Regulatory Politics in China's Telecommunications Service Industry:

When Socialist Market Economy Meets Independent Regulator Model

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I. Introduction

The neo-liberal perspective on state regulation, which has swept through the world since the 1980s as the most desirable benchmark for "good governance," highlights the importance of autonomous regulatory authorities in order to enhance the efficiency as well as to encourage and supervise fair competition in markets.[1] Although regulatory states in practice are "associated with particular patterns of government conduct because they are embedded in the nature of state-society relations,"[2] the regulator's independence is the primary concern in the neo-liberal perspective. As OECD study addresses, "one of the most widespread institutions of modern regulatory governance is the so-called

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[1] As Jordana and Levi-Faur (2004: 3) map out, I use the term "regulation" to include both the narrow definition of a set of authoritative rules and the broader definition of all-inclusive mechanism of social control. Jacint Jordana and David Levi-Faur, "The Politics of Regulation in the Age of Governance," in Jacint and Levi-Faur (eds.), *The Politics of Regulation* (Cheltenham UK: Edward Elgar, 2004)
[2] F. McGowan and H. Wallace, 1996. "Towards a European Regulatory State," *Journal of European Public Policy*, 3 (4), p. 563.

independent regulator."[3] This proposed paper has two goals: empirically, it explores the trajectories and features of China's telecommunications regulatory reform; thereby examines (would like to beg a question) the theoretical relevance of independent regulator model in explaining the Chinese *practices* of regulatory reform where the legacies of planned economy remain strong.

In order to situate the case of China in a broader context, I offer a brief introduction to the study of globalization and its effect on creating the regulatory state. Much of the literature states that the rise of the regulatory state is a global phenomenon. Scholars highlight the role of international institutions and policy diffusion, because "globalization impacts on institutional landscape of the state towards a regulatory reform as well as on policy choices."[4] There are also debates: while some argue for convergence of the regulatory state, assuming that variations across sectors and nations are temporary;[5] others put more emphasis on divergent practices of regulation across sectors as well as countries. After closely reviewing different notions of regulation and regulatory state in a global context, I briefly introduce the work of scholars of regulatory state in the field of comparative politics so as to distinguish China's regulatory governance from the neo-liberal type of independent regulator model.[6] These studies emphasize national variations in regulatory practices as a result of different state institutions, ideas, and historical pathways of industrialization.

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[3] OECD, *Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance* (Paris: OECD, 2002), p. 91.

[4] Kanishka Jayasuriya, "Globalization and the Changing Architecture of the State: the Regulatory State and the Politics of Negative Co-ordination," *Journal of European Politics*, 8 (1), (February 2001), p. 103.

[5] Jayasuriya (2001); Jordana and Levi-Faur (2004: 9)

[6] This model is highly based on the experiences and domestic conditions of advanced industrialized countries. It is a kind of global standards recommended by the major international institutions and regime such as OECD, the World Bank, and the WTO.

II. Globalization and Governance

While there is no one agreed-upon definition, globalization is in general conceived as the increasing trans-border flows of goods, service, information, culture, and people. It denotes the expanding scale, growing intensity, speeding up and deepening impact of such trans-border flows on inter-societal interaction from the global level.[7] In particular, economic globalization highlights "enhanced trade and financial integration"[8] facilitated by reduced transaction costs and policy barriers as well as technological progress and innovation.[9] While globalization has its roots in economic exchange,[10] it implies much more than a trade-GDP ratio. It also represents the increasing exposure of local identities and interests to international and transnational forces. Globalization, therefore, is a process rather than an end-goal.

To date, much scholarly debate has been centered on the effects of globalization on the state capacity and sovereignty.[11] Some argue that the role of the state has been significantly challenged and leaked away by the increasing power of private authority and a range of non-state actors across borders.[12] Others note the continuing salience of states

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[7] David Held et al., *Global Transformation: Politics, Economics, and Culture* (Stanford: Stanford University Press, 1999)

[8] Dani Rodrik, "Governance of Economic Globalization," In edited by Joseph S. Nye and John D. Donahue. *Governance in a Globalizing World* (Washington: Brookings Institution Press, 2000), p. 348.

[9] Jeffrey Frankel, "Globalization of the Economy," In edited by Joseph S. Nye and John D. Donahue. *Governance in a Globalizing World* (Washington: Brookings Institution Press, 2000), p. 45.

[10] Kevin H. O'Rourke and Jeffrey G. Williamson, *Globalization and History: The Evolution of Nineteenth-Century Atlantic Economy* (Cambridge: The MIT Press, 1999)

[11] Sovereignty is broadly defined as "state judicial control over its territory and citizens." Stephen Krasner provides four dimensions of sovereignty: international, domestic, the Westphalia, and interdependence. *Sovereignty: Organized Hypocrisy* (Princeton: Princeton University Press, 1999).

[12] Susan Strange, "The Defective State," *Daedalus* 124 (Spring 1995), p.56; Cable Vincent, "The Diminished Nation-State: A Study in the Loss of Economic Power," *Daedalus* 124 (Spring 1995), p. 27; A Clare Culter, Virginia Haufler and Tony Porter, *Private Authority and International Affairs* (Albany: State University of New York, 1999); Margaret E. Keck and Kathryn Sikkink, *Activist Beyond Borders: Advocacy Networks in International Politics* (Ithaca, N.Y.: Cornell University Press, 1998)

in both political and economic life in globalization.[13] Making an example of Singapore, Peter Evans argues that "successful participation in global markets may be best achieved through more intense state involvement."[14] Contrary to the globalist premise, Evans finds the positive correlation between trade openness and increasing role for the state.[15] More integration into a global market does not necessarily lead to "diminished" or "eclipse" of the state. Rather, strong but more sophisticated and competent state authority is required. The real issue is not the decline of the role of state, but the institutional *shifting* of the state and forms of public authority corresponding to governing a global political economy. This relates to the following issue of governance.

