

Foreign Assets for Chinese Control:
Capital Filtration, New Triple Alliance, and the Global Political Economy of
China's Information Industry (1995-2020)

by

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Supervisory Committee

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Supervisory Committee

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Abstract

For late developing countries, using foreign capital to modernize its economy is akin to wielding a double-edge sword. It complements much needed funding and technology that laggards lack endogenously but presents risks of economic dependence or even political subordination. How to maximize the economic benefits meanwhile minimize the challenges thus presents a daunting challenge for political and economic elites in the developing world. An emerging herd of information companies that rise from contemporary China represents a fascinating case to explore how Chinese policy makers manage to resolve this tension. Economically, its third-world and post-socialist context means internal investment resources are scarce, thus hampering a capital- and technology-intensive industry to emerge. Politically, an authoritarian regime that is vulnerable and vigilant to the liberalizing potential of communicational popularization is by no means an advantage.

My research investigates how China has managed to parlay foreign investment into a home-grown information industry between mid-1990s and 2020. I seek to explain how and why massive cross-border capital inflows into this sector, which potentially threatens the regime, did not challenge Beijing's authoritarian rule. Contrary to much of the scholarly literature, I find that the Chinese political elites apply a different mechanism of political control and censorship that targets the form of foreign capital inflow rather than informational content. Accordingly, I propose a theory of "*capital filtration*" to show how Chinese regulators "filter" foreign investment through an unarticulated, nationalistic, and two-pronged industrial strategy. On the one hand, Beijing allowed and supported China-based and Chinese-controlled firms to sidestep its inefficient and closed domestic securities market to seek financial investment from their counterparts in the Global North through shell companies registered in offshore financial centers. I call this new type of cross-border capital flow *offshore domesticated foreign finance* (ODFF). On the other hand, through stringent measures to restrict foreign direct investment (FDI) such as equity caps, approval red tape, national security review, and haphazard licensing and technology transfer requirements, Chinese regulators crippled foreign industrial investors' market entry, operations, and competitiveness inside China. By bringing in ODFF while pushing out foreign corporate influence, capital filtration has ushered in a *neo-triple alliance* among policy makers in Beijing, China-based and Chinese-controlled information service companies, and transnational financial elites. It also minimized economic dependency and political subordination, which had hobbled previous late developers after liberalizing domestic capital markets, and made informational censorship easier.

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List of Abbreviations

ADR	American Depositary Receipt
ADSL	Asymmetric Digital Subscriber Line
AGM	Annual General Meeting
BOT	Build-Operate-Transfer
BTS	Basic Telecommunications Service
BVI	British Virgin Islands
BVI	British Virgin Islands
CAC	Cyber Administration of China
CCB	China Construction Bank
CCF	China-China-Foreign
CCP	Chinese Communist Party
CCTV	China Central Television
CDB	China Developmental Bank
CDMA	Code Division Multiple Access
CDN	Content Delivery Network
CEO	Chief Executive Officer
CEPA	Closer Economic Partnership Arrangement
CFIUS	Committee on Foreign Investment in the United States
CFO	Chief Financial Officer
CIC	China Investment Corporation
CICC	China International Capital Corporation
CITIC	China International Trust Investment Corporation
COO	Chief Operating Officer
CSRC	China Securities Regulatory Commission
DGT	Directorate General of Telecommunications
EU	European Union
FDI	Foreign Direct Investment
FL	Foreign Loan
FPI	Foreign Portfolio Investment
FTA	Free Trade Area
GCBD	Guizhou Cloud Big Data
HKSE	Hong Kong Stock Exchange
HoCo	Holding Company
ICP	Internet Content Provider
ICT	Informational and Communicational Technology
IDC	Internet Data Center
IMF	International Monetary Fund
IPO	Initial Public Offering
IRC	Internet Resource Collaboration
IRCS	Internet Resource Collaboration Service
ISO	Incentive Share/Stock Option
ISP	Internet Service Provider
KPMG	Klynveld Peat Marwick Goerdeler
MEI	Ministry of Electronic Industry

MEP	Ministry of Electric Power
MII	Ministry of Information Industry
MIIT	Ministry of Industry and Information Technology
MNC	Multinational Corporation
MNE	Multinational Enterprise
MoF	Ministry of Finance
MoFCOM	Ministry of Commerce
MoFTEC	Ministry of Foreign Trade and Economic Cooperation
MOR	Ministry of Railways
MOU	Memorandum of Understanding
MPT	Ministry of Post and Telecommunications
NASDAQ	National Association of Securities Dealers Automated Quotations
NDRC	National Development and Reform Commission
NTT	Nippon Telegraph and Telephone
NYSE	New York Stock Exchange
NYSE	New York Stock Exchange
ODFF	Offshore Domesticated Foreign Finance
OFC	Offshore Financial Center
OpCo	Operating Companies
PBoC	People's Bank of China
PCAOB	Public Company Accounting Oversight Board
PRC	People's Republic of China
PTA	Post and Telecommunications Administration
PWC	PricewaterhouseCoopers
SAIC	State Administration of Industry and Commerce
SAMR	State Administration for Market Regulation
SAP	Structural Adjustment Programs
SAPPRFT	State Administration of Press, Publication, Radio, Film, and Television
SARFT	State Administration of Radio, Film, and Television
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration of Taxation
SCREC	State Commission for Restructuring the Economic System
SDPC	State Development Planning Commission
SEC	Securities and Exchange Commission
SETC	State Economic and Trade Commission
SMS	Short Message Services
SOE	State-owned Enterprise
SPC	State Planning Commission
SPV	Special Purpose Vehicle
TNC	Transnational Corporation
UIG	Unicom Investor Group
VATS	Value-added Telecommunication Service
VIE	Variable Interest Entity
VPN	Virtual Private Network
VSAT	Very Small Aperture Terminal
WFOE	Wholly Foreign-owned enterprise

WTO

World Trade Organization

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Dedication

To my Family

Chapter 1: Introduction

September 19, 2014 marked an iconic moment in the history of capitalism. Alibaba Group, a conglomerate specializing in various Internet-related businesses such as e-commerce, cloud computing, and electronic payments, hit a record US\$ 25 billion through its initial public offering (IPO) on the New York Stock Exchange (NYSE) -- the largest ever in the history of the stock market.¹ The massive amount of funding that Alibaba had managed to raise, as well as its successful debut on the international stock market, gained the company lavish limelight in both Chinese and international media coverage. *Xinhua*, China's state-owned news outlet and the Chinese Communist Party's (CCP) mouthpiece, dedicated a special report that spared no praise by dubbing Alibaba as "a Chinese Miracle' on Wall Street."² The CCP Hangzhou Municipal Committee, based in the same city as Alibaba's headquarters, sent out a letter of congratulations to the corporate giant that called it "the golden business card of the city and the pride of every citizen."³

However, perhaps to the great surprise of many, an inconvenient and often overlooked fact lay behind this business and media fanfare: foreign investment is forbidden in China's Internet sector.⁴ In fact, over the years, Chinese regulators have reiterated the importance of Internet security and have consistently upgraded the Internet sector's blacklist against foreign capital due

¹ This record was only recently surpassed by Saudi Aramco's \$29.5 billion in 2019.

² *Xinhua Net*, "Alibaba Shangyan Hua'erjie 'Zhongguo Qiji'", [Alibaba shows a "Chinese Miracle" on Wall Street], <http://www.xinhuanet.com/fortune/gsb/86.htm>, published Sept. 19, 2014, assessed July 21, 2020.

³ *CNR News*, "Hangzhou Shiwei Shizhengfu Fahexin Zhuhe Alibaba Chenggong Shangshi" [Hangzhou's CCP Committee and Municipal Government sent congratulatory letters for Alibaba's successful IPO], http://news.cnr.cn/native/city/201409/t20140920_516473326.shtml, published Sept. 20, 2014, assessed July 21, 2020.

⁴ Various updates of the Catalogue for the Guidance of Industries for Foreign Investment from 2002 to 2019 have consistently barred foreign investment from entering Chinese Internet services. Since 1995, ministries in charge of macroeconomic planning and foreign commercial affairs used this catalogue to indicate the sectors in which foreign investment is welcome, restricted, and prohibited.

to the sector's political sensitivity.⁵ More perplexingly, Alibaba Corporation, the company listed on the NYSE, was not even a Chinese company in the legal sense. It was domiciled in the Cayman Islands and thus was governed by the Caribbean island-state's articles of association and Companies Law. Furthermore, Softbank, a Japanese conglomerate, and Yahoo, an American web service provider, along with many other Western institutional and financial investors held more than half of Alibaba's shares both before and after the company's extravagant IPO on the NYSE.⁶ In contrast, three dozen of Alibaba's Chinese co-founders and managers own an aggregate minority of its issued shares, having only 14.6% of them at the time of the 2014 IPO.⁷

For this project, an intriguing enigma lies in Alibaba's convoluted corporate structure, and more perplexingly, in Beijing's self-contradictory attitude and treatment regarding the company. Although written regulations and policies clearly and consistently reiterate that foreign investment is prohibited in the Internet sector, the Chinese officialdom seems to have willfully ignored Alibaba's obvious contempt and brazen circumvention of these tough restrictions by allowing a foreign-registered company with foreign investors holding most of its ownership to invest in China.

Why did the Chinese authorities openly condone Alibaba's contraventions of its official rules by allowing the company to operate on its own terms over the years? Why did the Chinese party-state -- widely known as a powerful juggernaut -- do nothing to resolve this inconsistency, whether by cleaning up such irregularities as per its written code of practice or by revising the code's dysfunctional or obsolete provisions to meet contemporary economic realities?

⁵ Office of the Central Cyberspace Affairs Commission, "Xi Jinping: Meiyou Wangluo Anquan Jiumeiyou Guojia Anquan" [Xi Jinping: There is No National Security without Cyber Security] http://www.cac.gov.cn/2018-12/27/c_1123907720.htm, published December 27, 2018, assessed July 22, 2020.

⁶ See the case study of Alibaba's corporate structure offered in Chapter 5 for more details.

⁷ Securities and Exchange Commission, "Alibaba IPO Prospectus," <https://www.sec.gov/Archives/edgar/data/1577552/000119312514184994/d709111df1.htm>, published May 6 2014, assessed July 7 2019.

1.1 Homegrown yet Foreign Funded Information Companies in 25 Years: The Empirical Focus and Time Frame

Alibaba is archetypal of China's emerging bevy of information companies that my research is interested in. Numbering about one hundred,⁸ these companies share the contradictory characteristics of being registered outside Mainland China and funded by foreign sources, while also being based in China and controlled by Chinese nationals or state entities.⁹ More precisely, they are all domiciled in offshore financial centers (OFCs) such as the Caribbean islands and Hong Kong, and are therefore governed by non-Chinese business laws. Additionally, global investors hold a substantial percentage -- usually more than half -- of the shares that these companies issue and trade them outside of Chinese financial markets such as in the American and Hong Kong securities markets. On the other hand, the "Chinese-ness" of these companies is obvious. The companies' primary assets, headquarters, operations, accounting records, company seals, and board meetings are all in Mainland China. Their corporate decisions are administered by Chinese nationals, residents, or state-owned entities who habitually reside in Mainland China despite their minor shareholding status.

Moreover, these companies also share a commonality of specializing in information and communication technology (ICT) services provision. In other words, I pinpoint companies that offer *intangible* output that operate in the tertiary sector of the economy and exclude ICT manufactures.¹⁰ The reason is twofold. One is that, unlike tangible informational manufactured goods involving towers, transmitters, chips, laptops, cellphones and other wearable electronic

⁸ China Internet Network Information Center, "the 47th China Statistical Report of Internet Development," <http://www.gov.cn/xinwen/2021-02/03/5584518/files/bd16adb558714132a829f43915bc1c9e.pdf>, published February 2, 2021, assessed July 21 2021.

⁹ Throughout this study, China is used interchangeably with Mainland China and People's Republic of China (PRC). Unless otherwise noted, such usage excludes Hong Kong and Macau because of their unique financial and economic systems between 1995 to 2020, which forms the time range of this study.

¹⁰ For more information on the trichotomy of economic activities, see Wikipedia, "Three-sector model," https://en.wikipedia.org/wiki/Three-sector_model.

devices that consumers touch and feel, information services, such as the operation of telecommunications and Internet networks or the provision of mobile phone applications, are *intangible*. The other is that, as later chapters will show in detail, Beijing's interests in hosting foreign capital and western ICT manufactures' motivation in entering China differ between IT equipment and services. Numerous studies have shown that Beijing eagerly welcomed foreign equipment manufactures to set up production lines in the form of FDI in China, with an intent to access advanced foreign technology. Meanwhile, foreign companies with technological superiority have been reluctant to move their state-of-the-art technology in China for fear of implicit or explicit technological transfer.¹¹ Also, for international IT equipment manufacturers, one of the motivations of market entry, in addition to local sales, is *exportation*, i.e. to take advantage of lower labor, resource, and production costs and then ship part of their locally-manufactured products out of the host country for sale. Quite differently, multinational companies seeking to provide ICT services is *market-oriented*, which not only result in direct competition with China's domestic companies, but also challenge the authoritarian regime's informational control.

For my research, information services that these companies provide also differ from and thus exclude conventional media outlets. These traditional channels such as newspapers, radios, and televisions spread out information in a *unidirectional* way. In terms of data *generation* and *transmission*, information services include a mixture of oral, written, audio, and visual languages

¹¹ See, for instance, Harwit, Eric. *China's Telecommunications Revolution*, Oxford University Press, 2008; Yu, Hong. *Networking China: The Transformation of the Chinese Economy*, 2017; Horsley, P. Jamie. "PRC Regulation of Foreign Telecom Equipment and the WTO," *China Business Review*, (September-October 2001); DeWoskin, Kenneth J. "The WTO and the Telecommunications Sector in China." *The China Quarterly* 167 (2001): 630-54; Zhang, Bing. and Mike W. Peng, "Telecom Competition, Post-WTO Style." *The China Business Review* 27, no. 3 (2000): 12-21.

Moreover, China's Foreign Investment Law stipulated that telecom manufacturing was encouraged, while service provision was restricted.

that are disseminated at a faster speed and to a larger audience. In addition, mobile technology allows ICT service users to *individualize* information in an electronic form and propagate it in a *bidirectional* or *multidirectional* form, or in a synchronous or asynchronous manner, thus enhancing the interactivity, efficiency, and flexibility in information flow enormously.

Based on the two considerations, the companies under this project's empirical investigation can be generally narrowed down and split into two categories. The first group refers to telecommunications services providers including China Mobile, China Unicom, and China Telecom.¹² Known together as the Big Three, they are all national oligopolies owned and controlled by the Chinese state that initiated their dual listing on the Hong Kong and New York Stock Exchanges in 1997, 2000, and 2001 respectively.¹³ The other category includes a much larger flock that operates in various Internet-based subsectors, including but not limited to web searches, e-commerce, social networking, instant messaging, ride hailing, cloud storage, and electronic payments. These companies, which include Alibaba, Tencent, Jingdong, Baidu, Didi, and Weibo, run various kinds of smartphone applications and software that Chinese Internauts use daily. Like the Big Three telecom services national champions, their major assets and operations are also largely located in Mainland China, while their corporate funding principally comes from securities markets in the U.S. and/or Hong Kong.

To analyze the relationship between the Chinese regime and these companies' complex corporate structure in foreign capital acquisition, my research covers the period between the mid-1990s and 2020, a less-than-thirty-year range that saw the inception, takeoff, and maturity of

¹² China Netcom initiated its overseas IPO in 2004, but was merged into China Unicom in 2008.

¹³ All were delisted from NYSE in May 2021 following an executive order issued by the American president that demanded so. But they were still listed on HKSE when this chapter was written. For more information, see, Chong Koh Ping & Alexander Osipovich, "NYSE to Delist Chinese Telecom Carriers After Rejecting Appeals," *Wall Street Journal*, published May 7, 2021, accessed August 20, 2021.

China's information services industry. I use the mid-1990s as a cut-off for two reasons. The first reason is that China barely had an information services market before that period. Prior to the mid-1990s, even a fixed-line telephone was a privilege for party-state officials rather than a common household appliance.¹⁴ However, this situation changed when central state-initiated corporatization reform ended the monopoly of the Ministry of Post and Telecommunications (MPT) and its local administrations as the sole operator and regulator of China's telecommunications assets. With a diminishing state budget and the repeal of exorbitant subscriber charges, the corporatized MPT system and its newly founded state-owned companies had no choice but to explore new financing channels, so foreign investment naturally became an option.

The second reason is that, it was also in mid-1990s when the 2nd generation (2G) of cellular network standards¹⁵ was brought into China by international telecom companies via the newly corporatized Chinese SOEs. Compared with the previous generation that only allowed for voice services with clumsy brick-sized mobile phones and immobile fixed-line telephone services, 2G technology allowed for voice services, texting, and picture messaging, thus propagating information in much larger and more diverse forms and quantities. Moreover, the Internet was also commercialized in China during the mid-1990s, which heralded the rapid emergence of these Internet-based companies.

¹⁴ According to data from the World Bank, a miniscule 1.1% of China's 1.13 billion people had access to a fixed-line telephone and a negligible 18,319 users had mobile phones in 1990. The World Bank, Mobile cellular subscriptions, <https://data.worldbank.org/indicator/IT.CEL.SETS>, assessed July 22, 2020.

¹⁵ The arrival of the 3G era in the late 1990s allowed for faster and larger amounts of data, video calls, and mobile Internet usage. 4G, the current and most prevalent standard, was commercialized in the late 2000s with a speed 500 times faster than that of 3G, higher image quality, and better connection for mobile devices. The 5G that telecommunication service companies have been deploying since 2019 provides more efficient connection and speed.

1.2 Funneling in Global Finance, Filtering Out Foreign Control: Theoretical Arguments

To me, an intriguing enigma that these companies reveal boils down to how and why a foreign financed information sector managed to emerge in China. As a post-socialist economy in the 1990s, China's internal investment resources were scarce, thus hampering the emergence of an indigenous capital- and technology-intensive industry. As a result, investment from rich countries became vital. However, for any late developing countries, using foreign capital to modernize its economy is akin to wielding a double-edge sword. On one hand, it serves as much needed funding and technology that laggards lack endogenously. On the other hand, it presents risks of economic dependence or even political subordination. Accordingly, how to balance out the economic benefits with these investment challenges is a daunting task for political and economic elites in the developing world. Such risks were aggravated in the Chinese case because of an authoritarian regime that is vulnerable, vigilant, and averse to the liberalizing potential of communicational popularization. However, bucking these structural adversities, a homegrown information sector has been burgeoning in China in the past two decades, with the help of foreign investment but without shaking off Beijing's authoritarian rule. How can we understand this phenomenon?

I propose a theorization of *capital filtration* as an answer. Capital filtration refers to a set of unarticulated, nationalistic, and industrial strategies that Beijing designs, practices, and upgrades to filter the inflow of foreign investment so that it suits China's post-socialist, developing, and authoritarian "recipient." I emphasize that the filter target is not *informational content*, but the mode of foreign capital flow into the information services industry in China. Accordingly, the purpose of capital filtration is not to limit Chinese netizens' access to certain

types of information -- an issue that many studies have elucidated¹⁶ -- but to restrict and eventually deprive foreign investors of *corporate control* over locally invested assets.

I argue that capital filtration has two components. One refers to parlaying *financial* investments acquired from global securities markets into China-based and Chinese-controlled companies. This mode of investment channeling ushers in a new type of cross-border capital inflow that I call offshore domesticated foreign finance (ODFF). To be more precise, firms based in Mainland China could camouflage as foreign entities by creating special purpose vehicles (SPVs) in OFCs, all thanks to the globalization of financial markets and Beijing's acquiescence and support. Because of their historical and legal affinities with the major financial regulations of the Global North, SPVs, despite being shell companies that exist primarily on paper, are legally recognized as companies in the Global North and are thus able to raise funds from financial markets in the developed world. Ostensibly and legally speaking, SPVs are owned and controlled by non-Chinese investors from the developed world for two reasons. One is that they possess more than 10% of the SPVs' issued shares.¹⁷ The other is that cross-border capital flow into China takes a form that allows SPVs to establish local affiliations inside China. However, the *de facto* power

¹⁶ See, for instance, Xu, Xu. 2021. "To Repress or To Co-opt? Authoritarian Control in the Age of Digital Surveillance." *American Journal of Political Science*, 65.2: 309-325. Roberts, Margaret. *Censored: Distraction and Diversion Inside China's Great Firewall*, 2018; King, Gary, Jennifer Pan, and Margaret E. Roberts. 2013. "How Censorship in China Allows Government Criticism but Silences Collective Expression." *American Political Science Review*, 107(2), 326-34, 2013; MacKinnon, Rebecca. "China's 'Networked' Authoritarianism'." *Journal of Democracy* 22(2): 32-46; Qiang Xiao, "The battle for Chinese Internet." *Journal of Democracy* 22(2): 47-61, 2011; Kalathil, Shanthi, and Taylor C. Boas, *Open Networks, Closed Regimes: The Impact of the Internet on Authoritarian Rule*, Washington, D.C: Carnegie Endowment for International Peace, 2003. King, Gary, Jennifer Pan, and Margaret E. Roberts. 2014. "Reverse Engineering Chinese Censorship: Randomized Experimentation and Participant Observation." *Science*, 345 (6199): 1-10. Harwit, Eric. and Duncan Clark, "Shaping the Internet in China: Evolution of Political Control over Network Infrastructure and Content," *Asian Survey* (May/June 2001), pp.377-408; Hughes, Christopher. "Controlling the Internet Architecture within Greater China," in *Cyber China: Reshaping National Identities in the Age of Information*, pp.71-90.

¹⁷ According to the guidelines established by the Organization of Economic Co-operation and Development (OECD), a minimum of 10% ownership stake in a foreign-based company is the threshold for a cross-border investment transaction to be qualified as a FDI that establishes a controlling interest. For a more detailed definition, see, OECD, Foreign Divestment Investment Statistics: Explanatory notes, <https://www.oecd.org/daf/inv/FDI-statistics-explanatory-notes.pdf>, assessed July 20, 2019

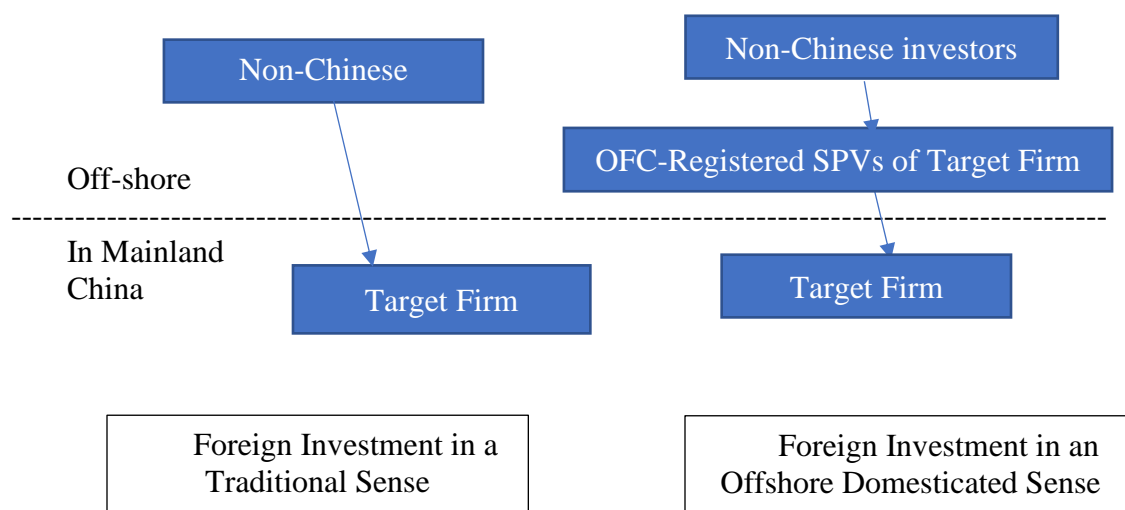
dynamics between the SPVs and their global investors is the opposite. As later empirical chapters will show in detail, in a time span of around two decades, three ODFF modes emerged to guarantee that foreign invested and China-based businesses and assets would be controlled, managed, and operated by Chinese nationals or state-owned entities.¹⁸ The reason why Alibaba, a company mainly owned by foreign investors, could bypass Beijing's foreign investment prohibition was not because of regulatory negligence, but rather because Beijing had vetted its corporate structure and knew the company was Chinese-controlled, thus treating it as a domestic firm.

Arguably, ODFF challenges our conventional understanding of “foreignness” as related to cross-border capital flow. As Diagram 1.1 demonstrates, the term “foreign” is conventionally a geographic term, designating only that the residence of the investor is different from the residence of the receiving corporate entity. However, financial globalization has made “foreignness” a malleable concept.¹⁹ Companies based in China and controlled by Chinese legal persons can disguise themselves as foreign ones by creating and registering shell companies offshore. As a result, rather awkwardly, the offshore shell companies are simultaneously “foreign” investment recipients and “foreign” investment senders. In other words, the shell companies acquire capital from Global North financial markets and they “invest” the proceedings back to inside China parent companies that retain control rights in appointing management, disposing assets, and setting strategic directions. Therefore, ODFF has made cross-border capital flow, a conventionally one-step process into two, with the global northern financial markets serving as intermediaries.

Diagram 1.1 *Traditional and Transformed Understandings of Foreign Capital Inflow*

¹⁸ Control rights include “the rights to appoint management, dispose of assets, and set the strategic direction of firm.” Huang, Yasheng. *Capitalism with Chinese Characteristics*, 2008, p.13

¹⁹ In the entire project, I use “foreign” from a corporate control perspective rather than a purely geographical one. Expressions such as “foreign companies” or “foreign investors” refer to non-Chinese controlled and outside-China headquartered firms, thus *excluding* the offshore SPVs set up for funding purposes by China-based and Chinese-owned companies.



Figuratively, I argue that “domesticated” also means that a third-world recipient tames investments originating from the Global North, as the associated political and economic risks on local society are mitigated, much like how wild animals lose their intractability and ferocity to become docile and submissive when tamed. ODFF arguably helps to minimize the political and economic challenges of conventional cross-border financial inflow -- either from foreign portfolio investment (FPI) or foreign loan (FL). The *offshore* status of ODFF means that capital acquisition takes place *outside* China’s borders and that global investors do not directly invest into the target company via China’s financial market, which remains largely closed off to global investors. Thus it is shielded from the risks associated with sudden foreign capital outflow that many developing economies have encountered after liberalizing their domestic financial markets, as well as the resultant banking, economic, social, or even political turmoil.

