

Taming the Dragon: China's Efforts to Regulate the Internet

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The advent of the Internet has posed an unprecedented dilemma for the Chinese government.¹ By emphasizing ideas and human capital over pure physical capital, it is an area in which China has the potential to develop rapidly and to compete with the West, providing an attractive proposition to a leadership intent on fostering economic growth and achieving world power status. On the other hand, because of its global spread and open nature, the Internet also brings access to much that the government has attempted to insulate China from, whether independent news, pornography, or anarchic discussion. In addition, it provides a means of widespread and rapid communication, making the establishment and organization of potentially dissident groups considerably easier such as the notorious Falun Gong case. The dilemma the Internet poses is therefore essentially one between economic growth and political control. To assert that these are mutually exclusive, however, would be simplistic if not simply wrong. Indeed, they are in essence the two basic goals of the Chinese government. However, to deny any tension between the two, particularly in the case of China, would also be unrealistic. The question of how China deals with the Internet is therefore of considerable interest because it is one of the areas in which this tension is most explicit.

By examining how the Chinese government has approached the introduction and regulation of the Internet, we may be able not only to assess how China has reacted in this particular case but also to draw more general conclusions on the government's aims, attitudes, and policies.

The government has attempted to achieve both of these goals simultaneously, supporting rapid growth in usage through its heavy investment in Internet infrastructure via the state-owned networks, while maintaining strict control over users. This paper examines the attempt both to foster and to control, with specific reference to the legislation enacted. It analyzes the different bureaucratic entities involved in the regulation of the Internet, before examining the government's attempts to control the Internet domestically through controlling access, content, and commerce and its attempts to control foreign ownership and enhance

the position of domestic entities.

Several themes run throughout. The first is the uncertainty and vagueness of policy and legislation, especially concerning prohibited content and foreign ownership. Combined with unpublished regulations and inconsistent enforcement, this has created an uncertain regulatory environment, hindering long-term growth. Nevertheless, as with other industries in China, many companies, both domestic and foreign, have leapt into the market heedless of the possible legal risks with their sense obscured by the prospect of rapid commercial gain. It is likely that many of these firms will suffer dramatic failures, given the added commercial risk of Internet business anywhere, although it is still somewhat early to tell. Second is the battle between different state groups for control over policy making on the Internet, a problem that is characteristic of Chinese bureaucracy but is exacerbated because of the Internet's multifaceted nature. The Ministry of Information Industry, the Ministry of Public Security, the State Press and Publication Administration, and the State Administration of Industry and Commerce, among others, have all issued regulations governing the Internet. In some cases, ministerial level regulation seems to run counter to the goals and policies of the top leadership. Many of the seemingly incomprehensible policies of the 'government' can only be understood once the 'veil of government' has been pierced and actions are viewed in the light of power struggles between different bureaucracies and even different individuals. A third, related, issue is the lack of separation between ownership and regulation. As in almost all major industries in China, the dominant companies are state-owned. These are under the control of the relevant ministry, which is often the same ministry that is responsible for the regulation of that industry, leading to a strong conflict of interest. The ability of the controlling bureaucracy to generate significant rents partly explains the struggle between bureaucracies to dominate. An extension of this is the restrictive attitude towards foreign ownership and involvement in the Internet; the incentive for protectionism is higher when the legislating body stands directly to gain from the success of domestic firms.

One particularly interesting question to which only speculative answers can be given is whether the Internet and its related technology will be a catalyst of declining government power through its facilitation of communication and thereby dissent, or whether it will actually strengthen central control through enabling closer scrutiny of provincial and lower level government.

A caveat should be added: since the growth of the Internet is such a recent phenomenon, the subject matter of this paper is still in a state of rapid change. It is therefore difficult to approach the topic with the benefit of hindsight and much of the analysis remains preliminary.

REGULATORY AGENCIES

The question of who controls policy concerning the Internet in China is not a simple one. As with many other areas of business in China, but particularly owing to its diverse nature and ramifications, the Internet is subject to regulatory oversight by several different agencies of the Chinese bureaucracy, both vertically and horizontally, resulting in a tangled web of control. The confusing network of agencies involved has been exacerbated by the frequent changes of name and responsibility that have occurred over the previous seven years, along with the rapid development of the Internet. As predicted in models of bureaucratic behaviour proposed by political theorists such as Niskanen² who suggests that bureaucracies will act to maximize the resources under their control and develop close patron-client ties with the participants under their oversight, many different agencies have laid claim to regulatory control over the Internet. Competition has developed between these agencies over responsibility for such a rapidly expanding and lucrative area of the economy.