The Effect of Globalization on Economic Governance

How does globalization affect governance? In this study, governance is defined as "the processes and institutions, both formal and informal, which guide and restrain the collective activities of a group."[16] The form of governance varies depending on the ways in which the state transforms and adapts to the society. The concept of governance is becoming popular because it "covers the whole range of institutions and relationships

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[13] Kenneth N. Waltz, "Globalization and Governance," *PS: Political Science and Politics* Vol. 32, No. 4 (December 1999); Robert Wade, "Globalization and Its Limits: Reports of the Death of the National Economy are Greatly Exaggerated," In edited by Suzanne Berger and Ronald P. Dore, *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996), pp.60-88; David M. Cameron, "The Expansion of the Public Economy: A Comparative Analysis," *American Political Science Review* 72, no. 4 (1978); Dani Rodrik, "Why Do More Open Economies Have Bigger Governments" (NBER Working Paper no. 5537, April 1996)

[14] Peter Evans, "Eclipse of the State?: Reflections on Stateness in an Era of Globalization" *World Politics,* 50, no. 1 (1997: 69-70)

[15] Evans (1997: 67)

[16] Robert O. Keohane and Joseph S. Nye, "Introduction," In Edited by Joseph S. Nye Jr. and John D. Donahue, *Governance in a Globalizing World* (Washington, D.C.: Brookings Institution Press, 2000), p. 12. There are various ways to define governance depending on the subject of the study. Pierre and Peters comment that "it has become an umbrella concept for such a wide variety of phenomena as policy networks, public management, coordination of sectors of the economy, public-private partnerships, corporate governance, and 'good governance' as a reform objectives promoted by the World Bank and the IMF. Jon Pierre and B. Guy Peters, *Governance, Politics, and the State* (New York: St. Martin's Press, 2000), p. 14.

involved in the process of governing."[17] Keohane and Nye state that "globalization is strongly affecting domestic governance, but it is far from making the nation-state obsolete as some predict."[18] The important issue here is the ways in which globalization has transformed the institutional landscape of the state. While the state has adjusted to changes in and demands of the global structure, it maintains control by developing institutional mechanisms for regulation.

More importantly, globalization has been regarded as the major driving force of such policy diffusion as regulatory reform programs that emphasize the streamlining government structure and the promotion of transparency and competition in the market.[19] In effect, a global trend towards the regulatory state as the best practice of governance is not irrelevant to bring about institutional shift in the forms of public authority.[20] Much of the globalization literature assumes a convergence of regulatory policy encouraged by the WTO regime and international institutions, such as the World Bank or the OECD. The role of these international institutions is significant in that they advise policy recommendations that emphasize competition, transparency, and accountability for "good governance." Furthermore, the convergence school holds that the divergent patterns of regulation may continue due to varying historical legacies and state intervention in the market. Nonetheless, these will eventually fade away over time.

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[17] Pierre and Peters (2000: 1)
[18] Keohane and Nye (2000: 36)
[19] World Bank, *World Development Report 2002: Building Institutions for Markets* (Oxford: Oxford University Press, 2002)
[20] Jacint Jordana and David Levi-Faur, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham: Edward Elgar, 2004); David Levi-Faur, "The Global Diffusion of Regulatory Capitalism," *The Annals of the American Academy*, 598 (March 2005): 12-32; Fabrizio Gilardi, "Spurious and Symbolic Diffusion of Independent Regulatory Agencies in Western Europe," Prepared for presentation at the workshop "The Internationalization of Regulatory Reforms," Center for the Study of Law and Society, University of California at Berkeley, 25-26 April 2003.

According to convergence thesis, domestic policies ultimately tend to become alike due to the growing similarity in structures, processes, and performances. It claims that the increasing economic interactions across countries have led to competition among various models of economic governance.[21] The most desirable set of institutions arising as a result of international competition diffuse and become implemented as a form of good governance.[22] As Elaine Kamarck points out international economic competition has been one of major driving forces in public administration reform movements over the last two decades.[23] It has aimed at not only enhancing efficiency in administration, but also organizing business-friendly market environment in order to attract more foreign investment.[24]

On the other hand, while convergence helps explain the global diffusion of regulatory policy, some pay more attention to the diversity, noting that different institutional arrangements formulated by domestic political and economic structures have shaped divergent national trajectories.[25] Pierre and Peters have commented that "It is virtually impossible to make any clear generalization about governance to date. It must be

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[21] Suzanne Berger and Ronald P. Dore, *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996), pp. 4-5. In the Introduction Chapter, although both Berger and Dore have a belief in the national diversity in an age of globalization, they point out three major factors to lead to convergence: the triumph of market forces, the result of diffusion of best practice and competition among institutional forms, and the internationally negotiated or coerced choice of set of rules and institutions.

[22] Depending on the domestic political, economic, and cultural contexts, although there is a great variance in policy implementation, Beth Simmons and Zachary Elkins evidence the empirically strong relationship between competition for capitals and the global diffusion of liberal economic policy. This finding is based on 182 IMF – member states from 1967 to 1996. Beth Simmons and Zachary Elkins, "The Globalization of Liberalization: Policy Diffusion in the International Political Economy," *American Political Science Review,* Vol. 98, No. 1 (February 2004), pp. 171 – 189.