Additionally, I argue that capital filtration has ushered in a *neo-triple alliance* among policy makers in Beijing, China-based and Chinese-controlled information service companies, and transnational financial elites.²⁰ This partnership is brokered and underpinned by Beijing’s political

²⁰ “Neo” is used in contrast against an earlier conceptualization adopted by Peter Evans (1979), who attempted to conceptualize an elite partnership among multinational corporations, local private entrepreneurs, and state-owned enterprises that contributed to Brazil’s industrialization but prevented the larger population from benefiting from it.

elites, who are wary of penetration from foreign industries into the information sector that will threaten their rule. But instead of blanketly prohibiting foreign investment, Beijing, under the careful guidance of western financial elites in general and investment banks in particular, has craftily resorted to using globalized securities markets to pair China-based firms experiencing credit crunch with international financial investors, all without opening its closed domestic capital market.²¹ Homegrown Chinese companies are thus allowed to escape from an inefficient internal capital market to draw on more efficient financial institutions located in the Global North. Meanwhile, global rentiers are offered a pathway to tap into China's lucrative information market by pouring cash into and taking profits from the growth and expansion of China-based companies. This partnership frees Beijing from having to liberalize its low-efficiency financial sector, which inevitably affects the vested interests of state-owned banks and increases exogenous risks of financial instability. Politically, an information industry dominated by homegrown firms and controlled by Chinese nationals, among which some are state-owned and -controlled, makes political control of the services that these companies provide easier.

I also find that the second component of capital filtration applies to foreign *industrial* investors which are excluded by the neo triple alliance. In other words, capital filtration contains a set of coercive rules that target multinational companies headquartered in the Global North that seek to enter China through foreign direct investment (FDI), compete with homegrown Chinese counterparts, and gain a foothold in China's information services market. As Chapter 6 will show

However, China's informatization trajectory against the backdrop of financial globalization brings in new winners and losers, thus offering a revamp of Evan's framework.

²¹ More precisely, China's domestic A-share stock market is only open to foreign investors through government-approved plans and channels such as the Qualified Foreign Institutional Investor (QFII) plan, and reforms in recent years have largely been in baby steps. As of late August 2021, barely 4.7% of the capitalization of shares issued on Chinese domestic stock markets are foreign-owned through QFII. Quan Yue, "Fang Xinghai: Jinyibu Tuidong Zibenshichang Zhuduxing Kaifang" [Fang Xinghai: Further Promote Institutional Opening of China's Capital Markets], *Caixin*, <https://finance.caixin.com/2021-09-04/101769006.html>, published and assessed Sept. 4, 2021.

in detail, Beijing has erected multiple FDI-restriction hurdles that obstructed market entrance, independent operation, and competitiveness of *industrial* investments. First, pre-entry equity cap obligates foreign entrants to form joint ventures with Chinese partners -- a measure that cripples foreign investors' autonomous corporate decision-making. Next, the government discretely carries out opaque, cumbersome, and nebulously worded red tape to increase foreign investors' admission-processing time. Third, for the handful of MNCs that eventually obtain an entry permit in the form of a Sino-foreign joint venture, the scope and scale of their local operations are severely constrained by the post-entry licensing and technology transfer requirements imposed by the multiple governmental agencies that share authority over the information sector.

Eventually, the FDI-restricting facet of capital filtration contributes to the *financialization of industrial capital*. In other words, international industrial giants that are unable to independently operate or even physically enter China are left to become financial rentiers in China's information bonanza. They give money to their Chinese counterparts; hold non-controlling shares issued by their competitors' offshore SPVs, and recoup dividends or interests but soon witness the very companies they financed expand outside of China and encroach on their own turfs globally.

1.3 Capital Filtration in Three Variants: Empirical Findings

As an unarticulated industry strategy, capital filtration was not created overnight, but evolved steadily over two decades. I classify this process into three variants, with later modes inheriting, learning from, and improving on previous ones. I find that the first form of capital filtration emerged in 1995 against the backdrop of China's reforms to the governance of telecommunications. To instrumentalize foreign investment for the state-of-art mobile communication network and minimize foreign corporate influence at the same time, Beijing gave China Unicom -- a newly created SOE owned by over a dozen Chinese ministries and non-telecom-

related SOEs -- the consent to adopt a double joint-venture structure called China-China-Foreign (CCF). Through this structure, a foreign investor (F), usually an international telecom service operator, would partner with a company owned by or affiliated with Unicom's stakeholders to form an intermediary, equity-based, and non-telecom-operating Sino-foreign joint venture (CF). This joint venture, legally considered a person under Chinese law, would then team up with Unicom to form another joint venture (CCF) to provide telecom services. However, the second partnership would not be equity-based, but would rather concern a 15–30-year *contractual* agreement, according to which the first (CF) joint venture would not directly operate the networks, but provide funding and equipment for network construction, lease the said equipment to Unicom, and teach Unicom how to use them. In return, China Unicom, which was responsible for operating the systems, would periodically distribute a portion of its operating revenues – usually more than 70% – in the name of “installation and consultation fees” to the intermediary JVs in Chinese currency.

Involving 46 projects scattered across China and 32 foreign telecom investors from 11 countries, the CCF strategy represented a test design for the initial capital accumulation of China's telecom services sector in the face of a shortage of government investment and foreign currency. The locally fragmented projects obliged technologically and financially superior foreign investors to cooperate with the local affiliates of Unicom's shareholders. These projects consolidated networks at provincial or municipal levels, thus hampering any foreign telecom company from dominating the Chinese national market. However, the goal of filtering out foreign investors' corporate influence saw only limited success due to how capital inflow took the form of FDI and because of how Unicom's future international competitors had to be physically present in China to undertake network construction and maintenance. Unicom's limited achievements were also

obtained at some expense to its own corporate prospects. With corporate decision-making being decentralized and fragmented, as well as country-wide projects each having their own terms and conditions, Unicom was unable to reach a nationalized tariff and interconnection settlement, thus preventing its own growth. Eventually, this first variant of capital filtration was scrapped in 2000.

The CCF plan's defects were remedied in the second incarnation of capital filtration, known as "Red Chip overseas listing". First emerging in 1997 and adopted by all of China's oligopolistic telecom operators,²² this variant marked a closer connection between Chinese state-owned telecom companies and global financial markets, thus paving the road for the former to become centralized and globally competitive national champions. To construct a Red Chip foreign listing, a Hong Kong-registered shell company would be created by each telecom oligopoly as their listing vehicle, but it would be owned and controlled by a British Virgin Islands (BVI)-registered company. Once established as the controlling entity, the BVI-registered company would not run any businesses but would only hold the listing vehicle's issued shares. BVI registration offered such advantages as having no requirements on the disclosure of a shareholder's information and receiving non-corporate taxes, which facilitated the injection and transference of assets that would be otherwise subject to transparency-related regulations in the listing place. In turn, the BVI-registered company would be owned and controlled by the parent company that created the overseas entities. And although it only existed in spreadsheets, the Hong Kong-registered listing vehicle would then receive high-value assets from its mainland parent company that would be packaged for international sales, normally through a duo IPO in New York and Hong Kong.

²² As Footnote 13 indicates, although the companies have been delisted from NYSE since May 2021, their shares are still being traded on Hong Kong Stock Exchange.

To filter out foreign corporate control, only around 25% of the assets without corporate voting rights would be allocated for international investors to purchase. The Chinese state would retain complete corporate control, not only because it constantly held around 75% of the aggregate shares through the BVI-registered companies, but also because the listed and Hong Kong-registered companies, although *de jure* foreign companies due to not being domiciled in China, were under the *de facto* control of the Chinese state, as the composition of board members and management teams were identical to the parent company in China. Afterwards, provincially managed telecom assets that were once scattered nationwide would be slowly but surely injected into the Hong Kong-listed vehicle. Because of its regional and interprovincial disparity in terms of asset quality and profitability, the reverse merger and acquisition would be conducted in several steps instead of being done as a one-time deal. In other words, the listed company would use the proceedings generated from the IPO to “buy” provincial assets from the parent company in batches until the parent company’s nationwide assets were completely injected into the listed company.

I argue that the “Red Chip” strategy offered three advantages that CCF could not. Firstly, foreign capital would come to China in a purely financial form, with foreign competitors having no local and physical presence in the Chinese market to challenge Chinese companies. Secondly, the “how” and “when” of the acquired fund’s usage would be far less constrained by foreign investors because of the opacity of having a BVI-registered shell company. Thirdly, the American investment banks’ *ideational* support of having a foreign IPO, which would be followed by reverse mergers and batches of acquisitions that were masterminded and midwived by global financial capitalists, would not only bring in ODFD -- a much cheaper and easier way of utilizing foreign capital -- but would also transform locally fragmented assets into national, unified, internationally competitive telecom giants.

The third form of capital filtration, known as the “variable interest entity (VIE)”, combines the CCF strategy’s rationale of having foreign investors hold contractual rather than equity-based control of the invested entity and the Red Chip strategy’s embedding of cross-border corporate construction into global financial markets using OFC-registered funding vehicles. Widely used by China’s Internet-based companies since the early 21st century, the VIE strategy has three advantages. Firstly, it represents a proliferation of capital filtration that can be understood in two senses. One is that when comparing its sheer number of users against those of CCF’s China Unicom and Red Chip’s three national telecom oligopolies, the VIE mode has been adopted by around 100 China’s Internet-based companies. ODFD channeled through the VIE have arguably created China’s booming Internet industry. The other sense of VIE as a proliferation of capital filtration is that, from the perspective of corporate ownership, the VIE is used by once privately held and later publicly listed companies with scant state ownership, unlike its two predecessors which were tailor-made for China’s telecommunications SOEs.

The second advantage of the VIE is that it applies CCF-inspired contractual control in a transborder context to global financial investors and on international financial markets. This allows Chinese entrepreneurs and management teams with negligible share ownerships to have disproportionately enormous dominance over corporate decision-making and management -- a privilege that Red Chip SOEs had to achieve using a numeric equity cap. Thirdly and finally, the VIE mode demonstrates a much earlier and deeper entwining in terms of the stage and level of corporate involvement from transnational financial elites. Unlike its predecessor “Red Chip”, whose engagement originated from the corporatization stage and the ensuing preparation of foreign listing, venture capitalists and private equity firms begin involvement in the construction of the VIE to finance the growth of Chinese Internet companies from scratch. For the more

promising ones, international investment banks, law firms, and accountancies bring their listing on foreign security exchanges through IPOs.

1.4 Synergistic Institutionalism: Methodological Considerations and Research Data

This project employs a basic methodology called synergistic institutionalism. It has two premises built upon neo-institutional analyses in the social sciences, namely historical institutionalism in comparative politics and social constructivism in international relations. This methodological choice emphasizes the coupling and synergistic cooperation between domestic politics and international relations -- in the sense that cross-border capital flow and nation-state governance are interactive forces that together shape a unique economic phenomenon. In this project, political elites in a post-socialist authoritarian setting are the self-interest maximizers. To attain the desired outcomes, they calculate the costs associated with each option using rational choice logic, seek strategic partnerships with other actors, and eventually, readjust institutions for better purposes. In this regard, institutions are not necessarily constraining, but *enabling* for dominant players.²³

More importantly, in contrast to conventional literature on institutionalism which focuses on domestic factors as variables to explain institutional evolution, synergistic institutionalism underscores that domestic contextualized settings impact how local political and economic actors perceive and respond to incentives or pressures exerted by *international* forces.²⁴ This exogenous variable has become even more salient since the latest wave of neoliberal capitalist globalization,

²³ North, *Institutions, Institutional Change and Economic Performance*, p.3.

²⁴ For similar canonical works linking domestic and international institutions, see, Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics," 1978; Hiscox, *International Trade and Political Conflict, Commerce, Coalitions, and Mobility*, 2002; Keohane & Milner (eds.), *Internationalization and Domestic Politics*; Milner, *Interests, Institutions, and Information: Domestic Politics and International Relations*, 1997; Hiscox, "The Domestic Sources of Foreign Economic Policies". In Ravenhill, ed., *Global Political Economy*, 2014; Frieden & Martin, "International Political Economy: Global and Domestic Interactions" in Katznelson & Milner, eds. *Political Science: State of the Discipline*, 2002; Wu, *Globalization Against Democracy*, 2017.

with increased global capital flows enticing new ideas in domestic actors' perceptions of interests and threats. Such exogenously induced *ideational* change is captured by the social constructivist school in the study of international relations, which argues that ideas shape the way in which actors understand the international structure, perceive their interests, identify friends or foes, and design strategies to challenges and threats.²⁵

Enlightened by this methodological choice, my research elucidates, in the international-to-domestic direction, how political and economic elites from developing and authoritarian China managed to seize structural opportunities associated with different forms of cross-border investment inflow to enhance self-interests. Meanwhile, it also shows how domestic actors' choices reshape the power dynamics between political authoritarianism and global capital. That said, synergistic institutionalism represents an effort to embed a comparative single-case political-economic analysis -- an endeavor that principally concerns itself with the political and economic dynamics *within* nation-states²⁶ -- into an international political-economic investigation -- a research aim interested in "the interrelationship between public and private power in the allocation of scarce resources"²⁷ within the international arena.

Furthermore, synergistic institutionalism also requires historical sequences to be taken seriously because, as a canonical piece on comparative historical methods has revealed, political events impact decisions and actions from which actors or agents draw experience, lessons, or expectations from for the future.²⁸ Process tracing of the evolution of an institution helps to shed

²⁵ For more literature on social constructivism in international relations, see, for instance, Wendt, *A Social Theory of International Politics*, Cambridge: Cambridge University Press, 1999.; Finnemore, M and K Sikkink, "Taking Stock, The Constructivist Research Program in International Relations and Comparative Politics." *Annual Review of Political Science*, 4(1):391-416, 2001.; Adler, E., "Constructivism" in Carlneas W., B. Simmons, and T. Risse (eds.), *Handbook of International Relations*, Thousand Oaks, CA: Sage, 2003.

²⁶ Menz, *Comparative Political Economy*, 2017.

²⁷ Ravenhill, *Global Political Economy*, 2014, p.18.

²⁸ Skocpol and Somers, "The Uses of Comparative History in Macrosocial Inquiry", 1980.

light upon how and why certain choices were made and certain outcomes occurred.²⁹ Therefore, I study the rules governing foreign capital in China's information sector over time, and pay attention to how internationally originated ideas and assistance catalyzed key events and steps at critical junctures that impact normative changes and their sequences.³⁰

As per the Chinese case, investigating Chinese politics is a tremendously difficult task. A major impediment is the challenge in obtaining relevant research data. Given the opacity of the Chinese policy-making process and its closed-door political operations and arrangements, the party-state's decision-making is often unknown to outsiders. However, one source of historical data that was not available until recently has offered me an opportunity to surmount this obstacle. Some retired Chinese officials and bureaucrats have published biographies, memoirs, and personal accounts of important historical events, disclosing behind-the-scenes events that they could or would not have spoken of when serving public office decades ago.³¹ Their retrospect and reflections are helpful in "restoring" previously misunderstood dynamics in decision-making that were either masked by propaganda or hidden from the public.

I also compare and contrast these accounts with reports, chronicles, magazines, and journals compiled by Chinese governmental agencies that record relevant historical events from their vantage point. Even though they provide a rich vein of information concerning activities and processes that are not usually viewed by the public, both resources still have their limitations. They are inevitably tainted with official bias, preoccupied with political correctness, or distorted by

²⁹ Collier, "Understanding Process Tracing," 2011.

³⁰ For more information on process tracing in qualitative research, see George, Alexander. and Andrew Bennett. 2005. *Case Studies and Theory Development in the Social Sciences*. Cambridge, MA: MIT Press; Mahoney, James. 2012. "The Logic of Process Tracing Tests in the Social Sciences." *Sociological Methods & Research* 41 (4): 570-597.

³¹ For a pioneering usage of such materials, see Wu, Guoguang. *China's Party Congress: Power, Legitimacy, and Institutional Manipulation*, Cambridge University Press. 2015. For a methodological discussion of the use of such resources, see Allen, Carlson, Gallagher, Lieberthal, Manion eds., *Contemporary Chinese Politics: New Sources, Methods, and Field Strategies*, 2010.

ensorship. Therefore, following a China expert's heeds, I "borrow the skills of the detective and investigative journalist"³² to draw a wide range of sources from different places together, and triangulate them with caution and scrutiny.

In this regard, open informational sources outside Chinese official channels offer a good complement. I consult firm-level data released by China-based, Chinese-controlled, and overseas-listed companies. One enormously useful type of document refers to the company filings that these companies regularly submitted to security and exchange regulators from where they were listed. Prospectuses for IPOs, annual and quarter reports, and other disclosed documents made for regulating authorities in the U.S. and Hong Kong offer a precious look into major issues such as corporate structure, decision-making, and financial conditions, and thus they have been perused extensively. My work also benefits greatly from biographies and memoirs written by Chinese and Western entrepreneurs and bankers, who tend to be more open than Chinese officials and offer additional perspectives in contrast to the official announcements.

Compared to the opaque nature of elite politics, business development and financial transactions receive relatively more limelight in China. Some Chinese business and financial news outlets, especially *Caijing*, *Caixin*, *21st Century Business Herald*, and *China Business Network*, offer high-caliber analyses on the motivations and processes of certain government regulations and more importantly, the impacts of these regulations on firm behaviors. These resources are thus cross-referenced with news reports from their international counterparts, such as *Bloomberg*, *Far East Economic Review*, *Financial Times*, *Market Watch*, *Wall Street Journal*, etc. Other non-Chinese resources such as reports and policy papers released by the U.S. Securities and Exchange Commission; World Trade Organization (WTO), American and European Union (EU) Chambers

³² Gordon, White. *Riding the Tiger: The Politics of Economic Reform in Post-Mao China*, 1993, p.13.

of Commerce in China, research institutes, think tanks, and marketing consultancies are also helpful.

I supplement these materials with four semi-structured online interviews in 2020 and 2021 which lasted between 45 minutes and a few hours. My discussions with two information technology (IT) engineers from two top American Internet companies helped me to understand the subsectors within the greater umbrella of the information industry, and motivated me to focus on the area of information services. Longer discussions with a financial consultant and an accountant based in Victoria, Canada enhanced my understanding of issues like global financial market structure, stock and bond trading practices, and corporate finance and governance. For confidentiality purpose, their accounts are quoted anonymously. All the above mentioned materials helped this project to reorganize, reanalyze, and reinterpret events and policies that might be familiar to readers of Chinese politics and business. Some of them have been featured in previous scholarship but still serve as useful evidence for my analysis.

1.5 Roadmap of the Project

Following this introduction, Chapter 2 will start by reviewing extant literature on the relationship between China's booming homegrown information industry and the ruling authoritarian regime. Then, I introduce my own theoretical construction of capital filtration by engaging with the utility and necessity of foreign capital for economic development in the developing world. Next, I turn to the challenges and risks that three conventional forms of cross-border capital inflow -- namely FDI, FPI, and FL -- present for their developing hosts. I show how the previous experience of late developers using each type of capital inflow incurred different levels of economic dependency or even political subordination. Based on these trajectories, I conceptualize an "impossible trinity" among closed financial markets, nationalized corporate

control, and foreign capital inflow to capture the developmental trilemma that late developers face. Lastly, I show that financial globalization ushers in a new type of cross-border capital flow named ODFD, thus allowing China, a post-totalitarian party-state with strong state autonomy, to forge a triple alliance with global financial elites and domestic entrepreneurs to maintain their exclusionary loopholes of capital filtration.

The next three chapters provide a chronological and empirical investigation of the inception and evolution of capital filtration as an informal state industrial strategy, with each chapter devoted to examining one of the three variants. Chapter 3 is devoted to the first form, China-China-Foreign (CCF, *zhong-zhong-wai*), which China Unicom pioneered between 1995 and 2000. I trace the rationale and politics behind Beijing's permission and support of this mode of foreign investment engagement; evaluate its impact and its implications towards the Chinese state, the company, and foreign investors; and analyze how and why this strategy was eventually abandoned.

Chapter 4 continues the exploration of capital filtration by investigating its second variant "Red Chip overseas listing (*hongchou haiwai shangshi*).” It starts by presenting the general features of this model through a shadow comparison with the abandoned CCF. Subsequently, I offer evidence on how "Red Chip" presented a more desirable solution to filter out foreign corporate influence while also benefiting the central state and telecom regulators in two ways -- through the consolidation of locally scattered assets into a centralized and competitive national champion, and through the share-option scheme that turned pre-reform telecom technocrats on public payrolls into red entrepreneurs rewarded on capitalist standards. But where did the idea of the "Red Chip" strategy come from? What steps were taken to float telecom assets on stock markets outside Mainland China? How did they make sure foreign listings did not challenge state control over assets? To answer these questions, the last section performs a detailed case study on

the rationale, preparation, and execution of China Mobile's partial overseas IPO in 1997 -- the trailblazing deal that inaugurated this variant of capital filtration.

Chapter 5 engages with the third variant -- the various interest entity (VIE, *kebian liyi shiti*) - - which emerged at the start of the 21st century and became widespread among China's Internet-based companies. I first describe the general characteristics of the VIE, with a heavier emphasis on those elements that it inherited and modified from the previous two variants. Then, I trace the historical origins of the VIE and show how Beijing's regulators helped and guided Chinese entrepreneurs to design it. To this end, I use Sina's (*xinlang wang*) overseas IPO affair in 2000, the first VIE-structured listing among all Chinese Internet companies, as a case study. Thereafter, I present evidence on how the various Chinese ministries that share power over the Internet sector vet foreign-invested companies based on corporate control rather than numerical shareholding; treat VIE users as domestic companies; and guarantee that the channel is not infiltrated or misused by foreign-controlled companies. Lastly, using a detailed case study of Alibaba's history of accessing ODFF and its decision-making institution, I explain the processes with company-level corroboration and demonstrate how Chinese VIE users manage to simultaneously absorb ODFF while maintaining Chinese control to the detriment of overseas investors.

How does capital filtration repress multinational companies that seek to enter and operate in the Chinese market through FDI? Chapter 6 aims to answer this question from two perspectives. It first presents a historical evolution of regulatory policies that govern FDI in China's information services sector, in which I introduce various hurdles that Beijing has erected to restrict industrial capital inflow in form of FDI. These obstacles include pre-entry equity caps that obligate foreign entrants to form joint ventures with Chinese partners; cumbersome, nebulously worded, and discretionary red tape that delays the market admission process; and haphazard post-entry

licensing and technology transfer requirements that constrain the scope and scale of local operations for the handful of MNCs that manage to obtain an entry permit in the form of a Sino-foreign joint venture. Subsequently, as evidence of how capital filtration 's repressive and discriminatory policies are applied to FDI entrants, I perform three small case studies on three globally renowned Internet giants -- Google, Facebook, and Apple -- and reveal their efforts, compromises, and frustrations in entering or operating in China.

Serving to draw conclusions for the entire project, Chapter 7 first reviews my major arguments and key findings and underscores its two key contributions: the emphasis on the globally *funded* nature of China's homegrown information industry, and the positioning of *modes of inward foreign capital movements* rather than informational content as the target of authoritarian control and basic unit/level of analysis. Next, I put my research findings into the enterprise of comparative political studies and show the two major contributions they have made in the theorization of the state's role in international development and the conceptualization of informal institutions. Then, I point out a direction for future research, i.e. to investigate the institutional relationship between CCP party committees and the China-based, non-state-held Internet companies in which they are established. Lastly, I extend the discussion of capital filtration, ODFD, and neo-triple alliance to recent political and policy movements in 2021, and discuss how they evolve along with the ongoing and deepening distrust and confrontation between Beijing and Washington D.C.

Chapter 2: Taming Foreign Investment, A Theoretical Framework of Capital Filtration

For late developing countries, using foreign capital to modernize its economy is akin to wielding a double-edge sword. On the one hand, it complements much needed funding and technology that laggards lack endogenously; while on the other, it presents risks of economic dependence or even political subordination. Accordingly, how to maximize the economic benefits meanwhile minimize the challenges present a daunting task for political and economic elites in the Global South.¹ Contemporary China as a host of an emerging herd of companies specializing in informational technologies and services represents a theoretically-informative and empirically-enriching case to explore how and why Chinese policy makers manage to resolve this tension. Theoretically speaking, post-socialist and authoritarian China faces two constraints to foster a cutting-edge information industry domestically. Economically, China's late-developing and post-socialist context means internal investment resources are scarce, thus hampering a capital- and technology-intensive industry to rise endogenously. Politically, a party-state authoritarian regime that is vulnerable, vigilant, and averse to the liberalizing potential of communicational popularization is by no means an advantage.

So why does a burgeoning information sector manage to emerge from China despite these structural constraints? How does its spectacular emergence, with the help of foreign investment yet largely in the absence of foreign domination, become possible? What makes Beijing so powerful and successful in parlaying and taming foreign capital inflow for informational modernization? This chapter is devoted to a theoretical elaboration of these questions. It presents a theory of capital

¹¹ This project treats China as part of the third world and Global South, and these two terms are used interchangeably with late developing countries. I thank Dr. Victor V. Ramraj's reminder.

filtration and analyzes its ideological rationale, functional necessity, and institutional impacts. The purpose is to sketch out a conceptual and theoretical framework for the ensuing four empirical chapters which will introduce the historical evolution and practical application of capital filtration throughout the chosen time span from 1995 to 2020.

The sections below will start with a literature review on extant political economy research on China's information industry. Subsuming them into two approaches, I elaborate how my own builds on yet differs from both by underscoring two under-researched aspects: foreign investment is instrumental in forging a worldwide cutting-edge information industry in late developing China; and authoritarian manipulation is applied over foreign capital inflow rather than informational content and technology. The remaining sections will elucidate my own theoretical framework. I begin with an introduction of the double-edged nature of foreign capital as a locomotive for local development that brings in much needed funding and technology yet associated with foreign corporate and governmental influence and even domination. Then, by unpacking cross-border capital flow and examining its three conventional categories -- foreign direct investment (FDI) made by industrial investors, and foreign loan (FL) and foreign portfolio investment (FPI) emitted by financial investors -- I engage with foreign capital acquisition experiences from previous generations' developers, with an intent to show the pros and cons that each form of investment inflow presents for the host societies and associated. These findings will be further discussed and condensed into an "impossible trinity," which illustrates that state preferences of an insulated domestic financial market, minimized foreign corporate influence, and foreign capital usage are mutually incompatible with any two of the three but never in full.