At the highest level, the Economic Information Joint Committee was established in 1993, and as it began to concentrate increasingly on the Internet, it was developed into the State Council Steering Committee on National Information Structure (SCSCNII) in 1996. Such Steering Committees are established in China when several bureaucratic bodies are involved in a particular area and a coordinating body is required to oversee policy strategy. The major responsibilities of the SCSCNII are the formulation of strategy, principles, rules and regulations in developing national informatization, coordinating projects and establishing standards.³ The SCSCNII therefore develops policy at the strategic level.

At the day-to-day regulatory level, the main body currently responsible for the Internet is the Ministry of Information Industry (MII). The MII was created out of the former Ministry of Posts and Telecommunications and Ministry of Electronic Industry in 1998 to serve as the primary body responsible for telecommunications and high-tech

industry. Its principle self-declared functions are:⁴

- i. The formulation of strategy, policy and plans for the information, telecommunications and software industries
- ii. To draft and enforce regulations governing these industries
- iii. To plan, build and manage public networks for government and military
- iv. To allocate and coordinate bandwidth
- v. To supervise telecommunications and information services markets and implement licensing
- vi. To assist the development of the information industry

From this list, it is clear that the MII plays a major role in policy, legislation, and regulation of the Internet. It is unclear to what degree exactly responsibility for policy-making is allocated between the MII and the SCSCNII. Although the SCSCNII is in theory a superior body to the MII, in practice it seems as if the MII is responsible for policy up to the highest level.

As well as being the regulator of the industry, the MII is also deeply involved in commercial operations in the Internet. It is closely involved with China Telecom, which owns ChinaNet, one of six network organizations operating internationally linked networks in China under permits issued by the MII. ChinaNet is the dominant network, with 83 percent of connections to the global Internet backbone at the end of 1999.⁵ With such a high market share, it virtually has monopoly control over the market. Smaller ISPs may lease bandwidth from China Telecom, but the high leasing fees charged have prevented these ISPs from gaining any significant market share. Although the MII was forced to relinquish its direct ownership stake in China Telecom in order to separate regulatory and operational functions, it still maintains close links. The MII is also involved in the content side of the Internet. In March 2000, the Center of Computer and Microelectronics Industry Development (CCID), which is the research and development arm of the MII, launched its own web portal, directly in competition with Sohu and Sina, two of the three most popular and privately run Chinese websites. At the launch of the website, in explaining why CCIDnet would be superior to its competitors, the CEO picked out the company's close relationship with the government.⁶ As the primary industry regulator, such commercial involvement has created a clear conflict of interest for the MII, which partly explains its efforts to prevent foreign investment. The separation of regula-

tory and operating functions should take place following China's WTO admission, but the current overlap remains an issue of concern.

The other main agency involved in Internet regulation is the Ministry of Public Security, which is responsible for the implementation and enforcement of laws. It is therefore responsible for the technical measures used to monitor and control Internet usage in China, including surveillance of computer networks, registration of all Internet users, investigation of crimes and prosecution. Numerous other agencies also play a role or have asserted a claim to regulate some aspect of the Internet.⁷ The State Information Office, the State Council's public-relations agency and news office, is currently drafting regulation for Internet Content Providers. The Chinese Communist Party's Propaganda Department, which is responsible for print media, has issued unpublished rules governing news content and may deem these rules to be applicable to online media as well. The State Press and Publication Administration has also drafted unpublished regulations governing news content. In addition, the Xinhua news agency is responsible for approving all foreign content disseminated in China. The State Administration of Radio, Film and Television has plans to supervise online broadcasting. As the regulator of China's cable networks, which have 80m subscribers, it is a potential competitor of the MII for dominance over the Internet. Also involved is the State Administration of Industry and Commerce, which regulates advertising. In April 2000, it announced plans to regulate online advertising, beginning with pilot projects in Beijing, Shanghai, and Guangdong.⁸ The China Securities Regulatory Commission is responsible for approving all public share offerings, an area of Internet business that has been of crucial importance in the rapid development of the Internet in other countries. Through its ability to approve or reject proposed public offerings, the CSRC is able to exert significant power over Internet businesses. The CSRC is also responsible for share trading, and in April 2000 issued regulations concerning online securities trading.⁹ Lower levels of the Chinese government have also begun to issue regulations. The Beijing Municipal Administration for Industry and Commerce has issued several sets of regulations including rules governing registration of websites and protection of consumer rights in e-commerce.¹⁰ The head of the BMAIC declared that these regulations were intended to clarify and remedy deficiencies in the existing regulation, but they might also be interpreted more cynically as an effort to assert another competing claim to regulatory power.