[23] Elaine Ciulla Kamarck, "*Globalization and Public Administration Reform,"* In Edited by Joseph S. Nye Jr. and John D. Donahue, *Governance in a Globalizing World* (Washington, D.C.: Brookings Institution Press, 2000), p. 232.

[24] Kamarck (2001: 232) indicated four major driving forces in these global waves of public administration reform: global economic competition, democratization, the information revolution, and the performance deficit

[25] Robert Boyer, "The Convergence Hypothesis Revisited: Globalization but Still the Century of Nations," In Edited by Suzanne Berger and Ronald P. Dore, *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996), pp. 56-59.

contextualized."[26] National diversities have been more accelerated because countries have different views on the desirable role of government in markets. These variations in state involvement have created different practices in regulation.[27] It also echoes Keohane and Milner's finding that "internationalization is having profound effects on domestic politics, but these effects vary cross-nationally due to different institutional as well as political-economic conditions."[28] As such, I suggest that this divergent convergence approach is particularly useful in illuminating how China's lingering legacies of Communist institutions, such as state ownership and the Party, has contributed to create distinct practices of regulatory state, making complex forms of regulation.[29] In order to help distinguish the pattern of regulation in China, I first present the conventional ideas on the regulatory state and various practices in the following.

III. Rise of the Regulatory State

Defining the Regulatory State

Regulation has a wide range of connotations: from the narrowest a set of authoritative rules accompanied by public agency for monitoring compliance[30] to an all inclusive concept of governance.[31] In the middle of them, regulation can be delineated as "the aggregate efforts by state agencies to steer the economy including rule-making or

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[26] Pierre and Peters (2000: 69)
[27] Vogel (1996); Mark Thatcher, "Regulation after delegation: independent regulatory agencies in Europe," *Journal of European Public Policy* Vol. 9, no. 6 (2002), pp. 954-972.
[28] Robert O. Keohane and Helen V. Milner, "Internationalization and Domestic Politics: An Introduction," In edited by Robert O. Keohane and Helen V. Milner, *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996), p. 7.
[29] Lance L. P. Gore, *Market Communism: The Institutional Foundation of China's Post-Mao Hyper-Growth* (Oxford: Oxford University Press, 1998)
[30] Jordana and Levi-Faur (2004: 3-4)
[31] McGowan and Wallace (1996: 562)

ownership,"[32] not just to correct market failure as the economic theory of regulation contends. While the economic theory of regulation argues that regulation occurs in order to correct the market failure by monopolized business, its ultimate purpose is *political* so as to promote "the interests of more influential pressure groups as a political instrument of redistribution and rent-seeking."[33] In addition, an institutional approach to regulation pays particular attention to political control over regulators. Terry Moe has pointed out that "oversight power by appointment or strict procedural requirements" have been used as the means of political control over regulatory agency.[34] As such, the problem of political control has been already indicated in existing studies.

What, then, is the regulatory state? It is an entity which highlights the necessity of the state in making markets work better.[35] The state still plays a role in the market, but its aim of intervention, providing institutional foundations, and the power of rule-making is different from the positive state that relies more on the authority to tax and spending than market principles.[36] This makes it for the form of regulation to be associated with "particular patterns of government conduct that may be embedded in the nature of state-society relations."[37] However, the terms of the regulatory state are defined in different ways across countries. For example, while the U.S. emphasizes the "reinvented" role of the state to encourage private economic activity that protects social and economic objectives, the regulatory state in Britain is the "withdrawal" of the state from the key

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32 Jordana and Levi-Faur (2004: 3)

33 Gary S. Becker, "A Theory of Competition among Pressure Groups for Political Influence," *Quarterly Journal of Economics* Vol. 98(1983): 371-400.

34 Terry Moe, "Interests, Institutions, and Positive Theory: The Politics of the NLRB," *Studies in American Political Development* 2 (1987)

35 Francis McGowan and Helen Wallace, "Towards a European Regulatory State," *Journal of European Public Policy,* 4 (1996): 560-576

36 Giandomenico Majone, "From the Positive to the Regulatory State: Causes and Consequences of Changes in the Mode of Governance," *Journal of Public Policy* 17, no. 2 (1996), p. 142.

37 McGowan and Wallace (1996: 563)

public sectors and underscores the importance of privatization and competition in the market.[38]

Likewise, although some argue that its characteristics vary at the national level,[39] the regulatory state tends to emphasize 'processes' rather than outcome as the desirable economic governance. Therefore, competition, transparency, and legalization are encouraged to help underpin the market. The regulator is independent from the central government and intervenes in the market by the use of "authority, rules, and standard-setting."[40]

National Diversity in Regulation

In advanced and developing countries, the state remains central to *re*-regulate business by making more rules and establishing institutional agency.[41] As a result, the regulatory state is evolving as a new mode of governance, but its patterns of regulation widely vary across countries as well as industries. While early studies focused on interest groups,[42] much research of late takes state institutions and ideas as key variables, persuasively showing how domestic political-economic institutions and policies under the similar global pressures create national diversity in regulatory innovations and practices.[43]

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[38] Colin Scott, "Regulation in the Age of Governance: The Rise of Post-Regulatory State," In Edited by Jacint Jordana and David Levi-Faur, *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (Cheltenham: Edward Elgar, 2004), pp. 148-149; Vogel (1996: 129-134)
[39] M. Markus Muller, *The New Regulatory State in Germany* (Birmingham: Birmingham University Press, 2002); Michael Moran, *The British Regulatory State: High Modernism and Hyper Innovation* (Oxford: Oxford University Press, 2003)
[40] Jordana and Levi-Faur (2004: 8)
[41] Vogel (1996); Jordana and Levi-Faur (2004); Majone (1996); Pearson (2005)
[42] George J. Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science* Vol. 6 No 2 (1971): 3-21; Barry R. Weingast and Mark J. Moran, "Bureaucratic Discretion or Congressional Control," *Journal of Political Economy* Vol. 91, No 5 (1983): 765-800.
[43] David Levi-Faur, "The Global Diffusion of Regulatory Capitalism," *The Annals of the American Academy*, 598 (March 2005), p. 16.