With that in mind, I then identify the two major factors that enabled Beijing to escape from this trilemma and foster a homegrown yet foreign-funded information industry without opening

its domestic securities market: China's strong state autonomy and the latest wave of post-Cold War financial globalization. On the one hand, I show that, as a post-socialist and post-totalitarian party-state with regime continuity, China possesses high level state autonomy when bargaining with foreign industrial investors and is thus effective in restricting FDI entrance into the Chinese market. On the other hand, thanks to the globalization of financial markets in general and the availability of Global North-based ones for Southern companies to fundraise in particular, the Chinese regime managed to build an alliance with transnational financial elites and its domestic companies. Eventually, by bringing in global financial stakeholders while pushing out foreign corporate influence, capital filtration helped foster an information industry dominated by local companies. It also minimized economic dependency and political subordination, which had hobbled previous late developers after liberalizing domestic capital markets, and made informational censorship easier.

2.1 Informational Revolution in Authoritarian China: Extant Studies and the Neglected Conundrum

Certainly, this project does not claim to be one of the first attempts to investigate China's booming information sector that is constrained by yet has emerged from a late developing post-socialist economy under a repressive authoritarian regime. Academic interests and efforts in this field have flourished during the past two decades along with this sector's rapid modernization. The first generation of scholarship, which I call the "developmental" approach, endeavored to answer the question "what factors have contributed to China's burgeoning information industry?" From multiple angles, they concurred that China's post-socialist and developing context which lacked internal investment resources served as an inhibitive factor, and asked how this capital- and technology-intensive information industry modernized. Accordingly, they proposed factors such

as Western educated talents and overseas returnees from the Silicon Valley,² the global financial network,³ and less persuasively, outstanding entrepreneurship⁴ and effective business strategies⁵ as factors that boosted China's informational revolution. In particular, the state's steerage in providing research and development funding,⁶ dominating industrial standard setting,⁷ and using regulatory measures favourable to domestic companies⁸ were proposed as key explanations.

Arguably, despite the merits in identifying various elements that helped to make a capital- and technology-intensive industry a "miracle" in China, this string of literature has largely investigated the informational technology (IT) sector as a bundle, mixing informational and communicational services provision and equipment manufacturing as the joint subject of investigation.⁹ However, Beijing's interests and Global North-originated companies' motivation of market entry differ

² Saxenian Annalee, 2002, "Transnational Communities and the Evolution of Global Production Networks: The Cases of Taiwan, China, and India." *Industry and Innovation* 9 (3): 183-202; Saxenian, Annalee, 2006, *The New Argonauts: Regional Advantage in a Global Economy*. Cambridge, MA: Harvard University Press.

³ Jia, Lianrui. and Dwayne Winseck "The Political Economy of Chinese Internet Companies: Financialization, Concentration, and Capitalization." *International Communication Gazette* 80, no.1 (January 2018):30-59. Jia, Lianrui, "Going Public and Going Global: Chinese Internet Companies and Global Finance Networks," *Westminster Papers in Communication and Culture* 13, no. 1(2018):17-36.

⁴ Tse Edward, *China's Disruptors: How Alibaba, Xiaomi, Tencent, and other companies Are Changing the Rules of Business*, Portfolio/Penguin, 2015.

⁵ Zeng Ming, and Peter Williamson, *Dragons at Your Door: How Chinese Cost Innovation Is Disrupting Global Competition*, Harvard Business School Press, 2007.

⁶ Fuller Douglas, *Paper Tigers, Hidden Dragons: Firms and Political Economy of China's Technological Development*. Oxford University Press, 2016; Wang, Cassandra, *Upgrading China's Information and Communication Technology Industry: State-Firm Strategic Coordination and the Geography of Technological Innovation*. Zhejiang University Press, 2013; Steinfield S. Edward, *Playing Our Game: Why China's Economic Rise Doesn't Threaten the West.*, Oxford, 2010. Chapter Six "Playing to Win? China's Advance into High-Tech Research and Development."

⁷ Wei Liang, Telecommunications: Primacy of Power and Regulatory Battles for Promoting National Standards, in Alon Ilan et al. (eds), *China Rules: Globalization and Political Transformation*, Palgrave Macmillan, 2009.

⁸ Works arguing in this favor include but not limit to Wang 2013; Hong, Yu, *Networking China: The Digital Transformation of the Chinese Economy*, Urbana: University of Illinois Press, 2017; Gu Shulin, *China's Industrial Technology: Market Reform and Organizational Change*. 1999. New York: Routledge; Ning Lutao, *China's Rise in the World ICT Industry: Industrial Strategies and The Catch-up Developmental Model*, Routledge, 2012; Harwit Eric, *China's Telecommunications Revolution*, Oxford University Press, 2008; Wu S. Irene, *From Iron Fist to Invisible Hand: The Uneven Path of Telecommunications Reform in China*, 2008, Stanford University Press.

⁹ See, for instance, Hsueh Roselyn, *China's Regulatory State: A New Strategy for Globalization*, 2011, Cornell University Press; Mueller Milton and Zixiang Tan, *China in the Information Age: Telecommunications the Dilemmas of Reform*, 1997, Praeger; Lu Ding and Chee K. Wong, *China's Telecommunications Market: Entering a New Competitive Age*, 2004, Edward Elgar Publishing; Ning 2012.

between IT equipment and services. Numerous studies have identified that Beijing eagerly welcomed foreign equipment manufactures to set up production lines in form of FDI in China, with an intent to access advanced foreign technology; whereas foreign companies with technological superiority have been reluctant to move their state-of-art technology in China for fear of implicit or explicit technological transfer.¹⁰ Also, for international IT equipment manufacturers, one of the motivations of market entry in addition to local sales is exportation, i.e. to take advantage of lower labor, resource, and production costs and then ship part of their locally-manufactured products out of the host country for sale. Quite differently, as the entire project and particularly Chapter 6 demonstrates, IT service-providing multinational companies that seek to enter China refer to a form of *market-oriented* foreign investment, because they intend to provide services to consumers in China. In fact, Beijing has largely been restrictive in terms of market-oriented FDI generally and information services-related FDI specifically.¹¹ Therefore, intra-sectoral difference makes the state actor adopt different strategies. Combining IT equipment and services as the joint unit of analysis only presents an incomplete landscape of Chinese regulatory strategy and pattern with broad strokes, which inevitably compromises the explanatory utility of the theoretical and conceptual findings.

Moreover, despite rightly highlighting the information industry as capital- and technology-intensive, this “developmental” school unwittingly downplays another particularity associated with information industry – its political sensitiveness vis-à-vis authoritarianism. In other words,

¹⁰ See, for instance, Harwit Eric, *China's Telecommunications Revolution*, Oxford University Press, 2008; Yu Hong, *Networking China: The Transformation of the Chinese Economy*, 2017; Horsley P. Jamie, “PRC Regulation of Foreign Telecom Equipment and the WTO,” *China Business Review*, (September-October 2001); DeWoskin, Kenneth J. “The WTO and the Telecommunications Sector in China.” *The China Quarterly* 167 (2001): 630–54; Zhang Bing and Mike W. Peng, “Telecom Competition, Post-WTO Style.” *The China Business Review* 27, no. 3 (2000): 12-21. Moreover, China's Foreign Investment Law stipulated that Telecom manufacturing was encouraged, while service provision was restricted.

¹¹ Branstetter Lee G. and Robert Feenstra, 2002, “Trade and Foreign Direct Investment in China: A Political Economy Approach,” *Journal of Economics Approach* 58 (2):335-358.

unlike other high-tech industries, a booming IT industry can unleash *social* effects of enhancing information dissemination and access, facilitating communicational exchange, and promoting networking at the grassroots level. Much research has revealed that such social effects could spill over to the *political* sphere, challenging the state's top-down governance structure,¹² empowering non-state actors to solve societal issues,¹³ and, in some cases, improve the quality of democracy.¹⁴

In non-democratic settings, studies on the relationship between Internet and the downfall of the Suharto regime in Indonesia¹⁵ and between the rise of social media and the eruption of the Arab Spring both showed how information technology had enticed the necessary social mobilization to overthrow long-term ruling dictators.¹⁶ Such political challenge is, of course, no stranger to the CCP party state in China. Like any of its authoritarian peers, the Chinese regime hates the liberalizing potential of communicational popularization. So how does Beijing guarantee such foreign linkages in the developmental effort do not spin out of its purview and control? In this sense, the cost of neglecting the social and political attributes of the informational and communicational industry and the *regime* factor is that this string of literature has overlooked or

¹² Hafler Virginia, *Public Role for the Private Sector: Industry Self-Regulation in a Global Economy*. Washington, DC: Carnegie Endowment for International Peace, 2001.

¹³ Pye Lucian, *Communications and Political Development*, Princeton University Press, 1963; Pool Ithiel de Sola, *Technologies of Freedom*, Cambridge, Mass: Belknap Press, 1983; Abramson, Jeffrey B., Christopher, Arterton, and Gary R. Orren, *The Electronic Commonwealth: The Impact of New Media Technologies on Democratic Politics*, New York: Basic Books, 1988; Barry N. Hague and Brian D. Loader eds., *Digital Democracy: Discourse and Decision-Making in the Information Age*, London: Routledge, 1999; Rosenau James and J.P. Singh, *Information Technologies and Global Politics: The changing Scope of Power and Governance*, Albany: State University of New York Press, 2002

¹⁴ Bimber A. Bruce, *Information and American Democracy: Technology in the Evolution of Political Power*, Cambridge: Cambridge University Press, 2003; Dahl A. Robert, *Democracy and its Critics*, New Haven: Yale University Press, 1989; McGinnis John, *Accelerating Democracy: Transforming Governance through Technology*, Princeton: Princeton University Press, 2013; Jessica Baldwin-Philippi, *Using Technology, Building Democracy: Digital Campaigning and the Construction of Citizenship*, Oxford University Press, 2015. J Hills, 1993, *Telecommunications and Democracy: The international experience. Telecommunication Journal*, 60(1), 21-29.

¹⁵ David T. Hill and Krishna Sen, "The Internet in Indonesia's New Democracy," *Democratization*, 7(1) (Spring 2000), pp.119-36.

¹⁶ Philip N. Howard and Muzammil M. Hussain, *Democracy's Fourth Wave? Digital Media and Arab Spring*, Oxford University Press, 2013; Laver Frederick, and John, Murray, *Information Technology: Agent of Change*, Cambridge: Cambridge University Press, 1989.

underestimated China as an outlier in terms of international development. In other words, despite these structural adversities, China successfully fostered a *politically sensitive* sector with the help of foreign investment yet largely in the absence of foreign competitors. This string of literature has not provided an adequate answer to why it became possible. The main lesson is that future academic endeavors must duly consider the relationship and interaction between an authoritarian regime and global capital which brings funding, business model, and technology.

The second set of literature, which I dub as the “*authoritarian control*” group, picks up the regime factor and revolves around the question of “how and why the popularization of the information technology does not necessarily unleash or spread the democratizing potential, but rather shores up Beijing’s authoritarian ruling?” This vast set of literature has shed light on how Beijing interferes with digital communication to contain challenges to its dictatorship.¹⁷ Scholars have revealed that one major way of authoritarian control was applied through *informational censorship*. A copious amount of literature has provided illuminating evidence on what content was censored, how censorship was carried out, under which circumstances were censorship tactics used, and which organizations were responsible for such policies.¹⁸ Furthermore, these studies have also found that the party-state did not merely passively react to the increasing flow of information fueled by technological progress. Rather, it *proactively* used information technology

¹⁷ Kalathil Shanthi, and Taylor C. Boas, *Open Networks, Closed Regimes: The Impact of the Internet on Authoritarian Rule*, Washington, D.C: Carnegie Endowment for International Peace, 2003. King Gary, Jennifer Pan, and Margaret E. Roberts. 2014. “Reverse Engineering Chinese Censorship: Randomized Experimentation and Participant Observation.” *Science*, 345 (6199): 1-10. Eric Harwit and Duncan Clark, “Shaping the Internet in China: Evolution of Political Control over Network Infrastructure and Content,” *Asian Survey* xli.3 (May/June 2001), pp.377-408; Christopher R. Hughes, Controlling the Internet Architecture within Greater China, in *Cyber China: Reshaping National Identities in the Age of Information*, pp.71-90. Kong Qingjiang, “Where Will China’s Internet Regulation Go after WTO Accession,” in *China’s Economic Globalization through the WTO*, Ashgate, 2003; Jiang Min, 2012, *Internet Companies in China: Dancing between the Party line and the Bottom Line*. IFRI Center for Asian Studies.

¹⁸ Ibid. and Footnote 17 in Chapter 1.

to shape public discourse;¹⁹ fan nationalistic sentiments; smear opposition movements;²⁰ and detect mass preference, public opinion and grievances which were otherwise hidden or misrepresented by local elites.²¹

Additionally, more recent scholarship has shown that the most avant-garde information technology such as artificial intelligence and facial recognition has also been increasingly and rampantly used to execute draconian human rights abuses against ethnic minorities,²² steal commercial and military secrets from the wealthy democracies in the Global North,²³ and as a new platform of warfare.²⁴ In a nutshell, the consensus is that contemporary China presents an intriguing case where with the advent of mobile communication and the Internet of things, societal actors are less empowered in comparison to an authoritarian regime,²⁵ while Beijing's autocrats have been skillfully wielding this dual-edged sword of information technology in its favor and morphing into an Orwellian "techno-enhanced authoritarianism" or "digital totalitarianism."²⁶

¹⁹ Hassid Jonathan, "Safety Valve or Pressure Cooker?" Blogs in Chinese Political Life." *Journal of Communication* 62(2): 212-30, 2012; King Gary, Jennifer Pan, and Margaret E. Roberts, 2013, "How Censorship in China Allows Government Criticism but Silences Collective Expression." *American Political Science Review*, 107(2), 326-343;

²⁰ Greitens Sheena Chestnut, 2013, "Authoritarianism Online: What Can We Learn from Internet Data in Nondemocracies?" *PS: Political Science and Politics* 46(2):262-70.

²¹ MacKinnon Rebecca, 2011, "Liberation Technology: China's 'Networked' Authoritarianism'," *Journal of Democracy* 22(2): 32-46; Qiang Xiao, 2011, "The Battle for Chinese Internet," *Journal of Democracy* 22(2): 47-61.

²² Reference on Alibaba's facial-recognition tech in Xinjiang, <https://www.forbes.com/sites/zakdoffman/2019/12/23/huawei-faces-new-backlash-over-mass-ethnic-persecution-in-china/#6590c05e7dae>; <https://www.nytimes.com/2019/05/22/world/asia/china-surveillance-xinjiang.html>.

²³ Choi, Martin, "It's China's Huawei against the world as spying concerns mount", *South China Morning Post*, <https://www.scmp.com/news/china/diplomacy/article/2186440/its-chinas-huawei-against-world-spying-concerns-mount>, posted February 17, 2019, accessed September 19, 2019; <https://www.bloomberg.com/news/articles/2019-04-30/vodafone-found-hidden-backdoors-in-huawei-equipment>

²⁴ Dean Cheng, *Cyber Dragon: Inside China's Information Warfare and Cyber Operations*, 2106, Praeger; Jason R. Fritz, *China's Cyber Warfare: The Evolution of Strategic Warfare*, 2017, Lexington Books.

²⁵ See, for instance, Damm Jens and Simona Thomas, *Chinese Cyberspaces: Technological Changes and Political Effects*, London: Routledge, 2006; Hughes R. Charsroper, Gudrun Wacker, *China and the Internet: Politics of the Digital Leap Forward*, 2003; Mengin Françoise (ed.) *Cyber China: Reshaping National Identities in the Age of Information*, 2004; Chu, Wai-chi Rodney et al., *Mobile Communication and Greater China*, New York: Routledge, 2012; Zheng Yongnian, *Technological Empowerment: The Internet, State, and Society in China*, Stanford University Press, 2008. Lee, Paul S. N. *Telecommunications and Development in China*, Cresskill, N.J: Hampton Press, 1997.

²⁶ Hoffman Samantha, "Technology-enhanced authoritarian control with global consequences," Australian Strategic Policy Institute, <https://www.aspi.org.au/report/social-credit>, published June 28, 2018, accessed September 27, 2019.

I do not negate or challenge all these insights, which have enormously helped us understand an authoritarian regime's manipulation of information technology and services. They persuasively refuted the once-popular, optimistic, but naïve accounts arguing that information technology's networking, liberalizing, and mobilizing effects inevitably stimulate political action from below and help to transform authoritarian regimes into democracies.²⁷ However, these dominant frameworks largely focus on informational content and technology as the unit and level of analysis, thus unwittingly neglect an important issue: digital communication and information flow are intermediated by the infrastructure, network, and services that are provided by *business* actors.²⁸ In other words, politically-motivated censorship and abusive use of information technology are carried by, or at least through *firms* that operate in this sector. The manipulation of information technologies by the state actor, in fact, points to Beijing's co-option of firms that provide such technologies and services. Therefore, despite this "informational control" group's insightfulness on the means and effectiveness of state ruthlessness, it leaves two important questions unanswered: the Chinese government is repressive against information flow and China's national economic condition is disadvantageous to foster an information industry, but why and how have these companies prospered on the first hand?

To bridge the gap that separates the two canons of literature reviewed above, I adopt a third way called "controlled development" by investing the relationship between foreign capital inflow and state governance. Put differently, I position the government-firm dynamic as the foci of research. This methodological choice helps to integrate authoritarian control and industrial

²⁷ Two recent empirical examples in the past two decades are the downfall of dictatorships in Indonesia and the Middle East. See, for instance, David T. Hill and Krishna Sen, 2000, "The Internet in Indonesia's New Democracy," *Democratization*, 7(1), pp.119-36; Philip N. Howard and Muzammil M. Hussain, *Democracy's Fourth Wave? Digital Media and Arab Spring*, Oxford University Press, 2013; Laver, Frederick, and John, Murray, *Information Technology: Agent of Change*, Cambridge: Cambridge University Press, 1989.

²⁸ Keremoğlu, Eda, and Nils B. Weidmann. "How Dictators Control the Internet: A Review Essay." *Comparative Political Studies* 53, no. 10–11 (September 2020): 1690–1703. <https://doi.org/10.1177/0010414020912278>.

modernization into one picture. In other words, this project highlights foreign capital inflow as both the contributing factor to this sector's modernization and simultaneously the object of authoritarian control instead of informational content and technology. This key intervention must be reiterated.

2.2 Foreign Capital as a Double-edged Sword: The Political and Economic Rationale of Capital Filtration

Economically backward countries all face substantial hurdles in the process of development. Alexander Gerschenkron, a founding scholar of international development, pointed out that promoting development is not merely an imitation of the experience in advanced or democratic countries, but must incorporate indigenously determined elements.²⁹ In the late developing world, among many factors, insufficient and diffused domestic capital supply is particular salient, meaning that investment from indigenous sources is incapable of giving a “big push”³⁰ for economic development.³¹ This deficiency can throttle the developing world's ambition to foster capital- and technology-intensive sectors which calls for large and consistent funding supply. The information industry is a case in point because it requires massive amounts of upfront capital for infrastructure construction before any return on investments can be realized.

The disjuncture between inefficient and weak domestic capital supply and the ambition to cultivate a cutting-edge industry means that late developers must turn to foreign capital that originated from the advanced economies. Early scholars such as Lenin and Hobson have illustrated the importance of export of international capital in speeding up capitalistic development in third

²⁹ Gerschenkron Alexander, 1962, *Economic Backwardness in Historical Perspective: A Book of Essays*, Cambridge: Harvard University Press. p.20.

³⁰ P.N. Rosenstein-Rodan, 1961. “Notes on the theory of the ‘Big Push’,” in Ellis S. Howard (ed.), *Economic Development for Latin America*, pp.57-81, Palgrave Macmillan.

³¹ Gerschenkron, *Economic Backwardness in Historical Perspective*, p.9.

world.³² Indeed, foreign investment can offer important resources that are inadequate or non-existent in the third world, such as the infusion of funding, entrepreneurship, technology, managerial skills, and lineage with the international market, which all help to boost economic growth.

However, foreign capital inflow is inevitably intertwined with foreign investors' interests and influence in the target destinations, which present numerous and multi-layered challenges for the recipient societies. At the *market* level, a large share of host market could be controlled by several foreign firms with privileged positions, therefore restraining domestic firms' growth and competitiveness by effecting "what they do, how much they produce, their price levels, whether they enter or level an industry" and "other economic parameters including output levels, technology, and even tastes."³³ Moreover, inflow of external capital also causes concerns to *macroeconomic* policy making in the host state because

...capital inflows can lead to inflationary pressures, especially when they are monetized. Since an inflow of capital also implied a higher demand for a nation's currency, it often means an appreciating exchange, which may widen trade deficit to uncomfortable levels. If a nation's banking system has difficulty handling the capital flows, there is some risk of financial destabilization and even banking crises.³⁴

Putting the market and macroeconomic challenges together, it is not hard to see that when foreign interests are not aligned with the domestic developmental objective, foreign capital could impose constraints and therefore condition or handicap states' development efforts in the developing world. To quote Albert Hirschman, a prominent economist:

... when newly arising investment opportunities are largely or predominantly seized upon by foreign firms, the national policy makers face in effect a dilemma: more development

³² Lenin Vladimir and Henry M. Christman, 1966, *Essential Works of Lenin*, New York: Bantam Books; Hobson J.A., 1902, *Imperialism: A Study*, New York: J. Pott&Co.; Lenin, *Imperialism: The Highest Stage of Capitalism*, 1948.

³³ Caporaso James and David Levine, 1992, *Theories of Political Economy*. Cambridge: Cambridge University Press. p.167

³⁴ Guillermo A. Calvo, Leonardo Leiderman, and Carmen M. Reinhart, "Inflows of Capital to Developing Countries in the 1990s," *Journal of Economic Perspectives* 10, no. 2 (Spring 1996): 123-39.

means at the same time less autonomy. In a situation in which many key points of the economy are occupied by foreigners while economic policy is made by nationals, it is only too likely that these nationals will not excel 'rational' policy-making for economic development; for a good portion of the fruits of such rationality would accrue non-nationals and would strengthen their position.³⁵

Furthermore, foreign investors are often not purely economic actors. An additional factor that can further limit late developing states' options is the inconvenient truth that foreign capital concomitantly comes with the state interests from the advanced economies where it originated. As a "class conscious agent of foreign capital," the states of the advanced economies also have an interest in influencing the developing world and making sure that policies will meet the advanced capital's needs.³⁶ In other words, the economic expansion of the advanced economies through capital export into the developing world could translate into an imperialist domination, which motivates states where capital originated to use political or even military resources to sustain its interests, infringe sovereignty of economic backward nations, and maintain this unbalanced relationship.³⁷

This point is well captured by the dependency scholarship and its offshoot world-systems theory. Emerging in the late 1960s and primarily using the post-World War II developmental trajectory in Latin America as empirical evidence, the dependency school, despite internal variants, made a two-tier and geography-based division of the world into a dominant core exploiting a less-developed periphery and argued that developed of the less industrialized countries was "dependent" on more advanced capitalist counterparts ,and such reliance became a vicious circle with peripheric ones became poorer relative to the core. Wallerstein's "world system theory" took

³⁵ Hirschman Albert, "How to Divest in Latin America and Why," *CrossCurrents* 21, no.3 (1971):320-33. p.7

³⁶ Hamilton, Nora. *The Limits of State autonomy: Post-Revolutionary Mexico*. Princeton, N.J. Princeton University Press, 1982. p.20

³⁷ Palma, Gabriel. "Dependency: A Formal theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment?" *World Development* 6, no.7(1978):881-924.

the dependency scholarship further by adding an intermediary bloc of semi-periphery economies that boast a home-owned industrial base but host obsolete or sundown industries that are no longer deemed profitable from the core.³⁸

China, as a late developing economy ruled by a post-socialist authoritarian regime, of course faces all the challenges posed by foreign capital inflow discussed above. Resorting to foreign capital to develop a competitive information sector further magnifies such risks which unfold in three dimensions. First, from a sovereignty and national security perspective, the communication infrastructure and networks belong to public utility sectors are important to public interest. Foreign ownership of any host nations' infrastructural network therefore poses a political challenge that might compromise sovereignty in case of emergency.³⁹ Such concern is well-captured by a government from a liberal market economy:

... telecommunications, taken in the broadest sense, will form the infrastructure of the new industrial society that is now coming into being around the world. Canadian sovereignty in the next generation will depend heavily on telecommunications. If we wish to control our economy then we will require a sophisticated telecommunications sector *developed and owned* [emphasis added] in Canada to meet specific Canadian requirements. To maintain our Canadian identity and independence we must ensure an adequate measure of control over data banks, trans-border data flow and the content of information services available in Canada. Telecommunications, as the foundation of the suture society, cannot always be left to the rigors of the market.⁴⁰

Second, an additional risk that foreign ownership would pose originates from China's developing status and socialist legacy. As telecommunication policy scholar Steven Globberman insightfully pointed out, many countries, particularly developing ones, have used domestic firms to serve as a vehicle to promote certain social objectives that are not necessarily profitable from a

³⁸ Wallerstein, Immanuel. *World-system Analysis: An Introduction*. Duke University Press. 2004.

³⁹ Joseph, Richard, 1995, "Direct foreign investment in telecommunications: A review of attitudes in Australia, New Zealand, France, Germany, and the UK," *Telecommunications Policy*, 19(5):413-26.

⁴⁰ Consultative Committee on the Implication of Telecommunications for Canadian Sovereignty Report supply and Services Canada, (Ottawa: Minister of Supply and Services, 1979), 65.

business perspective.⁴¹ The important position of the state-owned telecom companies is well captured by Minxin Pei, an authoritative China scholar, who insightfully pointed out that China's telecom service industry "is itself a huge patronage machine and a source of rent generation because it employs a large number of employees, invests massive capital, and collects monopoly rents. Direct control of this sector provides the regime the ability to reward and keep its supporters."⁴²

Last but not least, foreign capital inflow can also increase the anxiety and fear of the authoritarian leaders in Beijing about their regime security, because information, unlike gas, water or electricity, is not ideologically neutral. The advancement of information technology allows information to be generated, acquired, exchanged, stored, and analyzed at a massive scale. The communicational infrastructure and services, if controlled by foreign investors, can endanger the host state's information security because foreign governments could use their firms' investment in those sensitive sectors to eavesdrop on government and business in host countries.⁴³ Furthermore, a foreign controlled information industry can weaken authoritarian leaders' ideological monopoly and unsettle their informational control.⁴⁴ Indeed, the Chinese authority has long been cautious of "deleterious" effects of liberalized information access. From the "Anti-Spiritual Pollution Campaign" in 1983 as an effort to curb Western-inspired liberal ideas among the Chinese

⁴¹ Globerman, Steven. "Foreign Ownership in Telecommunications: A Policy Perspective," *Telecommunications Policy* 19, no. 10 (1995):21-28.