Companies that wish to engage in Internet business in China therefore face the daunting task of compliance with a number of different agencies and regulatory regimes. While the phenomenon of a number of bureaucratic agencies with overlapping jurisdiction is neither unique to China

nor to the Internet, the situation there is exacerbated by the lack of separation between state-owned operation and regulation. This means that agencies stand to gain directly from being able to assert regulatory power. As these agencies jockey for control over the Internet, the result is an increasingly complex and unpredictable regulatory environment for both foreign and domestic businesses.

CONTROLLING THE INTERNET

While recognizing the considerable growth potential of the Internet, China has remained preoccupied with the risk to security and political control that it poses through facilitating rapid global communication and dissemination of information. The government has therefore attempted to maintain strict control over Internet usage, through a two-pronged strategy of controlling access and restricting content. The main regulations specifically governing the Internet are contained in various pieces of legislation dating back to 1994.

The 1994 "Rules of Security Protection of Computer Information Systems", which predated the widespread use of the Internet in China, established the basis for government control over and surveillance of computer networks. The provisions of the Act deal with two areas: security protection of systems and security surveillance.¹¹ The Security Protection regulations provide that work units that use computer systems connected to an international network must report such systems (Article 11), adequately protect them against unauthorized access (Article 13), and that transportation of computer media in or out of the country must be declared to customs (Article 12). The surveillance provisions allocate responsibility to the Ministry of Public Security for maintaining the security of the networks through surveillance (Article 17). The provisions also include the authority to issue special orders on matters related to computer system security in cases of emergency (Article 19).

The first regulations to deal specifically with the Internet however were the 1996 "Interim Regulation on Administration of International Networking of Computer Information Networks". These regulations were revised and added to in May 1997 as the "Computer Information Network and Internet Security, Protection and Management Regulations." This legislation, issued by the State Council Steering Committee, but in all likelihood drafted by the MII, are the center of the government's efforts to ensure its grip over the Internet. The provisions of these regulations provides for two means of government control: physical limitation of access, and outlawing of designated content.

THE GREAT WALL: CONTROLLING ACCESS

The 1996 regulations provide for physical restriction of

access by setting up a three-tiered system consisting of international networks, interconnecting networks and connecting networks. International networks are those networks linking China to the global Internet, interconnecting networks are the national backbone networks that connect to the international networks, and at the lowest level are the connecting networks, effectively ISPs, which connect to individuals and businesses.

The regulations designate the former Ministry of Post and Telecommunications (MPT) – subsequently merged with the Ministry of Electronic Industry in 1997 to form the MII – as gatekeeper to the Internet. Access to the Internet by networks is restricted exclusively to channels provided by the MPT: “all direct international networking traffic must use international incoming and outgoing channels provided by the MPT’s national network” (Article 6). Thus the government is able directly to monitor and control access to the international network at the point of entry into China, not to mention the financial benefits that the MPT/MIJ derives from the monopoly power which it holds. This monopoly over international connection was confirmed in further regulation issued by the MPT in April 1996, the “Provisions Governing the Management of Internet Inlets and Outlets for the Computer Information Network.” The Interim Provisions further provided that the MII, the State Commission of Education, and the Chinese Academy of Sciences would administer existing interconnecting networks. Although other commercial networks have subsequently been licensed, notably Ninety, run by China Unicom, the backbone networks in China remain under the control of government bodies and state-owned enterprises, with foreign investment banned.