Contrasting the historical trajectories of industrialization in Britain and Japan, Steven Vogel claims that the policy-making elite's ideas on the role of government and state institutions generate considerable variations in reform across countries as well as industries.[44] Although Vogel does not refute the influence of global wave of deregulation and liberalization, he contends that the major driving force for regulatory reform lies in domestic politics, not international competition and pressures. Moreover, it is the government, not interest groups, which government initiates and controls the process even in the most industrialized countries. The state-led and designed reforms have given rise to diverse forms of regulatory state cross-nationally and sectorally. Most importantly, Vogel argues that regulatory reform towards freer markets and less government through deregulation paradoxically has contributed to strengthening the state's regulatory control over industrial activities. Hence *re*-regulation by governments in markets comes on the stage.

Another strand of extensive study on regulatory state is emerging in the Western Europe. Regulation in Europe has been traditionally through public ownership, assuming that public ownership would help government effectively regulate the economy for the public interests. Rather than making independent regulatory bodies, European countries preferred to assign "important regulatory responsibilities to central government department."[45] Changes in the mode of governance from interventionist to regulatory state slowly began to appear since the late 1970s. Economic globalization and regulatory reforms greatly accelerated in the 1980s.[46] Giandomenico Majone indicates that

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[44] Vogel (1996)
[45] Majone (1996: 22)
[46] Giandomenico Majone, "From the Positive to the Regulatory State: Causes and Consequences of Changes in the Mode of Governance," *Journal of Public Policy* Vol. 17, No 2 (1997): 139-167.

"statutory regulation by independent agencies is rapidly becoming the most important mode of regulation, indeed the leading edge of public policy-making in Europe."[47] However, there are some difficulties in generalizing a pattern of regulation in Europe, for there are extensive differences in historical legacy of industrialization, the goals and methods of government regulation in the market, and the relative importance of industrial policy among Britain, France, and Germany. Through regulatory reform, while Britain shows many similarities with "the American-style regulatory state," such as substantial separation of government from business activities, France and Germany appear similar to Japan with respect to the state-led reform and industrial policies.

Pointing out that the regulatory state is heavily premised upon state capacity, Colin Scott argues that the idea of regulation by state institution is incomplete. Scott introduces the notion of the "post-regulatory state," opens up the floor for a variety of governing mechanisms, norms, and control processes.[48] While the regulatory state emphasizes state law and hierarchical control by state institutions including government departments, courts, and independent regulator, the post-regulatory state gives much credit to non-state regulation (i.e., business associations or NGO) by non-state law. While enterprises and NGOs have been treated as the key regulators in the regulatory state regime, the post-regulatory state argues that "business and NGOs have the capacity to monitor the activities of both government and businesses for compliance with norms of their or others' making."[49]

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[47] Giandomenico Majone, "The Rise of Statutory Regulation in Europe," In edited by Majone, *Regulating Europe* (London: Routledge, 1996)
[48] Scott (2004: 147)
[49] Scott (2004: 165)

In sum, the existing literature has contributed to demonstrate how state institutions and ideas under the similar external circumstances and pressures construct a variety of forms of regulatory states. The goals of economic regulation also vary, from correcting market failure and promoting efficiency to steering the national economy. In the context of China, given that the ownership of assets is retained by the party-state, the underlying political logic is to secure their vested interests rather than to protect the public interests. For the purpose of this, regulation is defined as "the mechanisms of control characterized as rule-based behavior using of institutions for scrutiny and enforcement in order to promote specific public objectives."[50] This would help demonstrate how the Chinese state exercises regulatory control over strategic key industry, telecommunications service.

IV. Regulating China's Telecommunications Service Industry

State-run Monopoly: the Old Regime

Until the 1970s, the telecommunications system had been mainly used for semi-military and administrative needs.[51] As a consequence, China's telecom industry was backward, resulting from a lack of technology and investment capital, and inefficient management. Since the 1980s, the Chinese top leadership has perceived its critical importance as an infrastructure industry in order to boost future economic development and to enhance the standard of living. Through various preferential policies, such as tax reduction, bank loans, or high installation fees, the Ministry of Post and Telecommunications (MPT), the

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[50] McGowan and Wallace (1996: 562)

[51] Yan Wan, 2001, "Sector Reform," In edited by Jintong Lin et al., *Telecommunications in China: Development and Prospects* (New York: Nova Science Publishing), p. 161.

former regulator and operator before the reform, began to take advantage of financial resources in developing the sector.[52] Accelerated by government policies, China's telecom industry has developed rapidly. The revenue from the industry was 2 billion yuan in 1985, increasing to 11 billion yuan in 1990, 120.9 billion yuan in 1996, and 210.36 billion yuan (USD 25.3 billion) in the first five months of 2004.[53]