⁴² Pei, Minxin, *China's Trapped Transition: The Limits of Developmental Autocracy*, Cambridge MA: Harvard University Press, 2006. p.108

⁴³ Byrne, Matthew. "Protecting National Security and Promoting Foreign Investment: Maintaining the Exon-Florio Balance," *Ohio State Law Journal* 67, no.4(2006):851; Feng, Yiheng, "'We wouldn't Transfer Title to Devil': Consequences of the Congressional Politicization of Foreign Direct Investment on National Security Grounds." *New York University Journal of International Law & Politics* 42, no.1 (2009): 253-310; Seitzinger, Michael, "Foreign Investment in the United States: Major Federal Statutory Restrictions," <https://sgp.fas.org/crs/misc/RL33103.pdf> published June 17, 2013.

⁴⁴ Harwit Eric, *China's Telecommunications Revolution*, Oxford University Press, 2008, p.6. Wu, Irene, *From Iron First to Invisible Hand: The Uneven Path of Telecommunications Reform in China*. Stanford University Press, 2009.

population to the party chief and state president Xi Jinping's reiteration of "no national security without cyber security"⁴⁵ in the second decade of 21st century, an unchanged melody in CCP's mentality and practice is to ward off foreign ideological influence as a by-product of economic opening-up and foreign capital inflow.

Therefore, to sum up this section, I argue that if capital flow is the white cells that bring oxygen and nutrients from one part of the body to the other for the well-being of the human body; then foreign capital inflow could be construed as a process of blood transfer from the richer and stronger Global North to the poorer and weaker Global South. Despite its "health-enhancing" effects, from a recipient's perspective, it must be compatible with its bodily conditions in terms of "blood" type, quality, means and dose of transfusion, otherwise serious complications would occur.

2.3 Unpacking "Foreign Capital": Evidence and Lessons from Past Developmental Experience Worldwide

From late developers' perspective, choosing the right dose, form, and type of foreign capital inflow is not an easy task because the movement of capital on an international scale, regardless of its form, represents the capital owner's search for higher returns on their assets. As a rule of thumb, capital owners' interests are often misaligned with those of recipient societies. Conventionally, foreign capital inflow occurs in three forms: foreign direct investment (FDI), foreign portfolio investment (FPI), or foreign loans (FL).⁴⁶ As past developmental experience in the Global South has shown, each of the three types of capital inflow entails different levels of

⁴⁵ Cyber Administration of China, "Xi Jinping: Meiyou Wangluo Anquan Jiumeiyou Guojia Anquan," [Xi Jinping: Without Cyber Security, There is no National Security,] http://www.cac.gov.cn/2018-12/27/c_1123907720.htm, published December 27, 2018, accessed May 01, 2022.

⁴⁶ Capital inflow also includes official developmental assistance (concessional loans or grants) that is received by the government and remittances from workers working abroad sent to households. They are not considered in this project because they flow to either household or governmental agencies, rather than firms.

control possessed by foreign investors, thus presenting pros and cons for the host political economy.

2.3.1 Industrial Capital in Form of FDI and Three Levels of Foreign Control

FDI is one of the most visible forms of international capital usage. It refers to net flows of investment that acquires a lasting *management* interest (10 percent or more of voting stock) in a firm operating in the host economy other than the investor. A related term with FDI is multinational corporation (MNC), also known as multinational enterprises (MNE) or transnational corporations (TNC), referring to a firm that owns or manages income-generating assets in more than one country and operates across national frontiers, with corporate control retained by the home company located in the Global North.⁴⁷ MNCs' local presence in the host economy has been in the principal vehicle that FDI is made.

FDI is not only a proven way of boosting development in the Global South because of its local commitment and stability, but also from an investor' perspective, a preferred host-market entrance method in capital intensive sectors. MNC's investment of physical and productive assets such as buildings, labor, and technology make FDI effective in economic growth, employment creation, industrial upgrading, and transfer of technology and expertise.⁴⁸ Accordingly, because of its local presence and operation in the host economy, FDI yields returns on firm-specific assets in target markets over a longer period. It is thus considered to be more stable and productive than the other two types of financial flows – FPI and FL – which lack lasting interest and control over the firm. This form of market entry is understandably highly sought by the MNCs operating in the

⁴⁷ Fieldhouse, David, "A New Imperial System'? The Role of the Multinational Corporations Reconsidered." In *International Political Economy: Perspectives on Global Power and Wealth*, pp. 177-89, Routledge, 2000.

⁴⁸ Agenor, Pierer-Richard. "Benefits and Costs of International Financial Integration: Theory and Facts." *World Economy* 26, no.8(2003):1089-1118. Jensen, Nathan. *Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment*. Princeton, N.J.: Princeton University Press, 2006; Mosley, Layna, *Labor Rights and Multinational Production*. Cambridge University Press, 2011; Balassa Bela, *Developmental Strategies in Semi-Industrial Economies*, 1982; Balassa Bela, *The Newly Industrializing Countries in the world Economy*, 1981.

information sector for an obvious reason: market-oriented investment makes local presence, operation and management vital. To serve foreign customers more easily, international FDI providers must establish local branches to guarantee efficient and effective local service delivery.⁴⁹

However, from the recipient's perspective, FDI comes with a price of foreign investors' local influence, which is sometimes undesirable in the host society. The fact that foreign investors' considerable corporate control and management, shored up by their technological superiority and cash abundance, naturally means their autonomy in deciding the type of technologies to be used and the kind of business activities to be undertaken particularly in the local context.⁵⁰ Therefore, inward FDI could undermine local autonomy over the course and content of development in the third world.⁵¹ Such challenges have been fruitfully analyzed by the dependency school with empirical evidence from Latin America's industrialization.⁵² As Peter Evans, a prominent political economist points out, "If MNCs enter by taking over local firms and then set up oligopolistic industry structures resistant to entry by local capital, it is plausible that MNC penetration would have a dampening effect on local capital formation."⁵³ With their bargaining advantage that stems from their superior technological know-how, access to finance, marketing capabilities, and managerial skills, MNCs as a dominant and constraining player could substage the developmental

⁴⁹ Dicken, Peter, *Global Shift: Transforming the World Economy*, 1998, p.392; Hoekman, Bernard and Primo Carlos Braga, *Protection and Trade in Service*, 1997.

⁵⁰ Voss, Hinrich, Chapter 2 "The Global company," in Mikler John (ed.) *The Handbook of global Companies*, 2013, p.21

⁵¹ Hirschman Albert, *National Power and the Structure of International Trade*, 1969, Berkeley: University of California Press.

⁵² See, for instance, Moran, Theodore. *Multinationals and the Politics of Dependence: Copper and Dependency in Chile*, 1974; Tugwell, Franklin. *The Politics of Oil in Venezuela*, 1975; Becker, David. *The New Bourgeoisie and the Limits of Dependency: Mining, Class, and Power in "Revolutionary" Peru*, Princeton University Press, 1983.

Bennett, Douglas and Kenneth Sharpe, *Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry*, 1985, Princeton University Press.

⁵³ Evans, Peter, "Recent Research on Multinational Corporations," *Annual Review of Sociology* 7, no.1 (1981):199-223. p.210.

course by outcompeting local firms, taking hold over the most dynamic sectors of the local economy, and consequently denationalize the economic base.⁵⁴

As a result, an economically exploitative situation could emerge. MNCs siphon capital out of the developing world to developed countries through profit repatriation, payment of technology, and sales of products and services.⁵⁵ This FDI-induced exploitation further exacerbates social-economic malaises like industrial concentration, distorted market structure, undesirable trade and investment behavior.⁵⁶ In some instances, MNCs' introduction of inappropriate production processes, products, technologies, or services produces a vicious cycle of underdevelopment and aggravates poor economies' dependency on rich ones.⁵⁷ Consequentially, the maneuvering space for the state actor in terms of setting developmental priorities and regulating particular industries become straitjacketed.⁵⁸

Furthermore, outbound FDI from the Global North is also closely associated with interests and actions from the governments of the advanced capitalist economies. To protect their corporate interests, MNCs are found to lobby their home-country governments to keep Southern host governments in line, sometimes with the threats of sanctions.⁵⁹ And in certain cases, MNCs are

⁵⁴ Gereffi, Gary. *The Pharmaceutical Industry and Dependency in the Third World*, Princeton, N.J: Princeton University Press, 1983, pp.44-49; Rhys Jenkins, *Transnational Corporations and Industrial Transformation in Latin America* 1984, pp.8-12; Constantine Vaitsos, *Inter-Country Income Distribution and Transnational Enterprises*. Oxford: Clarendon Press, 1974.

⁵⁵ Bennett and Sharpe, *Transnational Corporations versus the State*, p.7; Gereffi, *The Pharmaceutical Industry and Dependency in the Third World*, p.61; Hymer, Stephen Herbet, *The International Operations of National Firms: A Study of Direct Foreign Investment*, 1976.

⁵⁶ Cardoso and Faletto, *Dependency and Development in Latin America*, 1979; Kaufman, "A Preliminary Test of the Theory of Dependency," *Comparative Politics*, 1975; Moran, *Multinational Corporations, and the Politics of Dependence: Copper in Chile*; Smith, "The Underdevelopment of Development Literature: The Case of Dependency Theory,"; Jackman, "Dependence on Foreign Investment and Economic Growth in the Third World," 1982.

⁵⁷ Newfarmer, Richard. (ed.) *Profits, Poverty, and Progress: Case Studies of International Industries in Latin America*, 1985; Biersteker, Thomas. *Distortion or Development: Contending Perspectives on the Multinational Corporation*, 1978.

⁵⁸ Jenkins, *Transnational Corporations and Industrial Transformation in Latin America*, p.28; Bennett and Sharpe, *Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry*, 1985; Gereffi, *The Pharmaceutical Industry and Dependency in the Third World*, 1983.

⁵⁹ Stepan, *The State and Society: Peru in Comparative Perspective*, p.231

representatives of the political and economic interests of their home countries. As Robert Walters notes, “MNCs are sometimes seen as instruments of a predator state through which the predator can achieve its self-interested ambitions by penetrating and securing effective economic and political dominance over the less developed state.”⁶⁰ Robert Gilpin reveals that the era of MNCs corresponds with the epoch of the American hegemony,⁶¹ and evidence suggests that the U.S. administrations used their connections with American MNCs to pursue foreign policy objectives, and even topple “uncooperative” governments.⁶² Put differently, FDI can be instrumentalized as a means of economic statecraft – in form of state actors’ employment of economic levers to achieve strategic objectives.⁶³ For instance, economic sanctions could be launched through the cancellation of promised FDI or the withdrawing of existing investment projects,⁶⁴ thus inflicting economic costs for host economies. This concern is especially heightened with economic globalization, which has largely enhanced the degree of complex interdependence worldwide.

Therefore, despite its stability, productivity, and long-term commitment in the host economy, FDI represents a way that Northern firms maintain their control over firm-specific assets through international expansion. Its entrance into a national economy has tensions with the host country’s interests and sovereignty.⁶⁵ In response, a pulse to limit the entry and operation of MNCs in a manner analogous to capital controls, tariffs, or non-tariff barriers always exists.⁶⁶ As pointed out

⁶⁰ Walters, R.S.1972. “International Organizations and the MNC: An Overview and Observations,” *Annals of the American Academy of Political and Social Science*, 403 (September): 127-138.

⁶¹ Gilpin, Robert. *U.S. Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment*. New York: Basic Books, 1975.

⁶² Two well-known cases are the United Fruit Co. and the CAI-sponsored coup d’état in Guatemala the in 1954, and the linkage between International Telephone and Telegraph (ITT) and Central Intelligence Agency (CIA) in overthrowing the socialist president Allende in Chile in the late 1960s. See Sagafi-Nejad, Tagi. *The UN and Transnational Corporations: From Code of Conduct to Global Compact*. Indiana University Press, 2008.

⁶³ Baldwin, David. *Economic Statecraft*. Princeton University Press. 1985.

⁶⁴ Kim, Dong-Hun. “Coercive Assets? Foreign Direct Investment and the Use of Economic Sanctions.” *International Interactions* 39, no.1 (2013): 99-117.

⁶⁵ Moran, *Multinational Corporations, and the Politics of Dependence: Copper in Chile*, p.5

⁶⁶ Pandya, Sonal. “Political Economy of Foreign Direct Investment: Globalized Production in the Twenty-First Century.” *Annual Review of Political Science* 19, no.1 (2016): 455-475. p.459.

by Jeffrey Frieden, an expert of international political economy, “there is generally a local consensus embracing technocrats, businessmen, military men and labor that some industries are too politically sensitive or too important to foreign direct investment.”⁶⁷

To use foreign capital to develop an information industry in China, savvy authoritarian leaders in Beijing probably have taken two principal lessons from predecessors’ experiences in FDI utilization. One is that industrial capital in form of FDI should be restricted because of their inherent quest for corporate control, which is not difficult. Researchers have found that local businessmen and politicians both gained more power after tightening control over foreign corporations.⁶⁸ Moreover, sector wise, the host state and local capital’s bargaining power vis-a-vis MNCs are stronger when the investments are made to cater the domestic market rather than export.⁶⁹ In fact, the strategy of FDI restriction has been well carried out by China’s neighboring “developmental states” throughout their industrialization process. The model of state-led development in Japan and Asian tigers demonstrated that late-developing host states could shape the context in which MNCs operate by erecting an array of regulatory obstacles when market-seeking FDI needs physical presence in the host market and conduct activities to which the host governments attach great importance.⁷⁰ Such capacity is further enhanced by the endorsement

⁶⁷ Frieden, Jeffrey. “Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea.” *International Organization* 35, no.3 (1981): 407-431.

⁶⁸ Jodice, David. “Sources of Change in third world regime for Foreign Direct Investment, 1968-1976”, *International Organization* 34, no. 2 (1980): 177-206; Dominguez, Jorge, “Business nationalism: Latin American national business attitudes and behavior toward multinational enterprises,” in *Economic Issues and Political Conflict: US-Latin American Relations*, 1982.

⁶⁹ Fagre, Nathan and Louis T. Wells. “Bargaining Power of Multinationals and Host Governments.” *Journal of International Business Studies* 13, no.2 (1982): 9-23; Encarnation, Dennis and Louis T. Wells. “Sovereignty En Garde: Negotiating With Foreign Investors.” *International Organization* 39, no.1 (1985):47-78. Moran, *Multinational Corporations, and the Politics of Dependence: Copper in Chile*; Grieco Joseph, *Between Dependency and Autonomy: India’s Experience with the International Computer Industry (1960-80)*, 1984; Encarnation, Dennis. *Dislodging Multinationals: India’s Strategy in Comparative Perspective*. Cornell University Press, 1989.

⁷⁰ Crystal, Jonathan. *Unwanted Company: Foreign Investment in American Industries*, Cornell University Press, 2003; Sigmund, Paul. *Multinationals in Latin America: The Politics of Nationalization*. University of Wisconsin Press, 1980.

from domestic competitors capable of providing similar services and wishing to squeeze foreign ones out.

As a matter of fact, limiting foreign industrial capital entrance is a hallmark of the Asian developmental states, which have used extensive controls on FDI in terms of ownership, entry requirement, and performance requirement throughout their developmental period. For instance, a scholarly publication on Korean industrialization has found that:

Korea has not by any means been hostile to foreign capital per se, it clearly preferred, if the situation allowed, for it to be under ‘national’ management, rather than relying on TNCs... The Korean government designed its FDI policy on the basis of a clear and rather sophisticated notion of the costs and benefits of inviting TNCs, and approved FDI only when they thought the potential net benefits were positive.⁷¹

Accordingly, FDI restriction helps to reduce foreign influence at the corporate level. For this project, foreign capital’s dominance over the developing world’s developmental course has three incremental degrees. As Table 2.1 shows, although the imperialist control depicts the highest sort of dependent relationship which concerns both political and economic domination, it originates from foreign economic actors’ dominance in third world’s most dynamic industrial sectors. This sectoral domination is because of the economic reality that key business actors in this sector are foreign-controlled entities, which concerns the question of corporate control. Therefore, foreign influence over the local political economy is exerted first and foremost from the corporate level, referring to “power *within* [emphasis added] each firm that determines cash flow, hiring and firing, research and development, merger and acquisition, and corporate strategy.”⁷² In other words, foreign control boils down to the decision-making power of the businesses. Although these firms

⁷¹ Chang, Ha-Joon. “Regulation of foreign Investment in Historical Perspective,” *European Journal of Development Research* 16, no.3 (2004): 687-715. p.702.

⁷² Gourevitch, Peter, and James Shinn. *Political Power and Corporate Control: the New Global Politics of Corporate Governance*, Princeton University Press. 2005. Pp.1-2.

operate in the third world, core decisions are made in the Global North. To cite an insightful remark made by Alfred Stepan, a well-known comparative political economy scholar:

The bulk of the assets and the most important decisions centers of foreign capital lie *outside* [emphasis added] the boundaries of the nation and therefore *outside* [emphasis added] the organizational format of state-chartered corporatist structures. State-chartered, national, hierarchical organizations cannot, for example, encapsulate the leaders and owners of multinational corporations and can only affect a small part of the enterprises' total assets.⁷³

Therefore, curbing foreign influence eventually boils down to the question of whether third-world host states can, partially or completely, directly or indirectly, expropriate or reduce foreign investors' rights to control, consume, and generate income from their invested assets.⁷⁴

Table 2.1 Three Levels of Foreign Control

	Subjects controlled by foreign economic actors
Corporate Control	Management and operation in a particular firm
Oligopolistic Control	Position and shares of the market in a specific industry
Imperial Control	Third world state's developmental strategy and sovereignty

Source: The author's conceptualization

2.3.2 Financial Capital in the Form of Foreign Loan and Foreign Portfolio Investment

To mitigate the challenges on local corporate control brought about by FDI, late developers could turn to alternative foreign capital inflow in financial forms such as FL and FPI. FL allows infant and indigenous industries in the Global South to access foreign capital without incurring foreign industrial competitors via *debt-based* instruments by borrowing from international creditors through bank lending. The borrowed loans can be provided by commercial banks, governments, or international financial organizations such as International Monetary Fund (IMF). Compared with FDI, FL offers two advantages. One is related to corporate control: FL providers

⁷³ Stepan, *The State and Society: Peru in Comparative Perspective*, 1978.

⁷⁴ Regarding the definition of property rights, see Haber, Stephen, Armando Razo, and Noel Maurer. *The Politics of Property Rights: Political Instability, Credible Commitments, and Economic Growth in Mexico, 1986-1929*. Cambridge University Press.

do not interfere in corporate management; thus it does not dilute domestic ownership vis-à-vis foreign investors. On the other hand, borrowers only need to service their debt as per the contract signed with the creditors by paying off the interest and principal on time. As a result, corporate profits could be retained in the country instead of being expatriated overseas.

However, the developing world's dependence and subordination could manifest in a different manner. In terms of FL, creditor nations could impose disproportionate and sometimes unbearable burden on debtor nations by attaching many unreasonable preconditions for loan release, which eventually hurts their autonomy in economic development.⁷⁵ Moreover, as established by a legal contract, outstanding debt must be serviced, and the amount could rise because of an increase in interest rates – a decision made elsewhere in the Global North. Although commercial bank loans provide more freedom regarding fund use and larger quantity in liquidity, the risks are also higher because of their floating interests and shorter maturities.⁷⁶ In addition, FL debtors' financial condition could worsen when their deepening debt burden intersects with the creditors' anti-inflationary monetary policies at home. Such a situation results in increased interest rates, loan default, and aggravates the negative social and economic externalities in borrowing societies.⁷⁷

In the 1970s, many developing countries borrowed heavily from private European and North American banks to finance their developmental programs. Proliferating debt issued by the American government and the sustained rise in the U.S. interest rates at the end of 1979 is considered to be the key trigger of the Latin America debt crisis, which not only made the costs of new borrowing more difficult, but also made servicing existing debts harder because a large

⁷⁵ Frieden, Jeffrey. "The Governance of International Finance." *Annual Review of Political Science* 19, no.1 (2016): 33-48. p.41

⁷⁶ Baer, Werner and Kent Hargis. "Forms of External Capital and Economic Development in Latin America: 1820-1997." *World Development* 25, no. 11 (1997): 1805-1820.

⁷⁷ Kim, Kwan S. and David F. Ruccio, *Debt and Development in Latin America*. "Introduction." P.1.

proportion of borrowing was at variable interest rates.⁷⁸ The rapidly draining external funds had ripple effects with negative implications for a society's overall economic wellbeing. As Frieden noticed,

[s]trapped debtors were thrown back onto already crowded domestic financial markets. Inflation skyrocketed as governments attempted to cover their obligations by monetizing their deficits; interest rates rose even further as nearly insolvent debtors attempted to cover their obligations by borrowing even more. Declining investment, rising inflation, high domestic interest rates, and cuts in public spending everywhere drove the continent into depression.⁷⁹

Moreover, FL is not immune from the inherent disadvantages of debt-based finance compared to equity-based instruments. Equity is permanent capital that does not need to be repaid. As it does not incur interest payments, it is flexible, making firms more resilient during hard times. For firms that rely primarily on equity-based finance, during economic downturns, their dividend payments and profit remittances to stakeholders will become lower. In contrast, as a pre-negotiated contract, debt-based finance does not have such an advantage, which does not bode well for a corporation's financial status during low-growth periods and is more likely to incur penalties from creditors.⁸⁰ Moreover, FL does not provide a sustainable financing channel, and few countries have actualized their long-term growth based on FL.⁸¹ Arguably, banks are "slow to lend, ignorant about business realities, bureaucratic, and risk averse,"⁸² and prefer mature industries. This poses a problem for innovative and intangible assets-rich businesses in the information sector, which in the beginning years has few tangible assets that banks accept as a collateral.

⁷⁸ Hyman Michael, *The Power of Global Capital: New International Rules, New Global Risks*, Delmar School Press, 2004. p.3; Sachs, Jeffrey. "External Debt and Macroeconomic Performance in Latin America and East Asia," *Brookings Papers on Economic Activity* 2 (1985): 523-64; Jansen, Karel and Vos Rob (eds.) *External Finance and Adjustment: Failure and Success in the Developing World*, Palgrave Macmillan, 1997.

⁷⁹ Frieden, Jeffrey, "Classes, Sectors, and Foreign Debt in Latin America." *Comparative Politics* 21, no.1 (1988):1-20. p.2

⁸⁰ Baer and Hargis, "Forms of External Capital and Economic Development in Latin America: 1820-1997."

⁸¹ Payer, Cheryl. *Lent and Lost: Foreign Credit and Third World Development*, Zed Books, 1991. Payer, Cheryl. *The Debt Trap: The International Monetary Fund and the Third World*, New York University Press, 1975.

⁸² Haskel, Jonathan and Stian Westlake, *Capitalism without Capital: The Rise of the Intangible Economy*. Princeton: Princeton University, 2018. p.162.

The risks and disadvantages inherently associated with FL could be remedied by the third option to attract another type of foreign capital in financial form -- FPI.⁸³ Channeled through developing countries' own financial market, FPI inflow allows financial investors from the Global North to purchase stock shares or bonds issued by fund-seeking local companies from the Global South, thus bypassing the constraints imposed by banks. Unlike bank lending which must evaluate depositors' interest before releasing credits, sometimes with conditions, stock and bond markets – with their impersonal character – can circumvent the intermediary of banks to channel funds directly from the public to the recipient corporations, thus significantly enhancing the efficiency of capital allocation. Also, because of its tradability, corporate bonds offer issuers more freedom and lower-interest payment compared with international bank loans.

Moreover, unlike FL or any form of debt instruments which are formal contractual obligations, the capital collected via the share issuance does not need to be returned unless investors pull them out. Banks are better equipped to finance mature industries because of their preference to engage low-risk and mature borrowers rather than young and innovative ones.⁸⁴ However, equity investors like venture capitalists or private equity firms are more willing to take a risk for higher profits in newer and higher-risk sectors.⁸⁵ They are thus preferred by companies operating in the information sector whose enormous appetite for capital cannot be satisfied by bank loans. Unlike FDI, FPI is not structured according to enterprise logic. In other words, foreign

⁸³ According to the IMF, FPI refers to inflows of foreign investment involving debt or equity securities. In terms of equity investment, unlike FDI, investors are not involved in the corporate management of the invested company and holds less than 10% of the equity shares. For more information, see International Monetary Fund, "Balance of Payments and International Investment Position Manual," Six edition, available online: <https://www.imf.org/external/pubs/ft/bop/2007/pdf/bpm6.pdf>

⁸⁴ Allen, Franklin and Douglas Gale. *Comparing Financial Systems*. Cambridge, MA: MIT Press, 2000; Allen, Franklin and Douglas Gale. "Diversity of Opinion and Financing of New Technologies." *Journal of Financial Intermediation* 8, no.1-2 (1999): 68–89.

⁸⁵ Wojcik, Dariusz. "Innovation and Stock Markets: International Evidence on Manufacturing and Services." In *Handbook on the Geographies of Money and Finance*, Edward Elgar Publishing, 2017. pp.197-222.

portfolio investors do not have direct control over nor actively manage the investments or the companies that are issuing the assets. Despite being less effective at generating growth than FDI, the merits of FPI inflow including its stability outshine that of FL flows, hence is a preferred option for economic growth in developing nations.⁸⁶

Because of these merits, many low- and mid-income countries' governments relaxed their regulation of international portfolio capital inflows in 1980s and 1990s, making it easier for foreign financial investment to enter their domestic securities markets. As Frieden pointed out:

“...the freewheeling finance of the 1990s was apart from that of the 1970s, when a few better-off LDCs and centrally negotiated big loans from a dozen huge international banks. Now governments and corporations in developing and transition economies dipped directly into a swirling international financial system. Mutual funds, investment trusts, and banks in rich countries brought small investors, retirees, union pension funds – anyone with even modest savings – into direct contact with stocks and bonds from Bangkok to Budapest to Buenos Aires, from Seoul to St. Petersburg to São Paulo.⁸⁷

Nevertheless, although relaxed governmental regulation over the *entrance* of FPI helps developing countries to tap into the large swath of external finance, it does not reduce much less alleviate financial risks because of the simultaneous easier *exit* for foreign financial capital. Compared with FDI, the more volatile FPI in purely financial form makes them much easier to sell. In this regard, FPI could be speculative and prone to producing financial bubbles.⁸⁸ Such risk is augmented by the lack of coordination among globally dispersed investors that number in the tens or hundreds of thousands. In case of negative investment outlook or regulatory uncertainties

⁸⁶ Kose, Ayhan, Eswar Prasad, Kenneth Rogoff, and Shangjin Wei. “Financial Globalization: A Reappraisal.” *IMF Staff Papers* 56, no.1 (2009):8-62; Mosely, Layna and David Andrew Singer. “Taking Stock Seriously: Equity-Market Performance, Government Policy, and Financial Globalization.” *International Studies Quarterly* 52, no. (2) (2008): 405-25.