At the next level, users must connect to the national backbone networks through connecting networks, effectively Internet Service Providers. These connecting networks are required to apply for a license for connection to the backbone and in doing so must provide information on the location of its host computers as well as the nature and scope of its networks. At the lowest level, under a Public Security Bureau circular of January 1996, individual users of the Internet are also required to register with the local PSB. The registration process is undemanding; basic information on education and background is required, along with signature of compliance with the regulations, and a fee of 400 yuan.^{12,13} However, this provides the PSB with information on the location of each computer connected to the Internet, as well as its owner, for surveillance and monitoring purposes. Failure to register is punishable under the 1994 provisions with fines or prison sentence.

Thus the government, through the MII, attempts to control physical access to the Internet by maintaining a monopoly on international links, a government oligopoly on the internal backbone networks, licensing system for ISPs,

and registration requirements for individual users. This vertical system contrasts sharply with the horizontal nature of the Internet elsewhere. The Chinese government has attempted to impose its own hierarchical system on the quintessentially egalitarian and center-less new medium of the Internet, reflecting both Confucian and more modern political traditions. This desire to interpose the state between the citizen and the outside world highlights the Chinese conception of relating to the rest of the world, reminiscent of the self-imposed insularity of Imperial times. However, the technical considerations discussed below suggest that such an effort to impose its worldview on an outside invention will be as unsuccessful as the Great Wall was in repelling outside influence.

BURNING THE BOOKS: CONTROLLING CONTENT

The government’s second strategy is careful control over content published on the Internet through outlawing the publication of and access to objectionable content. Although the 1996 regulations outlined what constituted objectionable content, the 1997 “Computer Information Network and Internet Security, Protection and Management Regulations” provides the most extensive list of outlawed content. Article 4 of the 1997 regulations states that “no unit or individual may use the Internet to harm national security, disclose state secrets, harm the interests of the State, of society or of a group, the legal rights of citizens, or to take part in criminal activities.” Article 5 goes on to prohibit specifically content which is:

- i. Subversive of state power or the socialist system
- ii. Damaging to national unity
- iii. Inciting discrimination between nationalities
- iv. Disturbing to social order
- v. Propagating feudal superstition
- vi. Pornography, gambling or violence
- vii. Insulting or libelous
- viii. Violating the Constitution or other laws

Various supplementary regulations have also been issued by other parts of the Chinese bureaucracy. In January 2000, the State Secrecy Bureau issued the “Regulations for Computer Information Systems on the Internet”, which provides for further limits on acceptable content and more stringent requirements for approval. The regulations extend the prohibition on leaking state secrets to email, bulletin boards, chat rooms, and news groups and require websites to be officially approved before publishing previously unpublished information, as well as to undergo unspecified security checks.¹⁴

The wording of these regulations is, however, vague. No

definitions of state security state secrets or information that could be 'harmful to social order' are provided, with the regulations merely referring to the relevant existing regulations. It is therefore important to examine what these other regulations specify and how the concepts have been interpreted in the past. 'State security' is an extremely flexible concept in China, and the state security statutes have been used in the past by the government against those dissidents seen as threatening the regime in any way, with laws allowing for severe punishment, including long prison terms and execution. The National Security Law of 1993 specifies the sale of state secrets to foreigners for profit as a threat to national security, but in turn the Chinese government has interpreted 'state secret' broadly. This flexibility in interpretation is clear in some of the cases that have qualified as leaking state secrets. In one case, a reporter leaked the draft of a speech to be given by Jiang Zemin at the Party Congress to a Hong Kong newspaper, and was subsequently sentenced to life imprisonment. In another, a reporter for Hong Kong's *Ming Pao Daily* newspaper who published information concerning the level of China's gold reserves was arrested and convicted of leaking state secrets.¹⁵ In such cases, public explanations for convictions are not required, meaning that officials may interpret the provisions as they wish. Punishments in these cases may be severe, as is clear from the former case above.

Likewise, 'social order' is undefined, and provisions for the protection of social order are often used as a means to control opposition. Most notoriously, the Tiananmen Square crackdown of 1989 was justified on the basis that the demonstrators were threatening social order. Public expressions of opposition to the regime through television and printed media such as leaflets are also considered to be counter-revolutionary offenses disturbing social order. The same standards are likely to be applied to expressions of dissent on the Internet; the government has established legal justification and precedents to take severe action against any potential threatening expression of opposition, whatever medium is used. Somewhat less clear is the extent to which it is technologically feasible to censor all the information that is available on the Internet.