Prior to the 1998 regulatory reform, the major feature of China's telecommunications regime was the state-run monopoly system. By integrating China Telecom into a commercial arm, the MPT had regulated the overall telecom market and at the same time operated the business of the telecom industry. The development of the telecom industry was basically planned, regulated and operated by the MPT.[54] This monopolized provider, the MPT, had made basic telecom service, including the fixed-line, mobile service, and data transmission, very expansive but low-quality. As an effort to improve the situation, in 1988 other related ministries such as the Ministry of Electronic Industry (MEI), the Ministry of Electronic Power (MEP), and the Ministry of Railways (MR) asked the State Council to organize a rival service provider, China Unicom.[55]Yet due to the strong resistance of the MPT, it was not until Deng's southern tour in 1992 that they realized the importance of some domestic competition. Following this, Jitong Communication Corporation was established in 1994 as another player in

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[52] Since China was seriously deficient in investment capitals for telecom industry in the early stage of development, the Chinese government made up a deficit by charging high rate installation fees for telephone lines. During the 7th Five year plan (1986-1990), the installation fees and sub-charge took up 30% of the total investment capitals in the telecom industry; over the 8th Five year plan (1991-1995), it grew up to 50%. Wan (2001: 163)

[53] Chen Xiaohong, 1999, "*Zhongguo Dianxinye: Zhengce, Chanye Zuzhi de Bianhua ji Kugan Jianyi,*" *Guanli Shiji* (*Management World*), No. 1, p. 131; "Ministry to Enhance Supervision on Telecom," *China Business Weekly* (July 12, 2004)

[54] Lynn Crisanti, "Untangling China's Datacom Networks," *The China Business Review* Vol. 24, Issue 5 (Sep/Oct 1997): 38-41; Huang (2002: 554)

[55] Pei (2006: 103)

order to provide Internet services. As such, the creation of China Unicom and Jitong demonstrates that the top Chinese leadership was conscious of the need and importance of introducing market competition in the sector. The Chinese government has undertaken successive structural reforms to *create* market competition.

In regulating local telecom business, the geographical and administrative structure of governmental authority was organized in three levels. At the central level, the MPT guided and supervised the overall industry. Local units of the MPT, known as Post and Telecommunications Administrations (PTAs) were established at the provincial and municipal levels. Under the leadership of provincial/municipal PTAs, Post and Telecom Bureaus (PTBs) were set up at prefectural levels. Under the system of dual leadership (*shuangzhong lingdao*), provincial/municipal PTAs were administered by both the central MPT and local governments simultaneously. By decentralizing decision-making authority and financial responsibility to the local levels, the MPT allowed local governments to make local telecom development plans and direct investment. Yet it was schemed not to transform but to maintain the pre-existing hierarchical structure. All revenues from telecom services were first collected by the MPT, and then redistributed to each PTA, while the MPT kept hold of much of this revenue.[56] Monopolized authority for the distribution of revenue between the MPT and the PTAs showed a hierarchically centralized management of the telecom industry.

Reform and New Challenges

The creation of a regulatory agency, the Ministry of Information Industry (MII) in 1998, and the concomitant market restructuring clearly signal the launch of substantial reforms

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[56] Milton Mueller and Zixiang Tan, *China in the Information Age: Telecommunications and the Dilemma of Reform* (Washington, D. C.: Center for Strategic Studies, 1997), p. 43.

in the telecommunications sector. The reforms were driven not only by internal demands and changes, but also by external forces, such as the requirements of WTO accession and a global wave of regulatory reforms. Internally, the 1998 administrative restructuring program, which abolished or integrated a number of industrial ministries to streamline the former inefficient bureaucratic structure, facilitated the establishment of the new regulatory body, the MII. There were demands to establish a regulatory agency responsible for overseeing and controlling the pace of growing competition in the telecom market. Externally, the most significant impetus to push the reform was the WTO accession.

While the telecom services had been exclusively closed to foreign investments, the Chinese government could not delay opening its telecom service market, because one of the entry requirements for WTO membership was the Basic Telecommunications Agreement (BTA).[57] The BTA stipulates the immediate opening of the telecom service market to foreign investments, and specifies the maximum ratio of the ownership of foreign firms within six years. Upon entry, foreign firms may take up 50 percent ownership of the value-added service firms in 2 years, and 49 percent ownership in the mobile and fixed-line service in five to six years.[58] BTA also requires the implementation of transparent and fair criteria for service licensing and the building-up of an independent regulatory body. Meeting these global standards would be the most challenging issue for the Chinese government. Moreover, incoming foreign telecom giants after WTO entry

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[57] See, the WTO official website on the telecommunications sector, http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_e.htm (Access: April 17, 2007)

[58] Bing Zhang and Mike W. Peng, 2000, "Telecom Competition, Post-WTO Style," *The China Business Review* (May-June), p. 14

provided the government with a strong stimulus to create large-scale telecom firms that would enable domestic players to compete with foreign giants.[59]

The reforms can be characterized by the following features. First, internally, the rise of the MII, replacing the MPT and assuming both the former regulatory agency and monopoly operator, is notable. This also contributed to reducing the bureaucratic tensions between the MPT and other ministries (i.e. MEI or MR) regarding the MPT's monopoly. Given that China Unicom had been always in unfavorable competition with China Telecom backed up by the MPT, integrating two competitive ministers, the MPT and the MEI, into the MII ultimately promotes fair competition in the telecom market. Moreover, officials and most scholars in state research institutions claim and tend to emphasize the achievement of the separation of government and business (*zhengqi fenkai*). By completing the separation of China Telecom, which had been already under way in the period of the MPT, the MII no longer operates the daily business of telecom companies. Instead, the MII holds the overseeing authority to encourage and oversee fair competition and takes charge of drafting most policies and rules (i.e. service fees or market competition).[60] Finally, as the successive break-up of China Telecom and the entry of new players indicate, market competition in the telecommunications market was in effect enhanced and fostered by the continuous state's efforts for restructuring of the sector.