⁸⁷ Frieden, Jeffrey. *Global Capitalism: Its Fall and Rise in the Twentieth Century*. 1st ed. New York: W.W.Norton & Company, 2007. p.386

⁸⁸ Soederberg, Susanne. *The Politics of the New International Financial Architecture: Reimposing Neoliberal Domination in the Global South*. LondonL Zed Books, 2004. Grabel, Ilene. “Speculation-led Economic Development: A Post-Keynesian Interpretation of Financial Liberalization Programmes in the Third World,” *International Review of Applied Economics* 9, no.2 (1995):127-149.

in the host economy, a large scale and uncoordinated FPI outflow is likely to occur. As many precedents in the Global South have shown, this situation can turn a liquidity crisis into a solvency or banking crisis.⁸⁹

In fact, barely a decade after the third world debt crisis, the onset of the Mexican Peso crisis and its snowballing effects on other financial markets in the developing world during the mid to late 1990s demonstrated the mutual vulnerability of all economies in a liberalized capital market. When foreign investors' confidence was shattered, they suddenly withdrew their investments in a frenzy of capital flight, throwing the Mexican economy into deep recession, soaring unemployment, and lower wages. Similarly, the East Asian financial crisis between 1997 and 1999 that engulfed Thailand, Malaysia, Indonesia, Philippines, South Korea, and Hong Kong was also caused and aggravated by speculative FPI's sudden and uncoordinated retreat from domestic financial markets.⁹⁰

As a result, foreign financial capital acquisition in the form of FL and/or FPI usage could generate severe political repercussions to the extent of impairing national sovereignty. From the 1970s to the 1990s, in order to mitigate the adverse socio-economic impacts brought by the debt and financial crises, Global South governments had to seek bail outs from international financial institutions. However, these so-called aids came with unreasonably demanding conditions that would further encroach state sovereignty. To help manage debt worries, the IMF, casting itself as an international lender of last resort and a debt collector for private banks, provided standby loans and transfusion of new credit subject to stringent requirements. At the core of reform packages,

⁸⁹ Baer and Hargis, "Forms of External Capital and Economic Development in Latin America: 1820-1997."

⁹⁰ For more information on the East Asian financial crises, see, for instance, Wade, Robert. "The Asian debt-and-development crisis of 1997-?: Causes and consequences." *World Development* 26, no.8 (1998): 1535-1553.

also called Structural Adjustment Programs (SAPs), was the holy grail of foreign trade liberalization, economic reforms and currency depreciation.⁹¹

To guarantee that these institutional changes were made, SAPs set performance criteria and linked the stages of funding release to the debtors' successful implementation of the agreed-upon terms. These were followed by the continuous monitoring of debtors' economic health and evaluation procedures to test their conformity with IMF standards.⁹² As a result, third world states' financial solvency was often achieved through reluctant, unpopular, and painful policy choices such as lowering government spending on social services and basic consumption goods subsidy. Such drastic policy changes yielded unintended and undesirable results for host societies, which include but are not limited to suppressed per capita income growth, soaring unemployment rates, and recurrent economic recessions.⁹³ All these malaises further crippled developing economies' ability to promote growth and pay off their debt.

If any lesson could be drawn from developing economies' engagement with foreign investment via financial channels, it is the political and economic risks that are associated with the liberalization of domestic securities markets for global financial capital. For both the Mexican Peso crisis in 1994 and the East Asian financial crisis in 1997-98, the prerequisite of a capital flight was the removal of restrictions on the entry of FPI in the name of capital account liberalization that allowed speculative and short-term investment to enter the liberalized local securities markets. When investors panicked, they could swiftly withdraw their portfolios, which caused profound

⁹¹ Lipson, Charles. "The International Organization of Third World Debt." *International Organization* 35, no.4 (1981):603-31; Killick, Tony (ed.). *Adjustment and Finance in the Developing World: The Role of the International Monetary Fund*, 1982.

⁹² Lipson, "The International Organization of Third World Debt." p.30.

⁹³ Fishlow, Albert. "Revisiting the Great Debt Crisis of 1982" and French-Davis, Ricardo. "The External Debt Crisis in Latin America: Trends and Outlook" in Kim, Kwan S. and David F. Ruccio (eds.), *Debt and Development in Latin America*.

social economic consequences such as economic recession, falling wages, soaring unemployment, and even social upheaval.

2.4 Authoritarian and Post Socialist China's Informational Ambition and the Developmental Trilemma

As the literature review above has demonstrated, foreign capital inflow, either in industrial or financial form, is inseparable from the challenges and risks for the local third world political economy. The strategic significance of the information industry to an authoritarian regime makes foreign capital usage and foreign control reduction an inseparable dual task. Accordingly, a major balancing act for Beijing's policy makers is to lure the available foreign capital in advanced industrial economies without incurring excessive economic and political costs. One possible scenario to avoid, from an economic perspective, is that more advantageous foreign competitors inundate or co-opt China's nascent industries. Another political one is that the services and products provided by foreign operators pose a security or even existential threat to China's ruling authoritarian elites. Therefore, a crucial task is to evaluate the pros and cons associated with each type of foreign capital inflow, and maximize the advantages of each while minimizing the disadvantages.

Arguably, for both economic and political reasons, the Chinese regime and homegrown companies' interests could be enhanced if FDI inflows into China are given heavier restrictions. Admittedly, equity-like features make FDI less volatile than FL and FPI, thus represent a more effective funding source for large-scale, capital-intensive, and high-growth sectors such as the information industry. But FDI inflow's stability and long-term commitment come with a high price for the local industry and the authoritarian rulers. As a form of MNCs' penetration into the local market with their overseas experience, managerial expertise, and technological superiority, inward FDI involves foreign industrial investors' physical presence in the recipient country and lasting

operation, management, and control of firm-specific assets in the host society.⁹⁴ For the information sector in China, market-oriented multinationals that enter China in this fashion would inevitably outcompete the nascent and weak domestic sector, which would pose challenges for the party-state's information control. To be more precise, from an economic perspective, the capital and managerial advantages of foreign firms could translate into foreign dominance, which inhibits the growth of China's indigenous companies. Politically, with foreign entities independently exerting decision-making power at the company level, such corporate control, if unfiltered, represents a threat to the political system. Foreign multinationals might control the information market and refuse to adhere to the party-state's demands of public information censorship.

Foreign financial capital inflow with low or no intentions of corporate control would be more desirable for Chinese entrepreneurs and politicians. Unlike FDI, FLs from international creditors, if paid duly, would neither challenge Chinese companies' corporate decision-making nor authoritarian Beijing's political-motivated information control. FPI, which allows overseas investors to own short-term interests such as bonds or minority stocks, can bring in a more scattered but larger pool of foreign financial investors who are uninterested in and/or unable to control the firm. Although theoretically speaking, shareholders, in addition to gaining profits by collecting dividends, also co-own the company and influence corporate governance by voting in shareholders' meetings. Because of the small amount of shares portfolio investors hold -- usually less than 10% of total -- and their lack of business knowledge in particular sectors, equity-based FPI does not entail active corporate management and control. Corporate bonds are issued to foreign investors at a lower interest rate and longer term compared with FL, which makes borrowing less costly and more sustainable. In this regard, FPI would be more suitable than FL. Loans generally

⁹⁴ Regarding FDI's definition, see World Bank, "Metadata Glossary," <https://databank.worldbank.org/metadataglossary/jobs/series/BX.KLT.DINV.WD.GD.ZS>.

and foreign loans specifically are ill-equipped to fund information-service companies in their infant stage. Banks are risk averse and unwilling to lend to immature firms like many in the information sector which have uncertain prospects; these start-ups begin with an idea which may be unprofitable for the near future. Their capital-intensive nature requires large initial sums of investment that debt financing channels cannot fulfil.

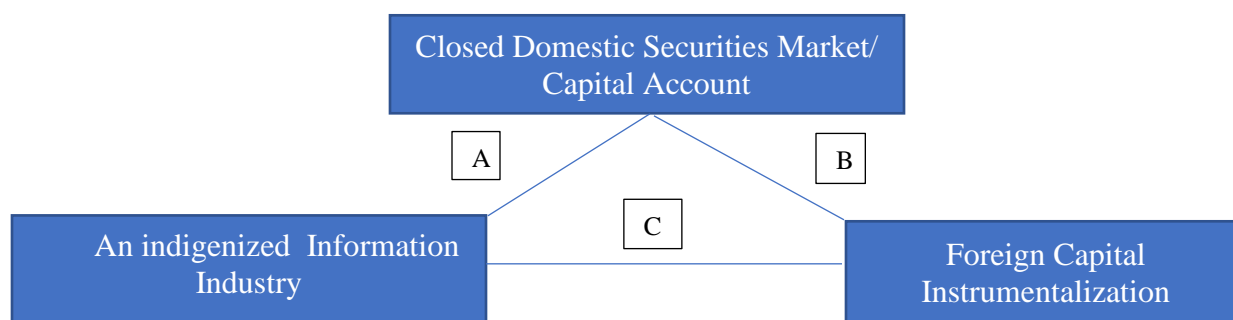
However, although FL and FPI usage could satisfy Chinese entrepreneurs' funding needs, the Chinese regime probably did not think so. To make it possible for Chinese homegrown firms to tap into FL and FPI, Beijing must relax its tight capital control and liberalize the Chinese domestic stock and bond markets to foreign investors, which inevitably increases the systematic risks associated with banking and capital crises. The volatility of speculative capital allows foreign investors to withdraw their portfolio investments at short notice, churning out a financial crisis in no time.⁹⁵ In contrast, non-tradeable FLs do not have such immediate consequences when the confidence of creditors is shaken; a default-triggered crisis might take months or even years to unfold. Therefore, it is in Beijing's interests to impose tight capital control rules and restrict foreign portfolio investors' access to China's domestic securities market.

For the Chinese regime, an impossible trinity arises among an indigenized information industry (put differently, foreign corporate influence minimization or FDI restriction), a closed domestic financial capital market, and the possibility to parlay foreign capital to foster an economically cutting-edge yet politically sensitive industry. The three goals are mutually exclusive, which means that simultaneously only two of the goals are achievable. As Diagram 2.1 below demonstrates, side A shows that if state-imposed inward capital control and regulatory adherence towards an information sector dominated by domestically-owned and -controlled

⁹⁵ Baer and Hargis, "Forms of External Capital and Economic Development in Latin America: 1820-1997."

companies are maintained, then the very ambition of tapping into foreign capital resources must be abandoned. Although the state can resort to using a limited amount of FL – a planned-economy practice adopted before the marketization reform as Chapter 3 will show – it would be too little. Side B indicates an alternative by relying on FDI, a more stable form of foreign capital inflow, rather than opening China’s domestic financial market for foreign portfolio investors and banks. This choice, however, would inevitably bring in foreign corporate influence, which is undesirable from Beijing’s perspective, and to a lesser extent, Chinese entrepreneurs. Alternatively, on Side C, Chinese indigenous firms could in principle opt for FPI and FL, which do not involve foreign investors’ corporate control. However, this solution requires Beijing to scrap its capital control policies by allowing foreign portfolio investors to trade bonds or stocks issued by Chinese companies on Chinese domestic securities market and to permit foreign banks to lend to Chinese firms. As a result, the vested interest of oligopolistic state-owned banks would be challenged, and so would the entire economic outlook.⁹⁶

Diagram 2.1 The Developmental Trilemma of a Foreign-financed yet Domestically controlled Information Industry in China



⁹⁶ In retrospect, China’s closed financial market and inward financial capital control did help reduce its vulnerability to rapid swings in short-term capital and avoided the fate of many developing or developed countries with open capital markets which fell victims to sudden surges of capital flight during the financial crises in the mid- and late-1990s and in 2008. For more information, see Lombardi, Domenico and Hongying Wang (eds.), *Enter the Dragon: China in the International Financial System*, CIGI Press, 2016. Ahmed, Shaghil and Andrei, Zlate. “Capital Flows to Emerging Market Economies: A Brave New World?” *Journal of International Monetary and Finance* 48:221-248.

Source: the author's conceptualization

2.5 Turning Dependency into Inter-dependence: Offshore Domesticated Foreign Finance as the Way Out

So how did the Chinese regime resolve this developmental trilemma? The globalization of financial markets in the Global North has provided a way out: Beijing does not have to loosen its restrictions on inward capital flow; Chinese home-grown companies can acquire adequate and stable funding without rendering corporate control to foreign investors; and global financial investors could also tap into China's booming information sector with growth and profit potential. Here is the "magic": rather than passively engaging with foreign financial capital inflow through its domestic financial markets, Chinese homegrown firms could dip directly into the financial systems located in the developed world by registering shell companies offshore and trade securities. In recent decades, the neo-liberal economic globalization has accelerated its pace and allowed Southern companies to fundraise from the financial markets located in the developed world. For instance, out of 3683 foreign listings by the end of 2006, 85% were done after 1980s and 65% since 1990.⁹⁷ This burst since the 1980s and 1990s also coincided with a new pattern of the origin of foreign listing firms -- corporations from emerging countries expand to demand capital in the wealthy Global North.⁹⁸

This new type of foreign investment, which I call offshore domesticated foreign finance (ODFF), represents Southern companies' stepping outside of their domestic financial markets and *outward* expansion into the financial markets in the Global North. Such presence is often facilitated and preceded by incorporating a shell company in offshore financial centers (OFC), in particular

⁹⁷ Sarkissian, Sergei and Michael Schill. "Cross-listing Waves." *Journal of Financial and Quantitative Analysis* 51, no.1 (2016):259-306.

⁹⁸ For more information on cross-listing, see, for instance, Karolyi, Andrew. "The World of Cross-listings and the Cross-listing of the World: Challenging Conventional Wisdom", *Review of Finance* 10, no.1 (2006):99-152; Edison, Hali and Francis E. Warnock. "Cross-Border Listings, Capital Controls, and Equity Flows to Emerging Markets." *Journal of International Money and Finance*, 27, no. 6 (2008): 1013-1027.

Caribbean islands such as British Virgin Islands (BVI) or Cayman Islands, where legal tradition and company regulations are compatible with major international financial markets. Of the many advantages that the OFC-registered shell can bring to Global South-originated and based corporations, better access to international capital is primary. As the empirical chapters will show later, OFC-registered shells are extensively used by Chinese entrepreneurs in the information industry to dip into the global venture capital market that had fostered many successful American counterparts in the Silicon Valley. Venture capital firms take equity stakes in the beginning phase of these businesses and provide rounds of financing to cope with the uncertainty of intangible investment. When the company of interest grows to a certain stage and wants to attract a larger scale of investment by issuing shares and corporate bonds in the securities markets, the OFC-registered shell also serves a cost-reducing listing vehicle.

Compared with the ones registered in the listing destination in the Global North or in homeland China, OFC offers several advantages. Its legal compatibility with listing requirements on major global stock exchanges allows companies to choose to list where they can raise most foreign capital with the highest valuation.⁹⁹ With the exit of venture and private equity investors, through initial public offering (IPO), ownership rights of a Chinese company are denominated in the currency of the host market, usually U.S. dollars, and traded like domestic U.S. stocks.¹⁰⁰ Cayman Islands is particularly preferred over other OFCs because its companies were allowed to list on both New York and Hong Kong exchanges, where the listed company can raise more funding compared to smaller capital markets elsewhere. Additionally, OFC-registered companies offer more opacity in terms of investor identity and better protection of property rights.¹⁰¹ Requirements on disclosure

⁹⁹ Sharman, J.C. "Chinese Capital Flows and Offshore Financial Centers." *Pacific Review* 25, no.3 (2012): 317-337.

¹⁰⁰ Wojcik, Dariusz, *The Global Stock Market: Issuers, Investors, and Intermediaries in an Uneven World*. Oxford: Oxford University Press. 2011. p.54.

¹⁰¹ Dharmapala Dhammika, and James R. Hines, "Which countries become tax heavens?" *Journal of Public*

of director interests, personal changes, and independent valuation of shares are optional in most OFCs, but compulsory in onshore jurisdictions.¹⁰² The shell companies have been found to reversely merge and acquire domestic Chinese companies, and help parent firms to pursue outward investment in the form of mergers and acquisitions because publicly traded stocks serve as a means to pay for equity in foreign companies.¹⁰³

Arguably, with its numerous benefits, ODFF is well-equipped to substitute for FDI, FPI and FL. It embodies the triple advantages of FDI's long-term stability, FPI and FL's financial nature, and more importantly, foreign investors' little to no interference in the operational management of assets inside China. As Table 2.2 below shows, ODFF presents an optimal escape from the "impossible triangle". Chinese-owned and -controlled firms' capability to acquire, pre-process, and channel back ODFF back into China means that Beijing has no pressure to open its financial market to attract conventional FPI and FL. The *offshore-ness* of investment acquisition removes the risk of financial upheaval caused by sudden FPI outflow or FL interest spike. Possible contamination to the entire economic system is thus minimized and *externalized*. This allows Beijing to continue its path since the 1980s to maintain strict inward short-term capital control and heavily regulated domestic financial market that have spared itself from crises that swept developing economies which have abrogated capital controls.¹⁰⁴ The maintenance of inward capital control also helps to ensure that all the central state-owned Chinese banks do not have to compete with foreign banks for the local market share.¹⁰⁵

Economics 93, no.9-10, (2009): 1058-1068

¹⁰² Sharman, "Chinese Capital Flows and Offshore Financial Centers," p.327.

¹⁰³ Xu, Warner, "Late Development" experience and the evolution of transnational firms in the People's Republic of China, *Asia Pacific Business Review*,10, 2004:324-345.

¹⁰⁴ Domenico and Wang (eds.), *Enter the Dragon: China in the International Financial System*, p.238; Bayoumi, Tamim, Franziska Ohnsorge. *Do Inflows or Outflows Dominate?: Global Implications of Capital Account Liberalization in China*. Washington D.C. 2013: International Monetary Fund, 2013. p.4

¹⁰⁵ Lardy, Nicholas. *China's Unfinished Economic Revolution*. Washington, DC: Brookings Institution, 1998.

Table 2.2 Correlations between Four Types of Foreign Capital Inflow and Their Political and Economic Impact on Developing Societies

	FDI	FL	FPI	ODFF
Financing Mode	Equity-based	Debt-based	Both	Both
Challenge on indigenous corporate control	High	Low	Medium	Low
Stability as a long-term funding channel	High	Low	Medium	High
Challenge to domestic financial and capital control	Low	Medium	High	Low

Source: the author’s conceptualization

Politically, the *domesticated* feature offers long-term stability without foreign influence over corporate governance in companies that provide informational services. From the Chinese leadership’s perspective, it helps to avoid the developmental curse that “more foreign capital means more foreign dependence” as experienced by many post-colonial Latin American and African states. OFC-registered companies could use a dual-class structure for share issuance, with one class offered to the international investors with limited or no voting rights, and the other offered to state entities, company founders, and management teams -- mostly Chinese citizens or state-affiliated organizations -- with higher voting power and more corporate control. Thanks to the acceptance of weighted voting rights in many western stock markets, even after issuing shares publicly overseas, Chinese nationals or state entities could maintain corporate control despite holding a numerical minority of the stocks.

2.6 When Authoritarian Leaders Join Hands with Capitalist Financial Elites: A Neo-Triple Alliance in Shape

As an extension of China’s lucrative information sector from state-imposed inward capital control into the global financial network, ODFF also shapes the very way that global capitalism works. Karl Polanyi once insightfully pointed out that, as an economic system, capitalism depends

upon institutions which the market cannot generate spontaneously but which are created and enforced by the state.¹⁰⁶ In Schoenfeld's words, "modernizing 'modern capitalism' is a state-mediated, not state-eclipsing, process. Capitalist development and state development are...inextricably intertwined."¹⁰⁷ I argue that the evolution and globalization of financial markets are not an exception. The economy is inherently political because it offers a platform for actors to exert power over one another.¹⁰⁸ To quote Frieden again:

[m]any international financial developments themselves have their origin in the domestic politics of the nations that make up the world economy... domestic economic and political developments create the basis for a country's international economic relations. These international economic relations can change the domestic economic environment and thus affect the interests of groups, firms, and individuals inside the nation. Those whose interests are affected can in turn act in the political arena to reinforce or defend their position in the light of the new international economic realities.¹⁰⁹

Arguably, Beijing's *intermediary* role to match domestic information companies' financial demands with transnational financial elites' profit-driven nature and cash prowess essentially means that it undertakes a task of "double movement"¹¹⁰ -- market creation and norm-embedding simultaneously. In this sense, the conventional yet simplistic understanding of state capitalism as a government having "an ownership stake in or significant influence over ... large companies by revenue in that country" needs an update. The state-capital synergy as evidenced in China's information industry represents a peculiar strain of "Communist Party-managed state capitalism"¹¹¹ demonstrated by the emergence of what I call a neo-triple alliance shown in

¹⁰⁶ Gamble, Andrew. *The Free Economy and the Strong State: The Politics of Thatcherism*. Basingstoke: Macmillian Education, 1988, p.37. Polanyi, Karl. *The Great Transformation: The Political and Economic Origins of Our Time*. Beacon Press, 1944; Harvey, David. *A Brief History of Neoliberalism*. Oxford University Press, 2005. p.2

¹⁰⁷ Levy, Jonah (ed.), *The State after Statism: New State Activities in the Age of Liberalization*. Harvard University Press. 2006. p.393

¹⁰⁸ Keohane, Robert. *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton: Princeton University Press.1984. p.21.

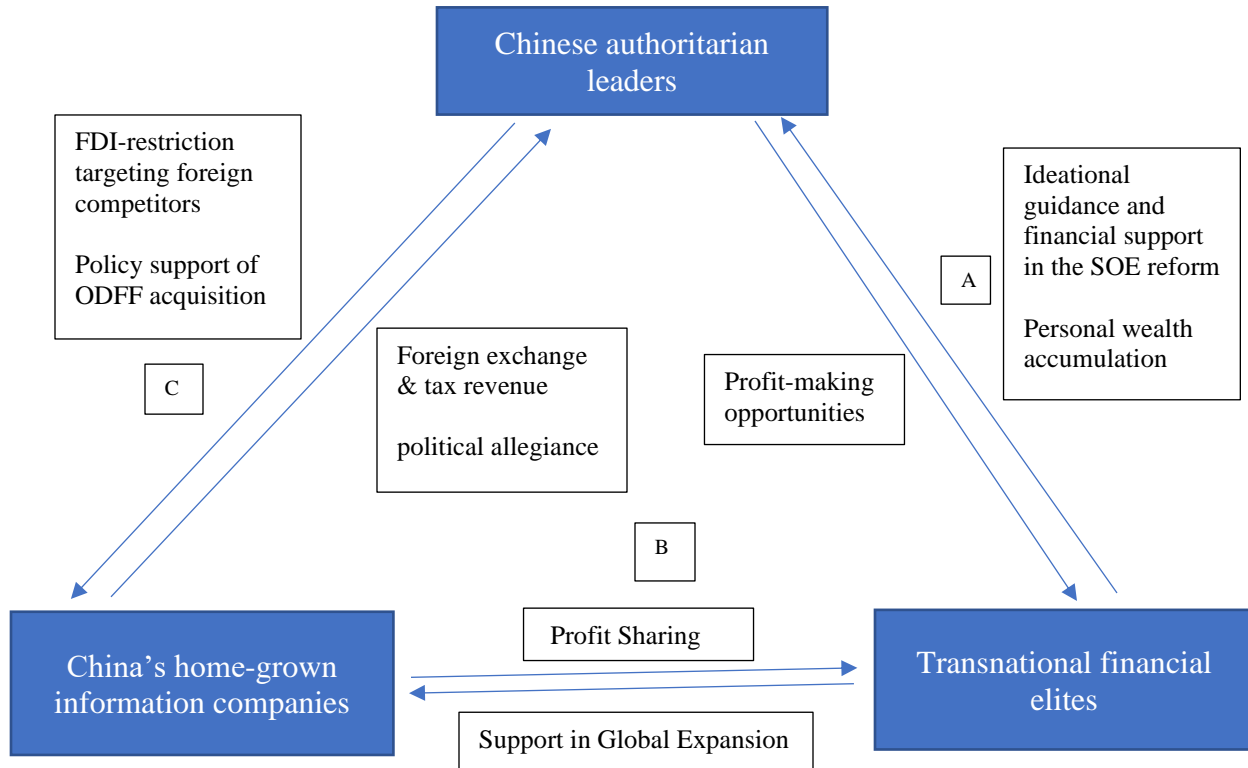
¹⁰⁹ Frieden, Jeffrey, and Andrew Bacevich. "American in the World Economy: From the American Century to Globalization," *The Short American Century*. Cambridge, MA: Harvard University Press, 2012. p.5

¹¹⁰ Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*.

¹¹¹ Lin, Nan. "Capitalism in China: A Centrally Managed Capitalism (CMC) and its Future." *Management and*

Diagram 2.2 below.¹¹² The direction of the arrows indicates the “gives” and “takes” of each of the three actors in this interdependent and synergetic relationship.

Diagram 2.2 A Neo-triple alliance as an Institutional Incarnation of Capital Filtration



Source: The author’s conceptualization

Side A shows that the institutional crystallization of neo-triple alliance revolutionizes our understanding of the relationship between a third world host state and foreign capital. I argue that the relationship between a foreign capital inflow and a recipient state actor is not locked in a zero-sum game, but can be mutually reinforcing. The “corporate power versus state power”¹¹³ paradigm and mindset has long been guiding students’ understanding of the conflicts between third world

Organization Review 7, no.1 (2011):63-96.

¹¹² “neo” is used to distinguish my model from the ones proposed by Peter Evans (1979), which involved state elite, foreign firms, and local firms. Evans, Peter. *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil*. 1979.

¹¹³ For a thoughtful summary and analysis of this paradigm, see Wu, Guoguang. *Globalization Against Democracy: A Political Economy of Capitalism after its Global Triumph*. Cambridge University Press. 2017, Chapter 2.

development and foreign capital inflow. The dependency school's central idea that global capitalism encroaches room of state maneuverer in developmental choices; the developmental state approach's emphasis on host states' capacity to obstruct foreign capital entrance; and the globalist school's assumption that economic and financial globalization cripple authority once monopolized by the state¹¹⁴ are all examples.