*FIGHTING A MULTI-HEADED DRAGON:
TECHNOLOGICAL FEASIBILITY OF CENSORSHIP*

While China's policy of blocking objectionable opinions and materials is the same for the Internet as it is for physical media, the government's ability to do so is significantly different. Officials have attempted physically to block objectionable sites and monitor information and message flows on the Internet. This has been pursued by using filtering programs, which use keywords to search out and block potentially objectionable sites, or by blocking predetermined

sites labeled as 'politically subversive'.¹⁶ Such sites include foreign news sources such as the *New York Times*, CNN, and the *Economist*, as well as domestic sites expressing dissident information. Blocking of sites has been delegated to the ISPs, with the PSB sending out a list of websites to be blocked from users. However, some observers have noted that the actual sites being blocked appear somewhat inconsistent: the *New York Times* is blocked but the *Washington Post* is not, for example.¹⁷ Furthermore, there seems to be somewhat erratic enforcement with some websites available through some servers but not others. Whether this is owing to deliberate or accidental negligence on the part of ISPs or a failure to publish the lists by the PSB is unclear. What can be concluded is that there is no coherent and consistent decision-making process by which content is deemed objectionable, and that enforcement is equally inconsistent.

Enforcement is likely to remain difficult simply because it is impossible to censor the Internet in a comprehensive manner. The quantity of information passing over it is vast - monitoring communication through email, instant messaging, and the other channels that the Internet enables is in itself an enormous and ever-expanding task. Moreover, the rapidity of technological development, combined with the ingenuity of hackers, means that methods of circumventing controls are produced as quickly as officials can devise them. In addition, the Internet has generated and linked together an anti-establishment community internationally which opposes and circumvents attempts by governments or authorities to control it. A service exists which sends blocked pages to those requesting them via email, for example. The founder of this service has stated that numerous requests for western media information have been received from China.¹⁸ Alternatively, using a cellular telephone, it is possible to connect to the Internet through a foreign ISP and completely bypass the Chinese system. Furthermore, dissident and human rights groups outside China are able to help such groups within China to bypass security controls by providing services such as anonymous remailers, which redirect email messages anonymously.

DETERRENCE AND SELF-CENSORSHIP

The Chinese authorities have recognised the technical limitations on direct controls and the relative ease with which such controls may be circumvented, and consequently have explicitly shifted their strategy from physical blocking towards a policy of deterrence and self-censorship. Deputy Secretary-General Yu of the SCSCNII commented: "if an individual is intent enough on obtaining pornography, that person will find a way to get it".¹⁹ Rather than blocking access, the PSB is able to monitor the account from which objectionable sites were accessed and to trace

and arrest the individual responsible. Indeed, while direct blocking is difficult, the Internet is conducive to detection and monitoring, because of the precise identification protocols used by computers to connect to the network, which leave an electronic trace. Thus it may even be more difficult to escape detection if distributing 'politically subversive' material via email than in a physical medium. The legal requirement for users of the Internet to register their computers means that the PSB has the potential to identify and deal with offenders quickly.

Nevertheless, whether or not the government has the technological capability to block certain areas, or to track down all violators may not be as important as long as the threat of monitoring and punishment exists. Nicholas Negroponte, head of the MIT Media Lab commented, "the use of centralist means to censor the Net is doomed to failure, unless you simply frighten people into silence."²⁰ This emphasis on deterrence is indicated in the 1997 regulations' increased emphasis on penalties for violators. Fines of up to 5000 RMB for individuals and 15000 for work units may be charged, and network licenses may be suspended or revoked. For offenses such as revealing 'state secrets', punishment could be considerably more severe. Such an approach is consistent with the approach China has followed towards traditional media, in which self-censorship rather than direct censorship by authorities has been practiced. This may also be a reason why the law is so vague on what constitutes subversion or state secrets: if citizens are unsure of what may be deemed illegal, they may opt for the side of caution. However, such a policy presents problems for Internet service providers. Under the regulations they are held responsible for the sites that their users visit, but they are caught between the technological difficulty of monitoring all traffic through their servers and the vagueness of the law on what exactly they should be monitoring.