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[59] This comment is from Zhang Xinzhu who closely works as the telecom policy-maker, and is director of Research Center for Regulation and Competition, the Chinese Academy of Social Science, "Netcom Expects Major Gains from Telecom Restructuring," *China Daily* (September 4, 2001)
[60] Interview, in BUPT, Beijing (December 2005)

Table 1: Comparison of the Telecom Regime

	Before reform	After reform
Operator	MPT	SASAC (boss) / Six Firms
Regulator	MPT	MII
Owner	Government	Government / Shareholders

Sources: Interviews in Beijing University of Post and Telecommunications (BUPT), Development Research Center (DRC) of the State Council, CASS (Institute of Industry Economy, Institute of Law), Beijing (December 2005 and January 2006)

New Regulatory Regime: Three Features

The new regulatory architecture consists of three leading state institutions beyond the top executive, the State Council and Party: the MII, the NDRC, and the SASAC. Compared with the old regime dominated by the MPT, there are more state actors; their division of labor is more likely to be transparent although often overlapped. Here I discuss the major characteristics of the new regime, which will shed light on the form of the regulatory state in the telecom services industry. I indicate three major features of China's telecoms regulatory regime: 1) substantially constrained regulator, MII; 2) carefully state-led market structure; 3) strong state ownership.

Constrained Regulator, the Ministry of Information Industry[61]

The creation of a regulatory institution is one formal benchmark in demonstrating state efforts toward regulatory reform. Throughout the administrative restructuring programs, the Chinese state abolished the bulk of industrial ministries, but the notable exception to

[61] As a result of "the super-ministry reform" as of March 2008, the MII is re-organized as the Ministry of Industry and Informatization.

this movement is the creation of the telecommunications regulator, the Ministry of Information Industry (MII). As indicated earlier, the MII's key responsibility is to facilitate and monitor fair competition among telecom service carriers. Yet its regulatory oversight over the telecoms market has been considerably constrained, due to the internal governing structure and poor coordination among state institutions resulting.

As for the internal governing structures, even though the MII is the formally-designated regulator, on top of the MII there are the party and two powerful comprehensive state institutions: the National Development and Reform Commission (NDRC) and the State-owned Asset Supervision and Administration Commission (SASAC). The MII is official "the regulator (*jianguan jiegou*)" but remains a state-designated *administrative* agency to meet WTO agreements.[62] It is responsible for promoting and supervising fair competition in the telecom market, while its function is not entirely free from both executives and the party. Unlike the Anglo-American independent regulator model, the MII's regulation is constrained by these top party-state institutions as long as it remains a "government agency," for it is institutionally subordinated to the NDRC. Moreover, most industrial policies and regulations drafted by the MII should be reviewed by the NDRC before the State Council's final stamp. The MII also retains the right to set up telecom service fees, but it should consult with the Price Bureau (*wujia ju*) under the NDRC. Likewise, although the MII encourages market

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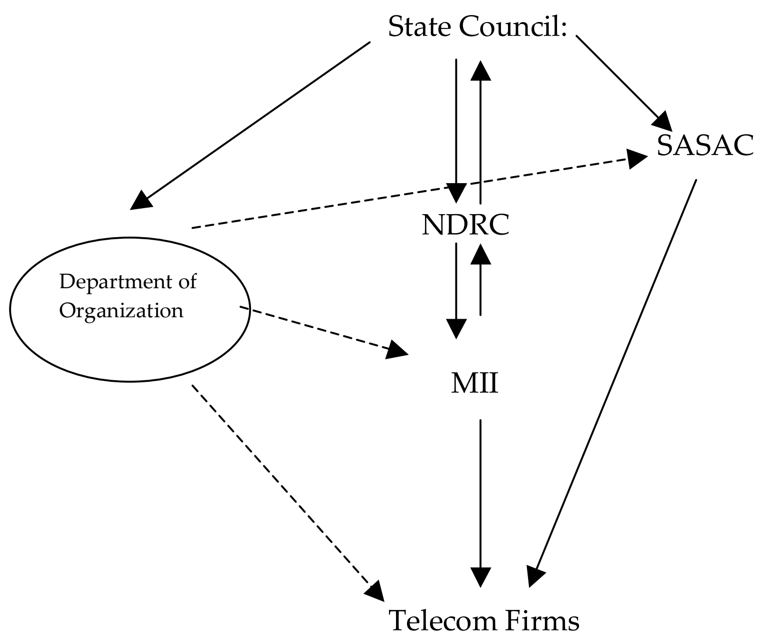
[62] Regulation can be translated into "*jianguan*" or "*guizhi*." They have similar meaning but slightly different usage. The former denotes more like "administrative base, while the latter originated from Japan and is used in legal context. Therefore, *jianguan* is generally accepted when we refer to the regulatory state agency. Interview with Zhang Xinzhu, CASS, Beijing (Feb 2006).
According to China's bilateral WTO Agreement with the U.S, "China has agreed to implement the pro-competitive regulatory principles embodied in the Basic Telecommunications Agreement, including independent regulatory authority. "Summary of U.S. – China Bilateral WTO Agreement," The White House Office of Public Liason (November 17, 1999), http://www.uschina.org/public/991115a.html (Access: July 20, 2007)

competition, service fees are determined not by market competition among firms, but by state institutions in the name of the security of the national economy. One Chinese scholar holds that even though the MII does not have the final say on service fees, what counts is that the MII is allowed to participate in the price policy-making process. He said this is why regulatory reform in the telecom industry is evaluated as more successful than other network industries.[63]