Yes, foreign capital inflow does have tensions with state power, but this tension can be reconciled because capital, above all, chases profits. Accordingly, capitalism is expansive in nature, and from a geographic and spatial perspective, it constantly seeks better profits worldwide.¹¹⁵ The end of the Cold War with many former socialist countries ditching socialist planned economy and embracing capitalism not only means less restricted flows of capital, services, information, and technology, but also a new epoque where fortune making capital owners have found new virgin lands to expand into.¹¹⁶ Against this historical backdrop, it would be a cliché to reiterate how much China's vast, unexploited, and thriving market with over a billion customers presents an irresistible temptation for cash-rich foreign investors. But what must be emphasized here is that industrial and financial investors represent two different types of capital to enter China. As a "gate keeper" of its vast promising and state-monopolized market,¹¹⁷ Beijing has the power to decide whether or not to issue international capitalists an "entry permit". Their market admission power is not only applied towards "individual corporations of global business,"¹¹⁸ but also refers to them strategically, selectively, and purposefully playing different forms of foreign capital inflow

¹¹⁴ Strange, Strange. *The Retreat of the State: The Diffusion of Power in the World Economy*. Cambridge University Press. 1996. Ohame Kenichi, *The End of the Nation State: The Rise of Regional Economies*, 1995, New York: Free Press. Etc.

¹¹⁵ Wu. *Globalization Against Democracy: A Political Economy of Capitalism after its Global Triumph*; Appleby, Joyce. *The Restless Revolution: A History of Capitalism*. W.W. Norton & Company, 2011.

¹¹⁶ Wu. *Globalization Against Democracy: A Political Economy of Capitalism after its Global Triumph* p.7

¹¹⁷ Ibid. p.71.

¹¹⁸ Ibid. p.74.

against each other; rewarding some while punishing other and eventually making sure that the state's political and economic interests are met.

More specifically, thanks to the latest wave of economic and financial globalization which makes financial markets in the Global North available to Southern firms, Beijing's authorities have chosen to partner with ODFF. Such a decision has nurtured an intimate relationship with a particular group of transnational financial elites, heralded by international investment banks, private-equity investment companies, venture capital firms, security exchanges, and auditing and legal consultancies based in the Global North. As correctly pointed out by Kellee Tsai and Barry Naughton, two authoritative investigators of Chinese political economy, the Chinese version of state capitalism "incorporates significant elements of today's globalized and financialized capitalism...with widespread use of corporate restructuring techniques pioneered by American investment banks."¹¹⁹

This power of entry admission of domestic market, according to Robert Bates' analysis in a different context, allows public authorities to "generate rents and economic premiums which lie above what the market could confer."¹²⁰ Carl Walter and Fraser Howie, two keen observers of Chinese stock markets, also noted that IPOs of shells of China-based and offshore-registered companies offered a comparatively 'clean' way for both Chinese political and economic elites and global financial investors to get rich quickly by selling their shares at the moment of the company's listing on the stock exchange.¹²¹ Because of its ambiguous transparency, ODFF helps to conceal

¹¹⁹ Naughton, Barry and Kellee, Tsai. *State Capitalism, Institutional Adaption, and the Chinese Miracle*. Cambridge University Press. 2015. "Introduction," p.3.

¹²⁰ Bates, Robert. *Toward a Political Economy of Development: A Rational Choice Perspective*. University of California Press. p.240.

¹²¹ Walter, Carl and Fraser Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise*, 2nd Edition, Singapore: Wiley & Sons, 2012, p.179.

corruption through which “well-connected party cadres receive huge payoffs and kickbacks from bankers, underwriters and business partners.”¹²²

Under the brokerage of Beijing, as side B shows, a win-win situation emerges between Chinese home-grown companies and international financial elites. ODFD makes Chinese information companies’ shares and bonds, though issued by the OFC-registered shells, more accessible to investors from the Global North because OFC-registration means a more impartial dispute resolution mechanism.¹²³ This could be exhilarating news for global investors who are eager to reap benefits from this vast market yet are deterred from China’s domestic equity markets because of issues like limited access, poor disclosure, weak regulation, and insider manipulation.¹²⁴

By providing expertise of the international capital market structure, practices, and standards, global financial elites contributed the necessary capitalist know-how and fundraising techniques for Chinese candidates to take their global expansion further. In return, their ideas and guidance are rewarded with hefty commissions. To list a company offshore through IPO, investment banks, most of which headquartered in Wall Street, play a pivotal role in this process by advising on issuers, promoting depository rights to investors, and underwriting them through the vehicle of OFC-registered shells.¹²⁵ Additionally, business lawyers prepare contracts, file registrations, and take care of regulatory compliance in the listing destination while accountants

¹²² Yeung, Henry Wai-chung and Weidong Liu. “Globalizing China: The Rise of Mainland Firms in the Global Economy,” *Eurasian Geography and Economics* 49, no.1 (2008):57-86. p.79

¹²³ Sharman, “Chinese Capital Flows and Offshore Financial Centers,” p.320.

¹²⁴ Pettis, Michael. *Avoiding the Fall: China’s Economic Restructuring*. Washington, D.C.: Carnegie Endowment for International Peace. 2013. Allen, Franklin, Jun Qian, Chenying Zhang and Mengxin Zhao. “China’s Financial System: Opportunities and Challenges.” In *Capitalizing China*, ed. Joseph Fan and Randall Morck. Chicago, IL: University of Chicago Press.

¹²⁵ For more information, see, JP Morgan, “Depository Receipts: Reference Guide,” 2009. Available online: http://quantlabs.net/academy/download/free_quant_institutional_books_/05BJP%20Morgan%5D%20Depository%20Receipts%20Reference%20Guide.pdf

prepare the issuers' financial statements. Stock exchanges that host their listings compete with one other by lowering standards for foreign companies because those with strict corporate governance requirements are unattractive.¹²⁶

On Side C, at face value, home-grown Chinese firms tapping directly into international financial markets seems to be a spontaneous market behavior irrelevant or even opposed to state intervention. However, it is better construed as a pathway or a favor that Beijing offered to global financial investors and Chinese information companies at its discretion. In other words, an indigenously controlled yet foreign financed information industry simply cannot germinate without Beijing's capital filtration. Of course, the Chinese regime nurtures a patron-client relationship with its domestic information companies. Therefore, the research school about how the development and popularization of the information technology does not necessarily unleash or spread its democratizing potential but rather solidifies Beijing's authoritarian rule can be reinterpreted as Chinese domestic information companies' pledge of allegiance and return of favor to Beijing.

On the other hand, this neo-triple alliance works to the disadvantage of foreign industrial capital. Because of its associated foreign corporate control, multinational companies providing information services that enter the Chinese market via FDI is put under severe restriction. Like its East Asian neighbors which had been the least FDI-dependent countries in the world throughout their industrialization period,¹²⁷ China sets up entry-admission requirements on equity cap,

¹²⁶ Wojcik, Dariusz, *The Global Stock Market: Issuers, Investors, and Intermediaries in an Uneven World*. Oxford: Oxford University Press. 2011. p.60; Licht, Amir. "Cross-Listing and Corporate Governance: Bonding or Avoiding?" *Corporate Ownership and Control* 1, no.4 (2004):36-48; Clark, Gordon and Dariusz Wojcik. *The Geography of Finance: Corporate Governance in a Global Market Place*, Oxford University Press. 2007. p.133.

¹²⁷ Wade, Robert. *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*. Princeton University Press. 1990. Amsden, Alice. *Asia's Next Giant: South Korea and Late Industrialization*, Oxford University Press, 1992; Haggard, Stephan, and Tun-jen Cheng, "State and Foreign Capital in the East Asian NICs," in Frederic Deyo (ed.) *The Political Economy of the New Asian Industrialism*. 1987; Chang, Ha-Joon. "Regulation of foreign Investment in Historical Perspective," p.702.

imposes asset-sharing and technology-transfer schemes with local firms as pre-entry conditions, or implements post-entry regulations that specifically target FDI that are immune to domestic ones. All these measures point to the same purpose of crippling MNCs' control over their own assets and to co-opt them under national management -- as a Chinese government official pointed out, their objective is to limit the management of telecommunication services to Chinese nationals.¹²⁸

Because of tough obstructions against FDI and the prioritized investment admissions that the Chinese regime gives to transnational financial elites, capital filtration also leads to a financialization of industrial capital. Made in the form of FDI, industrial capital "finances positions in real assets ... in order to produce and market industrial commodities in search of 'profit on enterprise'." ¹²⁹ The attempts of international giants of information services to make their way into the Chinese market is an example of industrial capital. However, as the later empirical chapters will show in detail, because of discriminatory and restrictive regulations applied to FDI such as equity cap, procedural red tape, post-entry license requirement, and haphazard law enforcement, industrial capital's profit-making endeavor is obstructed. The implicit message that the neo-triple alliance has for Global Northern informational MNCs is: you are welcome to make a fortune in the Chinese market, but only by handing your money to Chinese-owned companies. Industrial investors thus become financial rentiers that recoup dividends or interests. Purchasing OFC-registered companies' shares or bonds then means giving up their voice in the company and lacking the ability to challenge decisions made by the Chinese shareholders on the board of directors -- a situation of shareholding without control.

¹²⁸ He, Feichang, "Lian Tong: A quantum leap in the reform of China's telecommunications," *Telecommunications Policy* 18 no.3 (1994):206-210. p.208.

¹²⁹ Niggle, Christopher. "The Increasing Importance of Financial Capital in the U.S. Economy." *Journal of Economic Issues* 22, no.2 (1988):581-588. p.581.

2.7 Globalizing the Chinese Economy in the CCP style: Post-Socialist Autonomy and Authoritarian Advantage

But what makes Beijing capable of carrying out capital filtration so effectively? For this project, China's socialist economic legacy and single-party authoritarian political system, though often seen as a contributing factor of economic backwardness, serves a political advantage when engaging with foreign capital because of its high level of state autonomy.¹³⁰ In other words, Beijing has a strong aptitude of planning an agenda and acting independently from external and domestic social or economic forces; implementing its own goals without routine or institutionalized negotiations with them; and shaping their behaviors that conform with its interest.¹³¹

This autonomy originates from China's one-of-a-kind post-socialist and authoritarian political-economic structure and its historical trajectory. As Margaret Pearson, a China specialist reveals, unlike many African and Latin American developing countries, China does not maintain any lingering colonial relationship with powers that once and only partially colonized it.¹³² Colonial ties with Japan were severed in 1945 with the end of Sino-Japanese war, and a century-long semi-colonial history since the 1st Sino-British opium war in early 1840s ended with the foundation of People's Republic of China by Mao Zedong and his comrades in 1949.

Not only did connections between foreign capital and the former colonial powers not exist when Beijing decided to open to capitalism in the late 1970s, neither did domestic private capital.

¹³⁰ I borrow Krasner's definition, by conceiving the state as "a set of roles and institutions having peculiar drives, compulsions, and aims of their own that are separate and distinct from the interests of any particular societal group. These goals are associated either with general material objectives or with ambitious ideological goals related to beliefs about how societies should be ordered", see Krasner, Stephen. *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy*, Princeton University Press, 1978. p.10

¹³¹ Caporaso and Levine, *Theories of Political Economy*, p.182; Ikenberry, John. "Conclusion: What states Can do now?" in Ikenberry, John and John Hall (eds). *The Nation-State in Question*. Princeton University Press. 2003. P.366; Mann, Michael, "The Autonomous Power of the State: its Origins, Mechanisms, and Results." *European Journal of Sociology* no.2 (1984):185-213. p.188,

¹³² Pearson, Margaret. *Joint Ventures in the People's Republic of China: The Control of Foreign Direct Investment Under Socialism*, Princeton University Press. 1991.

The socialist transformation of ownership of the means of production in agriculture, handcraft industry, and capitalist industry and commerce (*sanda gaizao*) which took place nationwide between 1953 and 1956 had confiscated all forms of private capital and transformed them into state or collective ownership, thus eliminating the material basis of China's own bourgeois class.¹³³ Moreover, even within the socialist bloc, China enjoyed a high level of economic independence. Although Moscow's withdraw of industrial experts and technological assistance in the early 1960s aggravated China's isolation even in the socialist world, it helped to strengthen China's insulation and independence from economic penetration from the soviet union.

Therefore, the existence of a national bourgeois/comprador class and continuing economic ties with their former colonial powers -- which many researchers have identified as one of the primary factors that had undermined Latin American and African developers' capacity to control the form and degree of foreign capital inflow¹³⁴ -- does not apply to the Chinese case when Beijing's top leadership decided to open doors to foreign investors. As a result, when transitioning to a socialist market economy in the post-Mao era, a strong domestic societal force independent from the state actor that could have common interests with foreign investors – a relationship which could reduce the state's organizational unity and bargaining power to implement control on foreign investors – did not exist inside China. Because of this heritage, China opened its economy with virtually all assets in state hands with almost zero foreign influence on its economy, a privilege that few developing countries in the world enjoy. For foreign capital to enter the Chinese market, they inevitably had to deal with the Chinese authority, which is literally the only game in town.

¹³³ Ibid.

¹³⁴ Biersteker, Thomas. *Multinationals, the State and Control of the Nigerian Economy*. Princeton University Press. 1987, chapters 5 and 7. Bennett and Sharpe, *Transnational Corporations versus the State*.

Furthermore, this post-socialist legacy is further cemented by a post-totalitarian authoritarian system with a regime continuity in the form of a party state. Arguably, because of state participation, the market is quite heterogenous in character based on the underlying institutional context within which it is embedded.¹³⁵ Compared with other late developing peers or post-socialist transitional states, in China, marketization occurs without regime change. In other words, it was the same CCP-ruled party state that chose to abandon a state-planned economy and embrace capitalism. Because of a lack of responsive relationships between voters and those who hold public offices -- according to the minimalist and proceduralist requirement of a democracy¹³⁶ -- political elites are held accountable only by a much smaller group of elite fellows rather than the general populace, which means that neo-liberal prescriptions are tailored to fit their own interests.

Accordingly, in the absence of any independent private or foreign interests influencing the opening-up and reforming course, as rational and self-interested utility-maximizers, political elites inside the Chinese regime have the liberty to choose the areas, course, and speed of economic liberalization. As Walter and Howie insightfully argue, “in China the markets are operated by the state, regulated by the state, legislated by the state.”¹³⁷ Therefore the economic and financial reform is regime-consolidating rather than regime-dismantling. What appears to be a liberalization and privatization of economy is an incorporation of a burgeoning capitalist economy under state purview and control. The state has undertaken the role of building a market mechanism that goes beyond traditional concept of market that refers to “the *means* [emphasis added] to satisfy supply and demand”, but *rules* for allocating resources.¹³⁸

¹³⁵ Campbell, John and Ove Pederson, *The Rise of Neoliberalism and Institutional Analysis*, Princeton: Princeton University Press, 2001. p.250

¹³⁶ Schumpeter, Joseph. *Capitalism, Socialism, and Democracy*, New York: Harper & Row 1976(1942), p.269.

¹³⁷ Walter, Carl. And Fraser Howie. “*To Get rich is Glorious! China’s Stock Markets in the ‘80s and ‘90s*.” Palgrave Macmillan, 2001. p.10.

¹³⁸ Amsden, *Asia’s Next Giant*, p.11.

In fact, in the 1990s, according to Joseph Fewsmith, an expert on Chinese elite politics, “China’s leadership had determined that globalization was unstoppable and that China could either join the trend or be left behind.”¹³⁹ Strong and imminent pressure from globalization increases authoritarian elites’ anxiety and perception of vulnerabilities, insecurity, and translated into preemptive actions to protect their interests and shape this domestic-foreign inter-linkage largely in its favor. Put differently and theoretically, new ideas can cause groups to rethink their interests, and ideas facilitate rather than constrain action because they empower and enable political actors to generate solutions to their problems.¹⁴⁰

However, although plenty of ideas for solving economic and political problems exist, the prevailing one(s) that emerges from a particular political setting must obtain support from those who have political power.¹⁴¹ In the Chinese case, the ostensible “withdraw” of the state heralds state activism in other areas of economic life. Public authorities are much less incapacitated by the rise of neoliberal globalization than is often alleged. Rather, the state can block, adjust, or even manipulate neoliberal tendencies.¹⁴² It is simultaneously “rolled back and rolled forward, being no-interventionist and decentralized in some domains, yet interventionist and centralized in others.”¹⁴³

It must be reiterated that, for China, a post-socialist authoritarian state with regime continuity, globalization and marketization strategies were merely intended as a way to reap economic benefits and shore up political control, with no plans to transform into a real free economy that offers an equal playground for all companies, state-owned or privately-held, foreign or domestic.

¹³⁹ Fewsmith, Joseph. *China since Tiananmen: The Politics of Transition*. Cambridge University Press. 2001. p.211.

¹⁴⁰ Campbell, John, “Institutional Analysis and the Role of Ideas in Political Economy,” *Theory and Society* 27, no.3 (1998):377-409.

¹⁴¹ Gourevitch, Peter. *Politics in Hard Times: Comparative Responses to International Economic Crises*. Cornell University Press. 1986. p. 17

¹⁴² Campbell and Pederson, *The Rise of Neoliberalism and Institutional Analysis*, p.3.

¹⁴³ Gamble, *The Free Economy and the Strong State*, p.28.

As later empirical chapters will show, the party-state deems itself as a natural “superintendent” of the Chinese market who views foreign capital merely as an *instrument* for China’s informational modernization, and any economic openness vis-à-vis external capital input means granting a profit-sharing opportunity to foreign investment rather than its retreat from the economic sphere.¹⁴⁴

In this regard, ostensibly, the institutions governing foreign capital in China have undergone a fundamental change from the totalitarian, communist, and Maoist zero tolerance to the post-Mao and recent authoritarian and post-socialist transition that became more open to foreign investment. But for this project, institutions go beyond the written legal and policy documents enacted by the state. As a rule of game, institutions could also be *ideational*. The governmental structures that exert political control over foreign capital is deeply resilient and path dependent, although at face value a globalizing China has become more open to foreign capital. Basically, Maoist style blanket prohibition morphed into a new form of skillful manipulation since the 1990s. As an exogenous variable, the shifting broader and international socioeconomic context in general and financial globalization in particular do not necessarily unravel deeply ingrained ideational norms held by political elites. Rather, they enable strategic actors to consolidate and enhance existing ones. In other words, economic globalization is also state-enabling,¹⁴⁵ creating a larger room for state maneuver in the global political economy, and by doing so, at the global scale, the government transforms markets into political organizations that are used to support those in power.¹⁴⁶

¹⁴⁴ An example of how China’s understanding of “market” differs from the western idea, see, Massot, Pascale. “The State of the Study of the Market in Political Economy: China’s Rise Shines Light on Conceptual Shortcomings,” *Competition & Change* 25, no.5 (October 2021):534-560.

¹⁴⁵ Weiss, Linda. *States in the Global Economy: Bringing Domestic Institutions Back in*, Cambridge University Press. 2003.

¹⁴⁶ Bates, *Toward a Political Economy of Development: A Rational Choice Perspective*. p.244.

Therefore, capital filtration refers to how a post-communist apparatus that was previously so against foreign capital entry managed to modernize its information sector in ways that maintain authoritarian elites in power. This neo-triple alliance is by no means a pattern in which globalization and foreign investors have helped to diffuse foreign arrangements and transform domestic ones in China in a one-street way;¹⁴⁷ neither is it a purely business phenomenon where companies acquire functions or inputs provided by a foreign setting without establishing overseas subsidiary or investment.¹⁴⁸ Rather, it is a rise of a state-orchestrated information sector with profound political significance and implications for global capitalism. It is a mechanism in which authoritarian leaders absorb and digest the nutritional resources transfused by global capitalism to consolidate its rule. In other words, China is not only “playing our [read as capitalist] game” – rules made by the world’s advanced capitalist economies and in particular the U.S. – but also manipulating and rewriting it. The alleged “self-obsolcescing”¹⁴⁹ authoritarianism has yet to show any sign of dissipation. On the contrary, it is expanding overseas while being revitalized and enhanced against the backdrop of economic globalization.

2.8 Concluding Remarks

This chapter has attempted to develop a theory of capital filtration, which explains why a homegrown, foreign financed, and cutting-edge information industry manages to burgeon in China despite structural constraints. It also tried to shed light on what makes contemporary China capable of escaping from the curse of “more foreign capital with more foreign dominance” that hobbles many of the world’s previous developers. To sum up, constraints and challenges associated with

¹⁴⁷ Wilson, Scott. *Remade in China: Foreign Investors and Institutional Change in China*. Oxford University Press, 2009.

¹⁴⁸ Allen Mathew, 2013 “Comparative Capitalisms and the Institutional Embedness of Innovative Capabilities.” *Socio-Economic Review* 11, no.4 (2013): 771-94.

¹⁴⁹ Steinfeld, Edward. *Playing Our Game: Why China’s Economic Rise Doesn’t Threaten the West*, Oxford University Press, 2010.

the international capitalist system are faced by *all* developing countries. Policy makers everywhere evaluate the benefits and costs of external capital inflow, engage with foreign investors, calibrate their economic policies, and execute countervailing strategies to mitigate challenges and maximize benefits. By deconstructing “foreign capital inflow” into FDI, FL, and FPI and evaluating each type’s pros and cons, this chapter finds that the enigma of China’s homegrown yet foreign financed information industry can be explained by a state-administered and two-pronged industrial strategy which I have named “*capital filtration*”. This strategy has two components: funneling in ODFF acquired from global securities markets while restricting *industrial* competitors’ market entrance and operation inside China.

By proposing a conceptualization of ODFF, this chapter demonstrates that thanks to the globalization of financial markets and Beijing’s acquiesce and support, mainland China-based and Chinese-controlled firms could camouflage as foreign entities by registering empty special purpose vehicles in offshore financial centers and fundraise from Global Northern financial markets. Arguably, ODFF has two hallmarks that help mitigate the political and economic challenges that conventional cross border financial inflow – either FPI or FL – presents for the late developing host. The “offshore” nature means that capital acquisition takes place *outside* the PRC’s border. Global financial investors do not directly invest into the target companies via China’s domestic but inefficient financial market; rather, they purchase securities issued by their offshore intermediaries from international capital markets. Furthermore, ODFF challenges our conventional understanding of “foreignness” related to cross-border capital flow. Traditionally and geographically, “foreign” only designates that the residence of the investor is different from the residence of the receiving corporate entity. But ODFF demonstrates that “foreignness” is malleable, in that sense the SPVs are concomitantly foreign investment recipients and initiators.

When the real cross-border capital flow into China takes place, it is an *intra-firm* financial allocation with the financial proceedings already “domesticated” under Chinese corporate control in a literal sense. Figuratively, “domesticated” also means that Global North-originated investment is tamed by the Chinese recipient as the associated political and economic risks on local society is mitigated. On the other hand, the foreign-industrial-investor-targeting component of capital filtration is coercively applied to Global North headquartered *industrial investors*, which attempt to enter China in the form of FDI, compete with Chinese home-grown counterparts, and gain a foothold in China’s information-service market. Beijing has erected multiple FDI-restrictive hurdles which eventually contributes to the financialization of industrial capital.

So, what makes China an outlier regarding its powerful foreign capital inflow control? As the section above has argued, China’s post-socialist economic legacy and the ensuing authoritarian political system with regime continuity, though often seen as a factor of economic backwardness, serves a political advantage when engaging with foreign capital inflow because of its high level of state autonomy. It is also argued that the expansive and profit-driven nature of capital flow actually strengthened this authoritarian advantage and the state’s intermediary role when bargaining with different types of foreign investors, pitting them against one other, and choosing its preferred partners for alliance making.

Accordingly, this chapter further argues that capital filtration ushers in a *neo-triple alliance* among a post-socialist authoritarian state, China-based and Chinese-controlled information companies and transnational financial elites. This new partnership is pivoted by policy makers in Beijing, who are constantly wary of foreign industrial penetration in the information sector that could threaten their rein. But instead of indiscriminately prohibiting foreign investment, Beijing, guided by international investment bankers, has craftly resorted to the globalized financial markets

to match-make credit-crunch China-based firms with international financial investors without opening its closed capital market. Chinese home-grown companies are thus allowed to escape from an inefficient domestic capital market and use disciplined and efficient financial institutions located in the Global North. Meanwhile, global financial investors are offered a pathway to tap into China's lucrative information market by pouring cash into and taking profit from China-based companies' growth and expansion. This partnership prevents Beijing from liberalizing its low-efficient financial sector, which inevitably clashes with the vested interests of state-owned banks and increases the exogenous risks of financial instability. Politically, an information industry dominated by home-grown firms and controlled by Chinese nationals, among some of which are state-owned, makes the political control of these company's services easier.

This chapter has answered the question of *why* a homegrown and foreign-financed information sector manages to boom in China despite the structural constraints of an authoritarian regime in the political sense and a late-developing society in an economic sense. So *how* has the Chinese regime been carrying out "capital filtration" in practice? What concrete measures were taken to funnel in ODFI while filtering out foreign corporate control? The following empirical chapters will historically investigate the evolutions and details of capital filtration in different variants. Let's find out the answers there.

Chapter 3: China Unicom’s “China-China-Foreign” Strategy as the First Variant of Capital Filtration

This chapter details the first variant of capital filtration used by the state-owned telecommunications services operator China Unicom from 1995 to 2000. CCF refers to this SOE’s attempt to draw in foreign direct investment (FDI) while limiting foreign industrial investors’ corporate influence. As mentioned in Chapter 2, equity-like features make FDI less volatile than foreign loans (FL) and foreign portfolio investment (FPI), thus offering a more effective funding source for large-scale, capital-intensive, and high-growth sectors such as the information industry. But FDI inflow’s stability and long-term commitment come with a high price for China’s nascent information industry and its authoritarian rulers. Economically, foreign firms’ managerial advantage and capital abundance could translate into foreign dominance, which inhibits the growth of China’s indigenous companies. Politically, with foreign entities independently exerting firm-level decision-making, such corporate control, if unfiltered, represents a threat to the political system when foreign multinationals that control the information market refuse to carry out the party-state’s demands to censor the general public’s information acquisition and exchange. So how did Unicom engage with FDI and reduce its innate quest for corporate control?

Created in 1994, China Unicom was a result of China’s market-oriented reforms to the telecommunications sector’s governance, which aimed to end the monopoly of the Ministry of Post and Telecommunications (MPT) and its local administrations as both the operators and the regulators of China’s telecommunications assets. Against this historical backdrop, Unicom, as a duopolistic competitor of the MPT, was tasked with providing faster and cheaper telecommunications services. But due to having negligible funding from its stakeholders, Unicom was obliged to turn to foreign investors in order to finance, build, and operate a state-of-the-art

cellular network with 2nd generation (2G) standards – a new generation of communication standards that allowed for voice services, texting, and picture messaging, and thus represented a new market opportunity, a favourable likelihood for profit, and a competitive edge against the MPT system that dominated the 1st generation (1G) market.¹

But with a sector as politically sensitive as telecommunications services, Unicom was caught in a dilemma between the state's rejection of foreign corporate influence on national security grounds and the practical business interests of foreign investors. Chinese Vice Premier Zhu Rongji had told Unicom's founders in 1992 that “foreigners cannot interfere in the management and operation [of China's telecommunications network], otherwise there will be no secret to keep.”² So the question was how to reconcile these tensions. How would China Unicom encourage foreign investors to bring money and technology into China and build the advanced networks while also persuading the said investors to relinquish their operational control over the invested assets?