Further rules regulating domestic online media were issued in 2000 by the Communist Party Propaganda department. These regulations prohibit websites from providing links to outside news sources or posting content from any foreign news sources. Websites are also prohibited from hiring reporters independently; they are restricted to publishing news content provided through the state media. In addition, traditional media, both print and broadcast, were forbidden to use any content sourced from the Internet.²¹

Such restrictions could have an adverse effect on the growth of the Internet in China. Advertising revenues play an important role in the Internet world, and such revenues are closely linked to the quality of the content on a website, which drives the traffic. Without the ability to provide differentiated content, many of China's private websites will lose their business. Following the issue of the regulations, Sina.com, China's largest commercial website, announced that it would be abandoning its news and content business

in favour of e-commerce, and others may be forced to follow. These regulations again seem to coincide with the commercial interests of the government, by "effectively hobbling free-market competition" to the official state media.²² Such state media are unlikely to run foul of the state secrets provisions, and are guaranteed business as the sole providers of news content. The issue of the regulations came soon after the announcement that the five largest state media websites, including the People's Daily and Xinhua News, would receive funding directly from the central government.

HOLDING THE PURSE-STRINGS

The final strategy in the government's battle to control the Internet is its regulation of the sources of funding for domestic Internet firms. The public equity markets are a vital source of funding for almost all startup Internet companies, and the government is able to maintain control of this channel of funding by requiring approval for all companies seeking to offer shares publicly either domestically or abroad. Approval by the China Securities Regulatory Commission, which usually refers cases to the MII, is required for listing, and such approval usually requires a lengthy wait. The three leading Chinese Websites have all experienced long delays and problems in receiving approval to list on NASDAQ.²³ The MII also announced in March 2000 that Chinese websites wishing to list overseas were required to divest any China-based content assets from the entity to be listed. This provides a further obstacle for firms seeking to go public, as well as decreasing the potential attractiveness of their shares to investors. While regulating stock market listings is not sufficient to control all Internet business, it does provide the government with a stick with which it can threaten companies that attempt to disobey the regulations, since almost all Internet companies require approaching public markets at some stage.

CONTROLLING FOREIGN INVESTMENT

As in other sectors, foreigners have rushed to establish themselves in the Chinese market. Foreign firms have invested heavily, either in domestic startups, or in their own initiatives, eager to take advantage of 2.6 billion eyeballs, and many foreign educated Chinese returned home to start their own businesses. The question of foreign investment in the Internet was ignored by the government until September 1999, as the government welcomed the growth provided by the booming sector. Investors were therefore taken by surprise when Wu Jichuan, Minister of Information Industry announced that Internet businesses would be classed as value-added telecommunications services and would therefore fall under the provisions of the 1993 Regulations governing telecommunications services, the 'PRC Interim Pro-

visions on the Approval and Regulations of Businesses Engaging in Telecommunications Services'. These regulations contain no mention of the Internet; at the time, the Internet was barely known in China. Nevertheless the provisions are clear: foreigners are prohibited from owning, operating or managing telecommunications services in China.

"Foreign individuals and organizations, along with foreign invested or partnered enterprises that have already established in China are forbidden from investing or either solely or cooperatively operating in telecom services in China"

This prohibition is confirmed in later regulation. "Projects that are prohibited from foreign investment" in the 'Catalogue for guidance of Foreign Investment Industries' which forms part of Decree No 5 of the State Planning Commission, SETC and MOFTEC, promulgated in June 1995, specifically prohibits foreign management of postal and telecommunications services. By judging these regulations to be applicable to Internet business, the MII has effectively declared the illegality of all foreign-invested Internet businesses of any kind currently operating in China.

PROTECTIONISM

Several arguments have been advanced to explain the sudden decision to ban foreign investment. Although many Internet firms have sought to avoid regulatory hurdles by registering as non-Internet businesses, it is improbable that the MII was unaware of the extent of foreign involvement in the sector²⁴. Similarly, it is unlikely that the decision was motivated purely by Minister Wu's personal conservatism, although he has a reputation for obstructionism and is an enemy of Zhu Rongji's: he apparently maintained his job only on account of Zhu's humiliation in the WTO talks in April 1999, after opposing Zhu's proposed reform and opening of the telecommunications sector.