The MII's oversight is also restrained by the SASAC that asserts a great influence on the business management of centrally-owned state firms, including all telecom operators. While the MII puts more emphasis on breaking up the monopolized market structure and enhancing fair competition, it has no substantial authority to direct the market players. In other words, the norm of competition is encouraged and enforced by the MII, but the actual market structure that competition among telecom service carriers takes place is designed by SASAC. It ensures its plan to create national champions by pushing merger and acquisition aiming to create 80-100 globally competitive corporations by 2010. In fact, SASAC is less interested in breaking up the monopoly in the market as long as firms are globally competitive. For example, while there are four major companies in China's telecom service sector, only two players, China Telecom and China Mobile, dominate each fixed-line and mobile service. How to structure competition is in the hands of SASAC, not the MII.

[63] Interview with Zhang Xinzhu, the Research Center for Regulation and Competition of the CASS, Beijing (February 2006)

Figure 1: Governing Structure of Telecom Industry



* “------” indicating personnel decision

Sources: Based on the author’s interviews in Beijing, China (December 2005; January-February 2006)

Moreover, the MII is fettered not only by state institutions but also the party, for senior officials of the MII are nominated by the Department of Organization of the CCP. If regulatory oversight is “structurally” constrained by two top comprehensive state institutions, the party exerts “political control” over the MII through the powerful means of personnel. A number of interviewees confirm that while the MII was established to assume independent regulation, there are pressures behind the playing field, and they relate to the political interests of the CCP cadres who occupy the top positions of the MII.[64] Effective oversight of the MII is also limited by poor coordination (*xietiao*) with

[64] Interviews in the Center for Informatization Study of the CASS (January 2006); the Beijing University of Post and Telecommunications (January 2006); the Institute of Industry Economics (January 2006); the

other state institutions involved in policymaking and implementation. Often overlapped responsibilities led to produce different voices and make regulation of the MII less productive. The recent remarkable progress in regulatory reforms China's telecom industry (i.e. the establishment of the MII, the separation China Telecom from the MII, and the entry of new players) have brought about much progress in corporate governance, but the lack of an internal system to adjust mutual interests appears to be a significant obstacle to the effective regulatory function of the MII.

Regulating Market Entry

Market structure is in general organized out of competition, and at the same time competition is the major force in shaping market structure. Therefore, control over market entry can be regarded as control over the structuring of the market. In China's basic telecom service, the number of operators and forms of investment capital are strictly restrained by the state. Even though there is no official statute, only six companies are allowed to provide basic service.[65] These are China Telecom, China Netcom, China Railcom, China Mobile, China Unicom, and China Satellite. The central part of control is the areas of service; for example, mobile or international telecom services are very stringently restrained.[66] It is a path-dependent legacy of a state-run monopoly system that tightly restricted the entry of new telecom companies in order to maintain the monopoly system. Regulatory control over market entry is the exercise of administrative authority in establishing and preserving the relationship of enterprises. Since the 2000 Telecom

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Institute of Law of the CASS (February 2006). Some of them assert that the CCP is the most powerful body in China's telecom reform.

[65] The Development of Research Center (DRC) of the State Council, 2005, "*Zhongguo Dianxianye Guizhi Zhengce Xianzhuang he Zhanwang*" *Internal Report*, p. 118

[66] *Ibid*

Regulations Article 9 stipulates that the creation of new telecom enterprises should receive ratification from the State Council, in China's basic telecom service, the State Council takes the main responsibility for deciding on the market entry of new companies into the basic and value-added services.[67] The break-up and merger of telecom enterprises are also subject to the decision of the State Council. So far there have been two new telecom enterprises established by the ratification of the State Council, China Unicom and China Jitong, which was incorporated into China Netcom in 2001.

Furthermore, the nature of capital entering the basic telecom services is also controlled by the State Council. On the one hand, the entry of domestic private capital to the basic telecom services is restricted, although no clear regulations exist.[68] On the other hand, the WTO accession no longer allows the Chinese government to delay the entry of foreign capital into its telecom industry. Responding to these demands, the government, the State Council, and the MII clearly formulated the rules, and the entry and operation of foreign capital is controlled by the government based on these regulations.[69] The Regulation (*guiding*) of Foreign Business Investment in Telecom Enterprise, released in 2001, has three major parts in governing foreign capital.[70] First, regardless of basic or value-added telecom services, the Regulations Article 2 prohibits the establishment of a foreign company that consists of only foreign capital. Second, according to Article 6, foreign capital that enters China's telecom service areas must organize a joint venture with Chinese capital, and foreign investment in the joint venture cannot exceed 49 % in

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[67] "*Dianxinye de Zhengfu Guanzhi Wenti Yanjiu*," [The Study of State Control in Telecom Industry], *Jingji Yanjiu Cankao* [*Economy Research Reference*], 2003, (25), p. 6
[68] DRC Internal Report, p. 118
[69] "*Dianxinye de Zhengfu Guanzhi Wenti Yanjiu*" *Jingji Yanjiu Cankao*, p.8
[70] The State Council, "*Waishang Touzi Dianxin Qiye Guiding,*" http://www.gqb.gov.cn/node2/node3/node5/node9/node102/userobject7ai1554.html (Access: April 10, 2007)

fixed-line, or 50% in wireless and value-added telecom services. And third, foreign capital is allowed to invest within the confined areas of telecom service, but is not allowed to be an independent actor.