The paragraphs below will present Unicom's solution to this dilemma and evaluate its effectiveness in reaching the objectives of tapping foreign investment and minimizing foreign corporate influence. The next section will introduce the basic characteristics of the “China-China-Foreign” (CCF) strategy, a form of double joint venture that Unicom used to carry out capital filtration. But how did such a design emerge? Why did the formerly supportive Chinese central authority order the discontinuation of the CCF strategy merely four years after its birth? What measures were taken to end the CCF strategy? And how did foreign investors react? In the

¹ For a more detailed presentation of the history of 2G and its technological advantages compared to 1G, see Avila Carmona Jesus, *The History of 2G*, <https://www.intraway.com/blog/the-history-of-2g/>, *Intraway*. Published June 5 2020, assessed Oct.10 2021.

² He Feichang et. al, *Dapo Longduan: Liantong Dansheng Zhongguo Dianxin Tizhi Gaige Kaiduan* [Breaking the Monopoly: The Birth of Unicom and the Beginning of China's Telecom Governance Reform,] Beijing: Zhongyang Wenxian Chubanshe, 2015. p.51.

following sections, I will show how state involvement and support was integral to the process, with the last section of this chapter answering the final two questions.

3.1 Deconstructing the CCF Strategy: Pragmatic Innovation or Legal Violation?

The establishment of China Unicom as a brand-new telecommunications services operator in 1994 was inseparable from the endorsements by China's top leadership. The reformist Zhu Rongji, who had been vice premier since 1991, gained greater control over the economy after Premier Li Peng suffered a heart attack in April 1993.³ Dismantling the MPT's monopolistic status as both a regulator and operator in China's telecom business was high on Zhu's agenda. Under his leadership, two strategies were proposed to break the gigantic MPT apart: the first was to separate its regulatory functions from its business functions, and the second was to create another state-owned enterprise (SOE) to compete with the MPT. Other ministries took a liking to Zhu's proposals, as they had long been jealous of the MPT's monopoly over the lucrative telecommunications sector. Under the pretext of optimizing the usage of spare communication network capacities and resources under their operation, the Ministry of Electronic Industry (MEI), the Ministry of Railways (MOR), and the Ministry of Electric Power (MEP) all lobbied for China's top leadership to allow them to create a telecom SOE. The moment finally came in June 1994 when China Unicom was officially established.

Organizationally, Unicom was owned and controlled by multiple ministries, local governments, and non-telecom SOEs. In April 1994, on the eve of Unicom's official launch, Vice Premier Zou Jiahua who oversaw the telecommunications sector convened fifteen ministry-level agencies to hear Unicom's preparation report and stressed that the "anti-monopoly is carried out

³ Paulson, Henry. *Dealing with China: An Insider Unmasks the New Economic Superpower*, New York: Twelve, 2015, p.41

in steps, it is by no means a hands-off laissez-faire competition out of state purview.”⁴ In other words, Unicom and China Telecom – MPT’s business spinoff – were the only two companies allowed to operate telecom services in China. Other ministries or government organizations could join Unicom, but could not organize independent telecom companies. As Table 3.1 below shows, sixteen governmental agencies, SOEs, and local governments followed the spirit of the preparation report and made fair contributions to Unicom as its initial stakeholders, all under the coordination of the company’s three key founding ministries: the MEI, MEP and MOR.

Table 3.1 China Unicom’s Founding Shareholders in 1994

Shareholding entities	Initial investment (RMB million)	Ownership
Ministry of Electronic Industry (MEI)	100	8.75%
Ministry of Electric Power (MEP)	100	8.75%
Ministry of Railways (MOR)	100	8.75%
China Huaneng Group	80	5.71%
China Resources Holding	80	5.71%
Beijing Catch Communications Group	80	5.71%
China Everbright International Trust and Investment Corporation	80	5.71%
China National Chemicals Import and Export Corporation	80	5.71%
China International Trust and Investment Corporation (CITIC)	80	5.71%
China Merchants Holding	80	5.71%
Shanghai Scientific and Technological Investment Company (SSTIC)	80	5.71%
Guangzhou Municipal Government	80	5.71%
China Foreign Economy, Trade, Trust, and Investment Group	80	5.71%
Fujian Provincial Foreign Trade Center	80	5.71%
China National Technology Import and Export Group (CNTIEC)	80	5.71%
Dalian Vastone Telecommunications and Cables Co.	80	5.71%

Source: *Tongxin Toutiao*

“Chengli Liantong de Naxieshi” (The Stories Behind Unicom’s Establishment)

https://www.sohu.com/a/334836752_256502, published August 19, 2021, assessed October 01, 2021

⁴ Lin Zhihua, *Zhao Weichen Zai Jingji Gaige Qianyan* [Zhao Weichen at the forefront of Economic Reform], Hong Kong: Ruihua Chubanshe, 2008, p.212.

As a newborn telecom services provider, Unicom had to gain its funding from foreign sources. The capital-intensive nature of the telecommunications services industry means that a large sum of initial investments is required for the construction of telecom networks. However, as Table 3.1 shows, Unicom's sixteen founding shareholders altogether invested only RMB 1.34 billion (around US \$156 million), which was not enough to build even a mobile network in a city. It was against this backdrop that Unicom began to seek foreign sources of capital. But because existing parchent institutions had specific regulations in place that prohibited foreigner investors from operating and managing Chinese telecommunications networks,⁵ Unicom had to find alternative innovative means to absorb foreign capital. In fact, it took over a year for Unicom to find an appropriate source of foreign capital that finally led to the establishment of the CCF strategy. According to a retrospective from Unicom's chief engineer, the company "had considered any possible financing options such as direct state investments, bank loans, foreign debts, or the Build-Operate-Transfer (BOT) model", but the ministries that oversaw Unicom's foreign cooperation and financing modes denied all of its approval requests, because "telecommunications services were a special industry."⁶

To find a solution acceptable to both its supervising ministries and foreign investors, Unicom set up special groups to work on foreign cooperation and financing. One former group member recalled that they would first consult the company's ministry-level supervisors -- the State Planning Commission (SPC), State Economic and Trade Commission (SETC), Ministry of Foreign Trade and Economic Co-operation (MoFTEC), State Administration of Foreign Exchange (SAFE) and State Commission for Restructuring the Economic System (SCREC) -- that had

⁵ Ministry of Commerce of the People's Republic of China, "Waishang Touzi Chanye Zhidao Mulu," [Catalogue of Industries for Guiding Foreign Investment,] effective from June 20, 1995.

⁶ He et. al, *Dapo Longduan*, p.140

regulatory power over macroeconomic planning and management, foreign investment regulation, foreign exchange, and SOE reform respectively. Their recommendations would then be incorporated into Unicom's proposals, fleshed out, and handed over to prospective foreign investors. Next, the feedback from foreign investors would be "analyzed, categorized, and sorted out" by Unicom before being reported to the supervising ministries for further deliberation and correction. According to Unicom veteran Peng Jingxian, this process would go through "multiple rounds" and "was repeated countless times in a single year, because they were under the jurisdiction of multiple supervising ministries and the concern of many foreign investors."⁷

The CCF plan eventually came into being in 1995 under the leadership of Unicom's first chairman Zhao Weichen. Despite his lack of experience with telecommunications, Zhao had the trust of Zhu Rongji and was thus made Unicom's helmsman from the start.⁸ According to a well-connected business journalist and writer in China, Zhao drew some inspiration from the BOT plans that were widely used for infrastructure projects in China and approached Bell Canada executives to help him create a similar investment structure for China Unicom, one that would prevent foreign direct operation of the telecommunications services.⁹ In October 1995, the first CCF-structured deal was signed in Montréal, Quebec between Bell Canada and Yantai City, Shandong during Chinese Premier Li Peng's state visit.¹⁰

⁷ Ibid., pp.142-3.

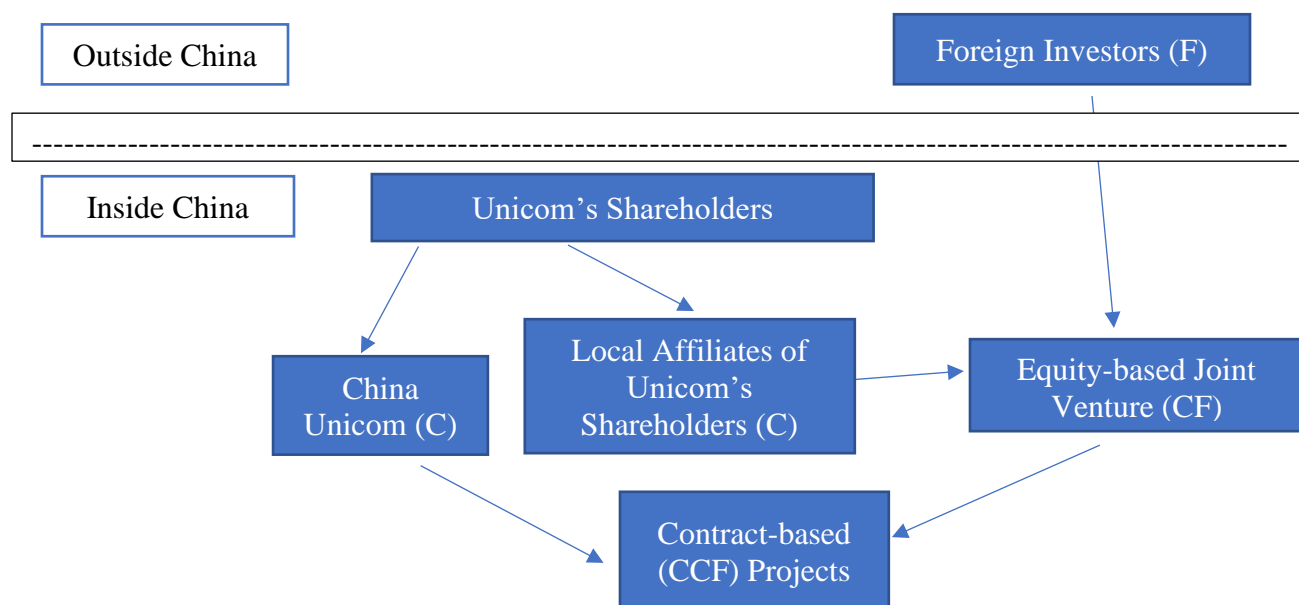
⁸ Lin, *Zhao Weichen Zai Jingji Gaige Qianyan*, p.204.

⁹ McGregor James, *One Billion Customers: Lessons from the Front Lines of Doing Business in China*, Free Press, 2005, p.240. BOT is a common financing model used to fund large infrastructural projects. It refers to a process in which investors build and operate the projects under a set time frame, and then return control and its assets to the local government. As mentioned earlier, the political significance of the telecom services industry meant Beijing opposed using this model for Unicom. For more information on the BOT model, see the World Bank, Concessions Build-Operate-Transfer (BOT) and Design-Build-Operate (DBO) Projects, <https://ppp.worldbank.org/public-private-partnership/agreements/concessions-bots-dbos>, published December 2, 2020, assessed July 17, 2021.

¹⁰ He et. al, *Dapo Longduan*, p.143.

So what was the innovative solution that Bell Canada helped Unicom create? Baptised as the China-China-Foreign (*zhong-zhong-wai* in Chinese) strategy, this new mechanism referred to an arm's-length joint venture between Unicom, its Chinese owners, and its foreign investors. As Diagram 3.1 shows, pursuant to CCF arrangements, a foreign investor (F), usually an international telecom services operator, would partner with a business entity unrelated to telecom services and owned by any of Unicom's sixteen stakeholders and form an intermediary Sino-foreign joint venture (C-F) with it. This joint venture, legally considered a person under Chinese law but not being allowed to directly operate and manage telecommunications networks in China, would then team up with Unicom to form another joint venture (C-(C-F)). Unlike the conventional BOT model, this second partnership would not be an equity-based investment, but would instead refer to a 15-30-year *contractual* agreement, according to which the first C-F joint venture would provide funding and equipment, build 2G networks, lease said networks to Unicom, and teach Unicom how to operate them. In return, Unicom, which was responsible for operating the systems, would distribute a portion of the networks' operating revenues (usually 70%) for "installation and consultation fees". These would be given on an annual or semi-annual basis to the intermediary joint venture in Chinese currency. When the contract reached maturity, China Unicom would then gain ownership of the network.¹¹

¹¹ Lin, *Zhao Weichen Zai Jingji Gaige Qianyan*, p.280.

Diagram 3.1 *Structure of Ownership in the CCF Plan*

This quasi-BOT model was as legally ambiguous as it was pragmatically clever. The CCF arrangement was merely based on a contractual relationship that was not, at least in form, a foreign equity investment from an international telecom operator with direct network operation and corporate management. As a result, it circumvented state parchment regulations that prohibited the foreign ownership, operation, and management of Chinese telecommunications businesses. Additionally, for international telecom services companies eager to enter China but obstructed by the unwillingness of the MPT and China Telecom to cooperate with foreign industrial investors, the CCF design presented a valuable opportunity to test the waters and occupy the “beachhead” of the Chinese market. On the other hand, foreign investors were fully cognizant of the risks – although they made investments, they did not own any shares in China Unicom. But the stakes were tolerable because of the potential of China’s vast market.¹² Unicom swiftly took advantage

¹² He et. al, *Dapo Longduan*, p.143

of this mentality. Each CCF contract had a special clause mentioning that if Chinese parchment regulations changed and China's telecommunications services industry opened to foreign investors, Unicom would renegotiate with its foreign investors and transform their contractual ownership into one of equity,¹³ which, according to Unicom's chief engineer Peng Jingxian, was the most alluring clause for foreign investors despite the legal risks.¹⁴

The CCF strategy was quickly promoted to foreign telecom investors through Zhao's personal outreach. Much of Zhao's time was not spent in his office, but on sponsored trips overseas, creating publicity for Unicom and helping the company make friends.¹⁵ According to his biographer, Unicom's lavish international attention was inseparable from Zhao's frequent contacts with high-level foreign leaders.¹⁶ Henry Kissinger, the former US Secretary of State who orchestrated the opening of relations with Beijing in 1971, was hired as Unicom's consultant. Zhao's footprints were scattered across the US, Canada, Japan, the UK, Italy, and Singapore, and he spared no effort in courting western companies to invest in Unicom during meetings with government leaders such as George Bush, Margaret Thatcher, and Edward Heath.¹⁷

As Table 3.2 below shows, from April 1995 to December 1997, Unicom managed to partner with thirty-two international telecom companies from eleven countries and build forty-six CCF projects throughout China. The total investment scale attained RMB 61.8 billion (roughly US\$ 7.5 billion), of which an equivalent of US \$1 billion was in place.¹⁸ According to Unicom's general manager at the time, almost all of the company's mobile projects relied on the CCF

¹³ McGregor, *One Billion Customers*, p.240

¹⁴ He et. al, *Dapo Longduan*, p.143

¹⁵ Lin, *Zhao Weichen Zai Jingji Gaige Qianyan*, p.220; Harwit, Eric. *China's Telecommunications Revolution*, Oxford University Press, 2008, p.60.

¹⁶ Lin, *Zhao Weichen Zai Jingji Gaige Qianyan*, p.220.

¹⁷ Ibid.

¹⁸ Wang, Shuangxi. "Huigu Zhongguo Liantong de Gaige he Shangshi" (Reviewing China Unicom's Reform and IPO), *Youdian Jingji (Economics of Posts and Telecommunications)*, 4(2017), 57.

structure.¹⁹ For the nascent Unicom, the CCF plan was not only helpful for resolving the credit crunch caused by limited foreign currency quotas and its local affiliates' decentralized fundraising responsibilities,²⁰ but it also allowed Beijing to conserve its valuable foreign exchange reserves.²¹ According to Unicom's chief engineer, the company gained desks, chairs, offices, state-of-the-art equipment and data centers, and the necessary budget to recruit talent, all thanks to the CCF strategy.²² More importantly, foreign partners also brought in scientific management, market operations, and risk control, which helped Unicom to compete with the MPT and China Telecom. This fundraising model allowed Unicom to build the 2G Global System for Mobile Communications (GSM) – the most technologically advanced system of the time, with a total capacity of about 2 million lines – in 88 major cities across China and made the company a powerful competitor to the dominant state-owned provider, China Telecom.²³

Table 3.2 Selective List of Foreign Investors, Chinese Partners, and Locations of CCF Projects

Foreign Investor and Origin Country/Region (F)	Local Chinese Partner/Unicom Shareholder (C)	Target Region
Ameritech (US)	MEI via ChinaCom	
Asian American Telecom. Corp. (US)	Huaneng	Shandong
Bell Canada (Canada)	CITIC	Shandong
Bell Canada (Canada) AIG (US)	N.A.	Shandong

¹⁹ Li, Yong. "Liantong Zhongzhongwai – Tuiyibu Nengbuneng Jinliangbu?." (Unicom's China-China-Foreign, One Step Back for Two Steps Forward?), *Caijing*, <https://magazine.caixin.com/1998-12-01/100076746.html>, published December 1, 1998, assessed April 14, 2019.

²⁰ In mid-1990s, because of the pressure from inflation, the State Planning Commission reduced Unicom's access to long-term foreign loans by requiring Unicom to gain their approval first; more than RMB 60 million (about US\$7.2 million) was needed by telecom SOEs. Harwitt, *China's Telecommunications Revolution*, pp.53-4.

²¹ Pitt et.al, "Touching stones to cross the river: Evolving telecommunication policy priorities in contemporary China," *Journal of Contemporary China*, 5(13), 1996, p.26.

²² He et. al, *Dapo Longduan*, p.204

²³ Gregson Reily, "CCF Investors in China May not Go Quietly," *RCR Wireless*, <https://www.rcrwireless.com/19990823/archived-articles/ccf-investors-in-china-may-not-go-quietly>, published August 23, 1999, assessed April 27 2020.

CCT Telecom (Hong Kong)	Shanghai Sciences and Technology Investment Corporation (SSTIC)	Shanghai
CCT Telecom (Hong Kong)	SSTIC	Shandong
Daewoo (South Korea)	N.A.	Zhejiang
Deutsche Telecom (Germany)	CITIC	Tianjin
France Telecom (France)	Guangzhou South China Telecom Investment (GSCTI)	Guangdong (Guangzhou, Foshan)
Master Call (Thailand)	CNTIEC	Beijing
McCaw International (USA)	SSTIC	Shanghai
NTTi and Itochu (Japan)	Beijing Catch Communications Group via Hebei United Telecom	Hebei
Singapore Telecom International (Singapore)	SSTIC	Shanghai
Singapore Telecom International (Singapore)	N.A.	Jiangsu (Suzhou)
Stet (Italy)	MEI via ChinaCom	Jilin
Telesystem International (Canada)	MEI via ChinaCom	Hunan

Source: Harwit, *China's Telecom Revolution*, pp.55-6; Ministry of Finance and State Administration of Tax, "Guanyu Zhongguo Lianhe Tongxin Youxian Gongsi Zhongzhi 'Zhongzhongwai' Xiangmu Youguan Shuishou Zhengce de Tongzhi" (Notification on Relevant Tax Policies Related to the end of China Unicom's CCF Projects) <https://www.taxhu.com/index.php?m=article&f=view&id=65866>, published May 17, 2000, accessed April 28 2020.

3.2 "Build-Operate-Thank You Very Much": Inherent Flaws in the CCF Strategy

However, as time went on, the drawbacks of the CCF strategy became increasingly evident for the Chinese regulators, Unicom, and its foreign investors. From the perspective of the foreign investors, investment without corporate control produced undesirable results. In the CCF arrangement, foreign investors were only *consultants* rather than network owners, meaning their veto power was seriously constrained when disagreements arose with their Chinese partners or when Unicom's inexperienced local affiliates made decisions that could prove detrimental to the networks.²⁴ Many foreign investors complained that their Chinese partners

²⁴ Chan, Jeanette K. and Charles F. Goldsmith. 1999. "The Regulatory Waiting Game." *The China Business Review* 26 (3):18.

used the near-equity investments given to them to purchase cars, office blocks, and even a few restaurants.²⁵ In some cases, their Chinese partners cut the profit split with fake depreciation numbers or evaded payment under the pretext of capital reinvestment.²⁶ Some Chinese partners' wayward behaviours and disregard for the interests of foreign investors basically made the CCF, in the words of one foreign investor, a "Build-Transfer-Thank You Very Much" scheme.²⁷

In addition to their inability to exert authority over corporate operations, foreign investors were also dissatisfied with the returns, which were much lower than expected. Unicom's unsatisfactory profits and slow growth were largely due to the MPT's sabotage and obstruction. In fact, the MPT had been the most ardent opponent of Unicom.²⁸ Between 1995 and 1997, the MPT pointed out the irregularities of the CCF strategy on numerous occasions and, as a regulator, it continued to defend its business spinoff China Telecom. However, the MPT's objections did not translate into substantial action against the CCF strategy because Unicom had the backing of its sixteen shareholders, which included three ministries, many state-owned firms, and several provincial governments, all of which possessed ministry-level status in the party-state system.

The weakened MPT, on the other hand, stood alone in its opposition to Unicom. In 1995, the State Council carved out the operating and business part of MPT into a corporation called Directorate General of Telecommunications (DGT). Renamed as "China Telecom" in 1995, this

²⁵ McGregor, *One Billion Customers*, p.246

²⁶ Ibid.

²⁷ Harwit, *China's Telecom Revolution*, p.58.

²⁸ As early as Sept. 1990, MPT submitted a special report stressing that telecom business must be monopolized by the state and managed by MPT, and was endorsed by the State Council led by Premier Li Peng. However, with Zhu Rongji took the Vice Premier in 1991 and gained greater control of economic policy making since 1993, MEI, MEP and MOR's proposals to establish China Unicom gained an upper hand among the State Council leadership. Hu Haiyan, "Liantong Zhi Qianshi Jinsheng," [Unicom's Yesterday and Today], *Caijing Shibao* [Financial and Economic Times], September 20, 2002.

new corporate was expected to operate all aspects of the public communications network that were under provincial or municipal telecommunication authorities' control. In the next year, China Telecom's head office moved out of the MPT compound to a rented property in Beijing, as a manifestation of "separation" between enterprise and government. Even so, the real boss behind China Telecom was MPT because major personnel decisions and network expansion plans needed MPT's concurrence.²⁹

Therefore, in practice, the MPT could still delay Unicom's expansion by wielding its regulatory power. One of the MPT's tactics against Unicom was to prevent or delay its rival's network from connecting to the fixed and cellular lines that the ministry, and later China Telecom, managed and operated. Without any interconnection, Unicom's subscribers would remain in a small and isolated loop that could not even reach emergency numbers of 119 and 110, China's equivalent of 911. Such MPT-imposed sanctions were a major factor in curbing both Unicom's growth and foreign interest in further investing. They were even responsible for causing some foreign investors to refuse to fulfill the negotiated terms.

From the perspective of Unicom, the CCF strategy also brought undesirable foreign influence. In some projects, the CCF arrangement worked to the advantage of foreign investors because they "had a free hand to negotiate favourable percentage returns from projects they invested in."³⁰ In fact, foreign partners sometimes had the dominant advantage in local joint ventures because of their superior funding, expertise, and technology. For instance, contrary to the spirit of the original 30-70% revenue distribution between Chinese partners and foreign investors, the distribution tilted to 10-90% in some projects. In Jilin and Yantai, foreign ownership actually

²⁹ Li, Yong. "Qiekai 'Zhongguo Dianxin'," [Slicing 'China Telecom'], *Caijing*, <https://magazine.caixin.com/1998-12-01/100076748.html>, published December 01, 1998, accessed March 08, 2022.

³⁰ Chan and Goldsmith, "The Regulatory Waiting Game."

reached 100%.³¹ Ostensibly, foreign investors provided only equipment, thus not violating state prohibition against foreign ownership, operation, or management of telecom interests. In fact, the majority of foreign partners had more or less participated in network construction through regular “project discussion seminars.”³² Moreover, as Yang Xianzu, Unicom’s chairman between 1999 and 2003 later admitted, decisions on construction, investment, and management for CCF projects all needed the consent of foreign partners in practice, which counted as *de facto* operational participation to some degree.³³ Since foreign telecom companies were the ones undertaking network construction, post-construction maintenance was undertaken by them as well, which was also deemed equivalent to network operation.³⁴ Perhaps because of CCF’s grey legal ground, Zhao Weichen, Unicom’s founding chairman, specifically urged that contractual content must be strictly confidential.³⁵

Another flaw that exacerbated the CCF strategy’s inefficient fund usage and corporate expansion came from Unicom’s *decentralized* corporate structure. Because the forty-six projects scattered throughout China were co-managed between foreign investors and the local affiliates of Unicom’s stakeholders, each project was negotiated on its own terms and conditions, which made it difficult for projects to reach unified settlements over tariffs and fees.³⁶ Local fragmentation also meant that Unicom’s Beijing headquarters had very weak control over local firms, which meant it was unable to centralize project funds and plan

³¹ Zhang Jiwei, “Liantong ‘Zhongzhongwai’ Jietao Neimu,” [Inside Story on How Unicom Got Rid of the China-China Foreign Noose,] *Caijing*, August 5, 2000.

³² Ibid.

³³ Hu Shuli and Zhang Jiwei, “Shangshi Guilai Hualiantong – Zhuanfang Zhongguo Liantong Gufen Youxian Gongsì Dongshizhang Yang Xianzu” [Talking About Unicom after Its Initial Public Offering – Special Interview with China Unicom Joint-Stock Company’s Chairman Yang Xianzu], *Caijing*, <https://magazine.caixin.com/2000-07-05/100562756.html?sourceEntityId=100567967>, published July 5, 2000, assessed April 27 2020.

³⁴ The author’s Zoom interview with a telecommunication engineer on March 03, 2021.

³⁵ Lin, *Zhao Weichen Zai Jingji Gaige Qianyan*, pp.279-80.