A more plausible explanation of the decision is simple mercantilism. Foreign investment was needed and accepted while the Internet was in its infancy, but once the sector had grown to a self-sustaining size, the Chinese government could jettison foreigners in order to keep the benefits of growth to itself. While this argument may contain some essence of truth, as the Chinese government has followed a strategy of protecting and promoting domestic industry by hindering foreign competition, it is lacking in its timing; considerable investment is still required if China is to rival America or Japan's capabilities, and domestic sources of capital remain highly undeveloped. Closing the tap of foreign investment completely would in all likelihood drain the Internet sector of much-needed capital.

The most convincing argument is that the ban on foreign investment is the result of *local* rather than national protec-

tionism. Wu's pronouncements should be viewed from a domestic rather than a foreign perspective as a move to consolidate the MII's control in the bureaucratic competition over the Internet.²⁵ This view sees the MII as an individual actor within the government, pursuing its own goals of size and prestige. The Internet is potentially an enormous and lucrative sector of the Chinese economy, patronage of which serves to increase the controlling bureau's power and authority. It is therefore highly desirable for the MII to maintain its primacy over it. By declaring that the Internet is a telecommunications service, it is announcing its claim to be the legitimate regulatory agency, to participants in the industry as well as to the other government agencies that also have some claim to it. Aside from the power derived from overseeing a large industry, the MII also benefits commercially from restricting foreign investment, through its involvement with ChinaNet and CCIDnet. By limiting foreign and foreign-funded competition against its sponsored entities, the MII itself stands to gain.

ENFORCEMENT

Will these threats be enforced? The Chinese government has taken an inconsistent approach to the enforcement of laws in several areas, particularly in terms of foreign investment. Authorities may turn a blind eye to violation of regulations for some time before pursuing sudden crackdowns that make examples out of certain firms, such as the crackdown on the retail distribution sector. Thus far no foreign investors involved in the Internet have been sanctioned, but the case of China Unicom should be borne in mind, especially since it fell under the 1993 Telecoms regulation, the very regulations which the MII claims apply to the Internet. In order to circumvent the prohibition of direct equity ownership and management of telecoms services, various large foreign firms had negotiated a complex series of consulting and leasing contracts with China Unicom, known as China-China-Foreign (CCF) investment. This arrangement had been sanctioned at the highest level, but in 1998 the MII announced suddenly that such investment was in fact illegal, as it was equivalent to equity ownership. Despite vociferous objections from the foreign firms involved, the Ministry ordered China Unicom in July 1999 to break off its agreement with the foreigners. The case illustrates the volatility of Chinese policy-making and the potential for conflict between different parts of the government.

Another case may be somewhat more comforting to foreign investors. In 1998, two brothers were arrested and brought before the courts in Fujian province for providing Internet telephony services without a license. The defendants won the case on appeal, by arguing that the 1993 regulations were inapplicable because computer network ser-

vices did not constitute a telecommunications service. While the verdict in the case might provide some comfort, the lack of doctrine of precedent means that the consistency of the Chinese judiciary should not be counted on to provide protection against sanctions by the MII, especially given that the case involved only domestic players. The decision creates no obligation on future judgements, nor does it place any constraint on bureaucratic agencies.

Foreign investors in the Internet would be well advised to be wary of the risks involved. The government in general and the MII are pragmatic enough to realize that the Internet will play a valuable role in China's economy and growth, and that the development of the sector would be considerably retarded without foreign capital or technology, given the lack of a domestic venture capital market. In addition, the WTO agreement negotiated with the USA provides for liberalization of telecommunications services specifically *including* the Internet, allowing up to 49% foreign ownership on accession, and 50% within two years.²⁶ Nevertheless, the lesson which foreign Internet investors should learn from the experience of many other industries, is that while the Chinese government is happy to receive foreign money and technology, it wants to do so on its own terms and will make considerable efforts to protect and support domestic firms. The general risks of investing in China and in the Internet are compounded by the security concerns that the Internet has evoked in China, and the competition between different agencies to exert their control. Investors should therefore be well aware of these risks before being blinded by the potential rewards.