With respect to state control over telecom market entry, we can also see some transitions in arguments within China's major government think-tank. As of May 2004, one report from the Institute of Enterprise Research of the DRC under the State Council argues that a licensing system (*xukezhi*) for telecom market entry in China is necessary for a while, because it helps moderate any potential disorder and conflict resulting from the rush of large scale companies into the market.[71] At the same time, the nullification of market entry licensing does not always accelerate market competition. For the public interest, the control of market entry may contribute to gradually opening up and putting the market in order. The report also claimed that a controlled market entry would be beneficial to the supply of stable services as well as harmonious development of the industry. Through a licensing system, the governmental agencies can make plans and coordinate technology standards ahead of time, which is conducive to not only facilitating the creation of a unified network but also to promoting a domestic manufacturing industry.[72] The same research institute presents somewhat contrasting arguments in the report of December 2005, holding that stringent controls over both market entry and types (nature) of capital are actually adverse to the development of the

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[71] Ma Jun, 2004, "*Dianxin Shichang Zhunru Zhidu de Gaige*, (The Reform a Licensing System of the Telecom Market), *DRC Internal Report,* No. 62, p. 4
[72] Ma (2004)

telecom industry and improvement of subscriber interests, by constraining effective market competition.[73]

Keeping up Strong State Ownership

The persistent public ownership in the sector invites another form of state control, and particularly its centralized state ownership has been empowering SASAC in governing the business of telecom firms. While the Chinese leadership contends that separation of the MII from China Telecom presents a successful implementation of "the separation of government and business" (*zhengqi fenkai)*, instead of the MII, SASAC is deeply engaged in the overall telecoms business management. SASAC's such power over the sector comes exclusively from centralized state ownership, which makes it possible for SASAC to create a mechanism for coherent central control over the telecom firms. While China's basic service market is steadily open to foreign investors, they are still reluctant to jump in the market due to the issue of transparency in business; privately-owned firms are primarily not allowed to be service carriers. As Lance Gore early argues, "the significance of continued public ownership is that it ties enterprises vertically to the state's command structure through state agencies to whose property rights are delegated. This vertical tie allows the organizational structure of the party-state to continue to structure the otherwise market economy."[74]

Of course, while public ownership remains dominant in China's telecoms service industry, it is not a traditional form of state ownership that has no share and is wholly and

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[73] Enterprise Research Institute, the DRC of the State Council, 2005, "*Zhongguo Dianxinye Guizhi Zhengce Xianchuang ge Zhanwang*," *Zhongguo Xinxi Chanye Zhengce Zichi Tizhi Yanjiu: Ti San Jieduan Baogao*, p. 118

[74] Lance Gore, 1999. "The Communist Legacy in Post-Mao Economic Growth," *The China Journal*, 41 (January)

directly owned by the Chinese government. Rather than privatization, the Chinese government has been strategically pursuing corporatization that "allows non-state investors to contribute funds to the enterprise without sharing in control."[75] Thereby, the state seeks to achieve triple goals at the same time: under the same level of state control, improving the state asset management, which ultimately contributing to increasing the value of crucial state assets. For example, each operator sets up a shareholding limited company, such as China Telecom Corporation Limited or China Mobile Group Limited by listing shares on New York or Hong Kong stock exchanges. But the company's controlling share is concentrated on the parent SOE that is directly owned by the Chinese central government: China Mobile Communications Corporation (CMCC) and China Telecom Corporations own each 74.33 percent[76] and 70.89 percent[77] of its stock.

V. Conclusion

This paper has sought to demonstrate how bureaucratic control still matters in China's telecoms regulatory regime despite the global spread of idealized version of independent regulator model. As Pearson indicates, while China as in Europe, unlike Japan or South Korea, has been actively embracing the model of independent regulators since the

[75] Donald Clarke, 2003. "Corporatization, Not Privatization," *China Economic Quarterly*, Vol. 7, no. 3, p. 28.
[76] See China Mobile's official website on corporate governance, http://www.chinamobileltd.com/about.php?menu=4 (Accessed: June 2, 2008)
[77] See China Telecom's official website on corporate structure, http://www.chinatelecom-h.com/eng/corpinfo/structure.htm
(Accessed: June 2, 2008)

1980s,[78] China's regulatory state exhibits significant gaps between institutional forms and actual practices/content. Formally-designated telecoms regulator, the MII, is never autonomous from political organs such as supra-regulatory bodies (i.e., NDRC and SASAC) and the party in practice. With institutionally subordinated to such comprehensive state bodies, the MII is not able to deploy pro-competition and liberalization policies. Hence market entry and service price are not determined by the market but tightly controlled by the Chinese central government. In other words, the norm of competition is encouraged by MII, but the actual competition among service operators is orchestrated and supervised by SASAC. Moreover, the party's political patronage through the personnel management of the Department of Organization appears to be another serious obstacle to the independent function of regulators.

In sum, the limitation of the US based neo-liberal regulator model has been rather empirically proved to better understand the case of Chinese telecoms service industry. It also suggests that the model that fails to consider institutional and normative traditions may not relevantly explain the dynamics of regulatory politics in China where the party-state and its public ownership continue to remain central.

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[78] Margaret M. Pearson, 2006. "Regulation and Regulatory Politics in China's Tiered Economy," paper presented for conference on "Capitalism with Chinese Characteristics: China's Political Economy in Comparative and Theoretical Perspectives," Indiana University, May 19-20, 2006, p. 10.