highest political priority. As Peter Lovelock has shown elsewhere⁴ the Golden projects arose largely from this concern by the top leadership for enhance their ability to manage the economy. The Joint Conference was the only mechanism that could break the gridlock between ministries.

Since 1966 the Joint Conference became the Leading group on Informatization, an upgrading of its status reflecting the growing political importance attached to China's version of the NII. This will bring in new players as the scope of the NII extends and the technologies converge, and the model would predict that the bargaining process will grow in complexity as a result. Complexity will require a greater degree of rule formalization, and

⁴ See Lovelock, Petrazzini and Clark (1996) China's Golden Project: Re-Engineering The National Economy' Harvard Business Case Study.

the long-overdue Telecommunications Law which the MPT has been instructed to draw up will itself become a battle ground for the various interest groups. The only way to avoid disruptions that would delay policy implementation will be to keep things as vague as possible within the formal framework of rules, regulations and responsibility guidelines. Bargaining requires flexibility, and while no rules may be more effective than tight rules, flexible rules are the preferred option of states. After all, how can a state, or a ministry, exercise its disciplinary powers to withdraw a licence to operate if no licence has been issued?

For this reason we do not expect China's long-awaited telecoms laws as alleviating the frustrations of foreign companies looking for clear guidelines as to future policy. Furthermore, if China has an external bargaining process to go through in joining the WTO, the more flexible its options the more flexible its negotiating position. Flexibility is also a central feature of strategic trade theory which emphasizes the role of non-tariff barriers to trade as a means of pursuing state and industrial policies, such as the encouragement to infant industries, in sectors which are increasingly important to trade.

Finally, we note a recent statement by the MPT (reported in the *South China Morning Post* 22 October 1996 p.B3) that it intends to reduce IDD charges in China and adjust the tariffing structure of China's telecoms industry.⁵ This was one of the pre-conditions mentioned by Professor Li Yinning for an opening of China's telecoms doors. We also note that once again China's membership of the WTO is on the agenda, and that telecoms is a major WTO item coming up for re-negotiation in February 1997. The bargaining model suggests that lots of foreign companies are going to become very excited over the coming twelve months. We recommend, in moderate doses of course, tranquilizers.

⁵ Ure (1994) *Financing China's Telecoms* AIC 1994 Asia-Pacific Telecommunications Forum, Shangri-La Hotel, Beijing, PRC, provides estimates of revenue growth that could flow from tariff rebalancing in China.