Investors are advised to follow the usual precautions of appropriate due diligence before investment, finding trustworthy local partners and staff and maintaining good contacts at all levels. More specifically, foreign investors would be well advised to steer clear of the content and ISP sectors. News and media sites are particularly risky owing to their political sensitivity. There is no definition of 'state secrets' or subversive content in the regulations, and interpretation of these concepts has been broad in past cases. Penalties for publishing what is seen by the government as dissent in any media may be severe. The tight restrictions on independent news and content also effectively protect the state media against private sector competition. ISPs are also potentially an area of political risk. Under the regulations, ISPs bear responsibility for content accessed by their customers.

However they are trapped with the technical difficulty of blocking content from consumers, and the difficulty of knowing exactly which content should be blocked. From the commercial aspect, the domination of the backbone networks by state-owned entities means that private ISPs may find it difficult to operate profitably despite the enormous growth in Internet users. The safest sector to operate

in from a regulatory and political standpoint is e-commerce, although this may in turn be subject to a host of commercial concerns such as low income levels, low numbers of credit cards, and low penetration of computers and technology in companies. Investors are also advised to be particularly careful in their budgeting and funding calculations, given the government's control over public listings. Delays and obstructionism may mean financial difficulties for startups. Investors should also be aware that the requirement for stripping assets in China from overseas listed entities may decrease the appetite for such entities from secondary investors. Finally, foreigners should be prepared for the capriciousness of policy and attitudes as the government attempts to deal with the novelty of the Internet and to keep up with its rapid change.

CONCLUSIONS

The Internet promises both economic potential and political threat for China. While the government has been keen to welcome the economic benefits, the increasingly draconian regulations that it has announced reflect a desire to maintain tight control over content on the Internet. While this is to some extent driven by the Communist Party's existing policy of suppressing free information (exacerbated by the fear that the Internet will become a tool of dissidents, inspired for example by the Falun Gong's use of email) one of the primary motives for some of the policies seems to be the more economic aim of promoting state-owned Internet businesses at the expense of competitors.

This problem is especially acute because of the overlapping of state regulatory and operating agencies. The top three websites in China are privately owned, but the next seven are all owned by branches of central and local governments. This mercantilist use of legislation to protect the government's own interests will be a large obstacle for private Internet business, both domestic and foreign by creating uneven competition, and an atmosphere of uncertainty. Such national protectionism is further exacerbated by the competition between regulatory agencies to establish their jurisdiction over the sector. The restrictive and uncertain regulatory environment created by these conditions is likely to stunt market development and growth, and disincentivize foreign investors and their much needed capital.

This paper has considered China's attempts to determine the course of the Internet, but in concluding, it is worth speculating briefly on the Internet's likely effect on China. While the government has attempted to maintain strict control over the Internet, the nature of the technology means that it is likely to remain one step behind. In the long-term, the Internet will be one of the factors that contribute to the erosion of the state's political control. To suggest that it will become an instrument of widespread dissent and a tool

for subversion, as the government seems to fear, is unlikely. Change is more likely to come through the increasingly tight links with the outside world that the Internet forges, and through its contribution to economic growth. In the shorter term, the government will be able to maintain its strict control of both online and offline expression, not through regulation but through its ability to use force to scare dissenters

into submission. As Mao remarked, political power grows out of the barrel of a gun. Although the gun is now better concealed, this remains the case in China. Nevertheless, despite the efforts of the government to keep the Internet under control, its ramifications are such that it is likely in the long run to prove longer lasting and more powerful than restrictive government.

¹ Although 'government' in China in principle includes all entities from the top Communist Party leadership down to village committees, in this paper I use the term to refer to the central government in Beijing.

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¹⁵ Stirring the Pot.

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²⁴ Anthony Cheng, founder of Renren.com, talk given at Stanford Graduate School of Business, February 2000.

²⁵ Ken Grant, "The Wu Way: Has China Closed the Net Door?" Virtualchina.com Perspective, 18 October 1999. "Eyes Wide Shut," Business China, 8 November 1999 and Gary Chen, "China's Booming Internet Sector: Open or Close to Foreign Investment?" ChinaOnline, 8 October 1999.

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