³⁶ Chan and Goldsmith, “The Regulatory Waiting Game.”

network construction effectively. In many projects, accounting was completely run by foreign partners, and Beijing headquarters had no idea how much investment foreign investors had actually brought into the CCF projects.³⁷ By the end of 1998, three years after the first CCF project was established, Unicom's net assets had only increased by RMB 1 billion (roughly US\$ 121 million), and the company had only managed to take 7% of the cellphone market's share in China.³⁸

3.3 Cleaning Up Irregularities Before Opening Up: Beijing's Changing Attitudes in 1998

The various drawbacks associated with the CCF strategy did not go unnoticed by China's top leadership. In 1997, the ministries overseeing China's SOE and telecom reforms co-submitted an investigation report on Unicom's development to the State Council that approved of the CCF strategy's contributions in channelizing foreign finance, but also pointed out some specific problems and defects that were "increasingly obvious (*biduan rixian*)".³⁹ As a solution, the report proposed having "no more repetition (*xiabu weili*)," which meant that new CCF projects would no be longer permitted, but existing ones would continue to operate.⁴⁰ The State Council's reply, issued in late May 1997, mentioned that in order "to solve the Unicom's funding penury in its early developmental stage, proper usage of foreign capital will be allowed, but it must adhere to state regulations." Meanwhile, the State Council leadership urged Unicom's supervising ministries to "research and correct the CCF model" and guarantee that "on the condition

³⁷ Zhang, "Liantong 'Zhongzhongwai' Jietao Neimu."

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ Li, Yong. "Liantong Zhongzhongwai – Tuiyibu Nengbuneng Jinliangbu?." [Unicom's China-China-Foreign, One Step Back for Two Steps Forward?], *Caijing*, <https://magazine.caixin.com/1998-12-01/100076746.html>, published December 1, 1998, assessed April 14, 2019.

that the contractual ownership percentage of foreign investors does not surpass the percentage of domestic ownership, other financing channels could also be explored.”⁴¹

From the perspective of foreign investors, at least in the first half of 1998, Unicom’s supervising ministries did not seem to have any plans to scrap the existing CCF arrangements, but simply intended to make minor revisions. According to a spokesperson for Sprint, an American telecom company that invested in a CCF project in Tianjin, the SPC even openly praised their CCF project.⁴² At the same time, SPC, SCREC and SETC had received a Unicom report on the CCF plan’s financing model and had made a joint decision to conduct “further research on” the CCF strategy’s legality issue. According to Peng Jingxian, who made the presentation, the three ministries’ decision “did not lead to any official adjudication on the CCF plan.”⁴³

The attitude of the three supervising ministries finally changed in August 1998 when Zhu Rongji, who had become premier in March, expressed his negative opinions on the CCF strategy. In a State Council meeting, Zhu mentioned that the “CCF was an irregular (*bu guifan*) form of investment and needed to be cleaned up.” He demanded that Unicom stop carrying out CCF projects, return the principal to the foreign partners, and offer adequate compensation to foreign investors. Zhu also stated that Unicom’s funding needed to explore new channels, with “overseas stock listings” being one possibility.⁴⁴

Three factors could explain why China’s top leadership ordered the elimination of the CCF strategy in 1998. As an expert on China’s telecom industry insightfully pointed out,

⁴¹ State Council, “Guowuyuan Guanyu Jiejue Zhongguo Lianhe Tongxin Youxiangongsi Fazhan Youguanwenti de Pifu” [State Council’s Reply to Questions Related to China Unicom Ltd.’s Development], May 22, 1997. http://www.gov.cn/xxgk/pub/govpublic/mrlm/201012/t20101203_63045.html, assessed April 29, 2020.

⁴² Zhang, “Liantong ‘Zhongzhongwai’ Jietao Neimu.”

⁴³ He et. al, *Dapo Longduan*, p.144

⁴⁴ Wang, “Huigu Zhongguo Liantong de Gaige he Shangshi”, p.60.

the first reason was that in October 1997, China Telecom, Unicom's archrival, floated the mobile assets of two provinces on the Hong Kong and American Stock Exchanges and brought back "readily available foreign funds without allowing foreigners to actually own a controlling stake"⁴⁵ – a story that the next chapter will delve into. The second reason was related to China's ongoing World Trade Organization (WTO) negotiations with the U.S. and the European Community, as foreign market access to the telecom services sector was a critical issue in the talks that Beijing did not want to yield in. The MPT, which served as a regulator and negotiator on behalf of the telecom services sector in these talks, was willing to allow foreign investors to own only a maximum of 25% in Chinese telecom companies, which was a much lower percentage than some foreign investors practically had under the existing CCF arrangement.⁴⁶ In other words, the fact that many foreign investors already held a majority in the quasi-equity ownerships of many CCF projects weakened Beijing's negotiation position. The third and last reason was that Beijing needed stronger national champions to compete with foreign entrants that would be allowed into the Chinese market after it acquired its WTO membership. For the Chinese top leadership, it was time to end the battle between China Unicom and China Telecom, strengthen Unicom, and establish a more balanced duopoly between the two companies. Accordingly, Beijing initiated a strategic reorganization of China's telecom sector in March 1998 by amalgamating the MPT and the MEI together to form the Ministry of Information Industry (MII).⁴⁷

⁴⁵ Harwitt, *China's Telecommunications Revolution*, p.63

⁴⁶ Chan and Goldsmith, "The Regulatory Waiting Game." Chapter 4 and 7 will illustrate why China's telecom regulator set the cap at 25% in its negotiations in 1998.

⁴⁷ An expert on Chinese politics observed that despite absorbing the MEI, the new MII seemed to just be the MPT under a new name, as the majority of MII officials came from the MPT. Lynch C. Daniel, *After the Propaganda State: Media, Politics, and "Thought Work" in Reformed China*, Palo Alto: Stanford University Press, 1999. p.173

3.4 Divide and Rule: Beijing's Brutal Nationalization of CCF Assets

But how would the foreign telecom investors be compensated for the discontinuation of the CCF arrangement? Between August 1998 and April 1999, the State Council held three meetings to specifically discuss Unicom's reorganization and the solution to the CCF strategy.⁴⁸ On December 1, 1998, at the first press conference after the MII's foundation eight months prior, Wang Jianzhou, the Director of the Planning Department, confirmed Beijing's official stance towards the CCF strategy by criticizing Unicom's sharing of installation fees with foreign investors. Wang also disclosed that the investigation of the CCF strategy was close to an end and that a feasible solution would be soon unveiled.⁴⁹ To speed up Unicom's reorganization, the State Council reshuffled Unicom's leadership in February 1999, with high-level officials from the former MPT being transferred to Unicom in order to clean up the CCF arrangements and prepare for an overseas initial public offering (IPO). Yang Xianzu, the former Vice Minister of the MPT and one of Unicom's most ardent opponents, took the triple role of company chairman, party group secretary, and chief executive officer (CEO). Before taking on the new positions, Yang drew up a list of over 300 MPT officials and bureaucrats that he wanted to bring over to Unicom and managed to successfully take the vast majority of them with him.⁵⁰

This reorganization of personnel signalled that the hatchet between Unicom and the MPT and China Telecom was being buried. In Yang's own words, the "junior brother,"

⁴⁸ Hu and Zhang, "Shangshi Guilai Hualiantong – Zhuanfang Zhongguo Liantong Gufen Youxian Gongsi Dongshizhang Yang Xianzu."

⁴⁹ Wang, "Huigu Zhongguo Liantong de Gaige he Shangshi," p.60

⁵⁰ Ibid. pp.55-6.

Unicom, was being accepted into the “big family” that was the MPT.⁵¹ Unicom’s first chief engineer also shared the sentiment:

When dealing with the MPT, Unicom always considered the big picture. In the early days after Unicom was founded, someone [read as MPT] deeply opposed us and did not give us any space to grow. We had to be tough. When Unicom could stand up by itself, we adjusted strategy. It is harmony that is prized, for China is a socialist country. Unlike in the western world, there is a noble but common interest above each department’s individual goals, and that is national interest.⁵²

Staffed with telecom specialists from the MPT, Unicom quickly formed a CCF clean-up task force in spring 1999 that was chaired by the company’s new leadership. Around the same time, the reorganization and overseas IPO preparation also began.⁵³

However, the unresolved CCF projects became a major obstacle. In order to conduct an overseas listing, Unicom had to clarify its CCF obligations to foreign financial investors. But progress had been slow as roughly 72% of Unicom’s total CCF assets were foreign-invested, and none of the foreign CCF investors were willing to relinquish their rights so easily.⁵⁴ To have their voices heard, fourteen foreign CCF investors gathered on February 3, 1999 to sign a letter to the State Council, in which they acknowledged the CCF arrangement’s “chaotic bookkeeping and inefficient capital usage, which seriously held Unicom’s development back.”⁵⁵ As a way out of the problem, the letter proposed that the

⁵¹ In contrast, Unicom’s first and second chairmen Zhao Weichen and Yang Changji, both had professional background in SETC, and the third and fourth Liu Jianfeng and Wang Jincheng, came from MEI. Gao Jianwei, “Yang Xianzu Zhesinian” (Yang Xianzu’s Past Four Years), *Guoji Jinrong Bao*, [International Financial Times] <https://tech.sina.com.cn/it/t/2003-06-27/0915202831.shtml>, published June 27, 2003, assessed April 30 2020.

⁵² He et. al, *Dapo Longduan*, p.278

⁵³ Wang, “Huigu Zhongguo Liantong de Gaihe he Shangshi,” p.60.

⁵⁴ Radio Free Asia, “Waiguo Gongsi Yangyan Zuzhi Zhongguo Liantong Haiwai Shangshi” [Foreign investors alleging to stop China Unicom’s Overseas Listing], <https://www.rfa.org/mandarin/yataibaodao/1067-19990725.html> published, July 25, 1999, assessed May 1, 2020.

⁵⁵ Zhang, “Liantong ‘Zhongzhongwai’ Jietao Neimu.”

contractual partnership of foreign investors could be turned into equity ownership under Unicom's overseas IPO.⁵⁶

However, the propositions that the foreign industrial investors made eventually turned out to be wishful thinking. Lobbied by global financial investors and investment bankers, Beijing's restructuring strategy took a different path. Morgan Stanley, the American investment bank that embarrassingly missed the China Telecom IPO in 1997 – for reasons that will be analyzed in the following chapter – was hired as one of the legal consultancies for handling the CCF mess. Morgan Stanley told Unicom that if the CCF structures were unravelled, the company would raise an unimaginable amount of money in the global listing,⁵⁷ so the most expedient and convenient way to resolve the CCF issue was “simply to declare them void.”⁵⁸ Pressure for a speedy resolution to the CCF problem also came from China's top leadership. On April 5, 1999, on the evening before his departure to the US to negotiate China's membership in the WTO, Zhu Rongji made a phone call to the residence of Yang Xianzu, urging him to hurry up with the company's overseas IPO.⁵⁹ A State Council Meeting held in the same month clearly demanded Unicom to “end the CCF financing mode.”⁶⁰

Starting in the summer of 1999, Unicom started to send official letters to their CCF arrangements' foreign partners, informing them of Unicom's plan to terminate their joint ventures under state policy, and inviting them to negotiate for compensation. At the advice of Morgan Stanley, Unicom divided all of its CCF projects into three categories based on

⁵⁶ Ibid.

⁵⁷ McGregor, *One Billion Customers*, p.247

⁵⁸ Harwitt, *China's Telecommunications Revolution*, p.63

⁵⁹ Wang Shuangxi, “Huigu Zhongguo Liantong de Gaige he Shangshi,” p.64

⁶⁰ Ibid.

their performance and revenue, treated the initial investment as the principal, and proposed to compensate each category based on banking rates.⁶¹ Low-profit projects, most of which were in inland provinces, were proposed compensation at a banking interest rate. Compensation rates for projects with mid-range profitability were proposed as equivalent to bank loan rates, which ranged from 6.21% to 8.01% in 1999. High-profit projects, which were mainly in coastal regions, were given higher compensation, with a 3-5% top-up above the prevailing market interest rates that was also applicable to long-term bank loans. Also, Unicom requested that the State Council give tax credits to foreign investors.

This compensation model actually meant that international telecommunications investors were treated as mere bank lenders that signed null and void contracts with Unicom's shareholders. According to Unicom's legal expert, the justification under Chinese law was that when invalid contracts (*wuxiao hetong*) occurred, both parties had to restore them to their original state (*huifu yuanzhuang*). To quote an investment banker from the China International Capital Corporation (CICC) – a joint venture between Morgan Stanley and the China Construction Bank – and a key participant in Unicom's negotiations with foreign telecom companies,

[the] Chinese government never officially approved of the CCF projects. As per international standards, only the approval of the regulatory ministry over public utility [read as the MPT] could lead to the business license. Otherwise, even the president nodding his head could not count as an approval. Other ministries have no say on this matter either. If you wanted to set up a hospital in China, could you allege that consent from the Ministry of Foreign Trade and Economic Cooperation [China's regulator of external business relationships] alone equalled approval?⁶²

The thin legal ground of CCF contracts and China's unique legal system also made solving the CCF problem through a litigation unlikely. According to one legal expert, disputes had to be

⁶¹ Ibid.

⁶² Zhang, "Liantong 'Zhongzhongwai' Jietao Neimu."

constantly negotiated in the absence of a commercial law code,⁶³ but the negotiation process was difficult, because the compensation that Unicom proposed was much lower than the industrial standard. Moreover, Unicom was dealing with forty-six projects that united thirty-two international telecom investors and Chinese SOEs – all affiliated with Unicom’s sixteen shareholders – so the question of relocating sacked personnel was a tough issue. It was not until August 9, 1999 that Unicom finally reached their first agreement, which was with Nippon Telegraph and Telephone (NTT), a Japanese telecom investor whose CCF project in Hebei did not go well.⁶⁴ The Tokyo-based multinational company had hired a Beijing law firm as their representative in the negotiations and managed to regain the original cost of their investment as well as a 7% return.⁶⁵ Soon afterwards, the South Korean investor, SK Telecom, also received proper compensation for its CCF project in Anhui.⁶⁶

But the successful compensation of NTT and SK Telecom were merely exceptions. European and American investors were infuriated over the compensation terms that Unicom had offered them and how they were being treated as mere bank lenders. The principal, combined with a bank interest that was slightly over 10% at the highest bid, appeared to be nothing more than the original amount of money that the investors had sunk into the joint ventures.⁶⁷ For western investors, the future value of the networks they had

⁶³ Blake, Pat. “The Wireless World Tour,” *Telephony Online*, April 21, 1997.

⁶⁴ Li, Luyang, Yue Shi, “Liantong Shangshi Zhihou – Zhuanfang Zhongguo Liantong Gufen Youxian Gongsi Zhixing Dongshi Changwu Fuzongcai Shi Cuiming” [After Unicom’s Listing: Special Interview with China Unicom Joint Stock Company’s Executive Director and Executive Vice President Shi Cuiming,] *Guoji Rongzi*, [International Financing,] (6)2002.

⁶⁵ *South China Morning Post*, September 3, 1999, requoted in Harwit, *China’s Telecommunications Revolution*, p.64.

⁶⁶ *Tongxin Xinxibao* [Communication and Information Times,] Hanguo Zhengfu Dali Tuidong Dianxinqiye de Guojihua Zhanlve [Korean Government’s Big Push of the Internationalization of its Telecom Companies,] <http://tech.sina.com.cn/it/t/2002-06-11/120005.shtml>, published June 11, 2002, assessed May 2, 2020.

⁶⁷ Zhang, “Liantong ‘Zhongzhongwai’ Jietao Neimu.”

built and managed were worth much more compared to the aggregate of US\$1.4 billion that they had put into the CCFs.⁶⁸ According to international banking customs, compensation should be based on the evaluation of all returns generated before the ending of a contract, which could be several times, or even several dozen times, more than the principal.⁶⁹

To voice their shared dissatisfactions, twelve western investors formed the Unicom Investor Group (UIG) to step up the pressure. Some investors even threatened to sue and file complaints with securities regulators in their home countries, believing that they were entitled to packages that took into account any losses in potential revenue and the costs of supporting the networks. As a result, Unicom's initial plans to make the company public at the Hong Kong and New York Stock Exchanges in late 1999 were delayed at least twice.⁷⁰

As Unicom alone was unable to satisfy western foreign investors with its compensations, Beijing intervened. On August 30, 1999, the MII issued a strongly worded policy with the State Council's approval, claiming that the CCFs "violated state policy and regulations, and must be resolved."⁷¹ The MII also urged Unicom to liquidate all CCF projects before mid-September, or by the end of the month at latest.⁷² In October, Unicom leadership unilaterally announced that they would cease distributing revenues to CCF joint ventures that month onward. One MII official even went so far as to threaten that all foreign investors had to quit their CCF ventures immediately or else they would have to deal with

⁶⁸ Gregson, Reily. [Investors left dangling amid CCF changes,] *RCR Wireless*, <https://www.rcrwireless.com/19991011/archived-articles/investors-left-dangling-amid-ccf-changes>, published November 11, 1999, assessed May 2, 2020.

⁶⁹ Ibid.

⁷⁰ Radio Free Asia, "Zhongguo Liantong Gongsi Dui Guowai Hezuoze Tingzhi Fukuan," [China Unicom Suspended Payments to Foreign Partners,] <https://www.rfa.org/mandarin/yataibaodao/15006-19990930.html>, published September 30, 1999, assessed May 2 2020.

⁷¹ Zhang, "Liantong 'Zhongzhongwai' Jietao Neimu."

⁷² Ibid.

any subsequent economic losses by themselves.⁷³ At the same time, the stalemate in negotiations with foreign investors did not shake the time-constrained Unicom's determination to float shares overseas. According to CICC's manager, Unicom even intended to use the assets of only three or four provinces for an overseas IPO in October 1999 through a substantially downsized plan to raise US\$ 1 billion.⁷⁴

3.5 Pitting Financial Investors Against Industrial Investors: Stock Warrants as an Authoritarian Instrument

To speed up negotiations with foreign telecom investors, Morgan Stanley proposed another market instrument: issue share warrants for foreign CCF investors that would allow them to buy Unicom's shares at the IPO price within a six-month period after Unicom's public listing.⁷⁵ This strategy managed to kill two birds with one stone. First, Unicom would not need to dispense any cash for compensation, and second, offering warrants for foreign investors would dissuade their objections against Unicom's overseas IPO. Obtaining Unicom's share warrants meant that the foreign CCF investors would become stakeholders in the fundraising vehicles that Unicom established in offshore financial centers. Therefore, their interests were aligned with the share price. This proposition was well-received by foreign investors, who considered it a sufficient substitute to their preferred method of

⁷³ Radio Free Asia, "Waiguo Touzizhe Beijinggao Wutouzi Zhongguo Liantong" [Foreign investors warned to divest from China Unicom,] <https://www.rfa.org/mandarin/yataibaodao/17142-19991026.html>, published October 26, 1999, assessed May 3, 2020.

⁷⁴ As the next chapter will show, eventually Unicom injected mobile assets from 12 provinces and nationwide pager and long-distance data assets for its IPO, and managed to raised US \$ 6.5 billion.

⁷⁵ A warrant certificate includes the terms of the warrant, such as the expiry date and the final day it can be exercised. Simply put, there are two types of warrants: the call warrant gives right to buy shares at a certain price in the future, and the put warrant allows holder to sell back shares to the issuer at a specific price in the future. In this case, all warrants refereed are call warrants.

compensation based on commercial value, as it was much higher than the banking loan previously proposed by Unicom.⁷⁶

Due to inadequate support from their home governments⁷⁷ and the risk of being shut out of China's markets in the future, many companies had no option but to accept Unicom's terms on share warrants. The turning point came on December 9, 1999, when Canada Bell and China Unicom reached a memorandum of understanding (MOU) on their projects in Shandong. On January 14, 2000, France Telecom, another key player in the UIG, signed an MOU on its projects in Guangdong, with Unicom also promising to grant prioritized cooperation with them once China entered the WTO. In a calm dénouement, all the CCF arrangements were terminated in February 2000 with no further interest accrued and just before the deadline for the injection of all CCF assets into the June IPO listing vehicle. In fact, most of the MOUs were only reached within one or two days before the deadline, or at an "unimaginable speed", in the words of an investment banker who had been consulted for Unicom's IPO.⁷⁸

Unicom issued twenty-six warrant certificates in total, constituting approximately 2.5% of the company's issued share capital to twenty-four holders. The total value was US\$ 610 million (RMB 5.024 billion), which allowed shareholders to subscribe for new Unicom shares at the IPO price of HK\$ 15.58 per share.⁷⁹ According to Unicom's IPO prospectus, the warrants could be exercised between December 23, 2000 and June 22, 2001. However, by the time of the expiration date, none of their shareholders or their designees had exercised the warrants. A

⁷⁶ According to Unicom's Prospectus in 2000 and Annual Report for 2001.

⁷⁷ For example, the U.S. embassy advised U.S. companies "to take it by the chin or else they may never be able to return to China" or "will be denied future market access." Hsueh, *China's Regulatory State*, p.68.

⁷⁸ Zhang, "Liantong 'Zhongzhongwai' Jietao Neimu."

⁷⁹ China Unicom, Annual Report, 2000.

plausible explanation for why is that Unicom's stock prices did not skyrocket as predicted, but instead mildly fluctuated between HK\$ 10.50 to 17.00 per share during the six-month exercisable period, and went even lower than the IPO price most of the time, thus rendering the warrant exercise unappealing.

So how much did Unicom pay for the CCFs, and where did the money come from? Since the spring of 1999, Unicom had wended through over six hundred negotiations to gain full possession of the foreign invested assets. A total of RMB 14.6 billion was paid to foreign investors. Of that total, around 10 billion was given as principals and 4.6 billion was given as compensation,⁸⁰ with an average rate of 12%, a top rate of 20.22% and a bottom rate of 5.45%.⁸¹ For comparison, returns on telecom deals are usually close to 30%.⁸² The vast majority of the money that Unicom had paid back actually came from state loans, with one transaction from a state-owned policy bank worth RMB 10 billion (US\$ 1.2 billion).⁸³

3.6 Concluding Remarks:

In retrospect, the CCF mechanism was simply a makeshift design for using foreign industrial investment to fulfill Unicom's objective of accumulating capital, as the company was greatly constrained by scant state budgetary allocation and a limited foreign exchange quota. The fermentation and fruition of the double joint venture plan was a process that the Chinese state had been closely involved with from the very beginning. A distinctive feature that contrasted the CCF plan from a Sino-foreign equity investment or BOT model was that despite their shareholding

⁸⁰ Liao Wenyan, "Liantong Ruhe Tupo 'Ziben Guan'zhi'" [How did Unicom Break Through 'Capital Control'], *Keji Zhinang*, [Think Tank for Science and Technology,] June 2005, 76-9.

⁸¹ Zhang, "Liantong 'Zhongzhongwai' Jietao Neimu."

⁸² "International News Media Coverage of how China Unicom Treats Agreements with Foreign Partners Increases," *Business Wire*, 2000.

⁸³ Li Kui, Zhang Zhenyu, Wang Guang, "Kaifa Yinhang Zuida Yibi Dianxindaikuan Qianyue" [China Development Bank's Largest Telecom Loan Signed,] *Zhongguo Touzi*, [China and Investment,] April, 2000.

status, the participation of foreign investors in local firms was governed by contracts rather than legally enforceable equity ownership.⁸⁴ In this regard, the CCF strategy could be construed as a meticulously designed compromise to lure foreign telecom FDI into a lucrative yet underexploited market while still conforming to state parchment prohibitions against foreign corporate management and control over the networks that foreign investors built for the Chinese.

For the young, weak, and locally fragmented Unicom of the mid-1990s, the CCF strategy spurred its initial growth and established its foundation for challenging the MPT's monopoly, but eventually proved to be an unsatisfactory workaround for Unicom, its foreign industrial investors, and the Chinese authorities. The crux laid in the irreconcilable contradiction between the Chinese party-state's objections against foreign corporate control and the innate quest for corporate control through FDI that is associated with industrial capital inflow. Although the CCF plan was craftily and carefully designed to limit the corporate influence of foreign investors, foreign corporate control was merely *reduced* rather than wholly eliminated, which was perhaps inevitable, given that CCF plan resulted in a prominent foreign industrial presence in the local Chinese market. The superior expertise and technology of foreign investors turned some Chinese partners into puppets who were not even aware of the magnitude of financial flows. Additionally, the sectoral specificity of telecom services made the idea of industrial investors not participating in network management a wishful hope for the Chinese, as the said investors also handled project construction and maintenance which was vital to network management. Meanwhile, the decentralized nature of the forty-six CCF projects scattered across China, each with its own partnership and conditions, made mutual recognition and interconnection difficult, thus largely reducing their profitability. Such

⁸⁴ It would be oversimplifying to argue that CCF was an "equity investment model", Pei Minxin, *China's Trapped Transition: The Limits of Developmental Autocracy*, Cambridge: Harvard University Press, 2006, p.106.

disappointment was only further aggravated by the MPT's sabotage, which delayed CCF-constructed networks from connecting with the national one.

For some, the creation and eventual abandonment of the CCF strategy showed the "inconsistency and uncertainty of policy implementation."⁸⁵ From this project's perspective, however, the political logic behind the CCF mechanism was clear. China's leadership, both the top-level decision-makers and the ministry-level regulators, were aware of the CCF plan's thin legal grounds, but the MPT's objections to Unicom's CCF model were largely ignored because it was outnumbered by the sixteen local and central ministry-level agencies behind Unicom. Additionally, the permission and endorsement of the CCF plan from China's top-level leadership, particularly Zhu Rongji and Zou Jiahua, conferred additional legitimacy on the plan despite its legal ambiguity, as they hoped to support Unicom and use FDI as way to break up the MPT's monopoly over China's telecom services industry.

But when new incentives and better options became available, political support and willingness towards the CCF plan tapered. Beijing's support for the CCF plan ebbed away between 1997 and 1998 for two reasons. The first reason was that *de facto* foreign ownership of the CCFs impaired China's bargaining position in WTO negotiations. The second was that Unicom's arch rival China Telecom had trailblazed a new financing model that proved more effective at absorbing foreign financial investment without incurring the physical presence and influence of foreign industrial competitors in the Chinese market. China's top leadership therefore became increasingly vocal and critical towards the drawbacks of the CCF plan, eventually ordering its disintegration. Ironically, the CCF plan was scrapped under the accusation of being abnormal under Chinese law

⁸⁵ Zhang, Bing. "Understanding China's telecommunications policy making and reforms: a tale of transition toward liberalization," *Telematics and Informatics*, 19(4), 2002, 331-49, p.344.

and thus in contradiction of state prohibitions against foreign corporate management. In this regard, the written rules were freely interpreted by the political elites to justify their actions. This authoritarian haphazardness and repressiveness were compounded by assistance from American financial capitalists. Morgan Stanley's idea and knowledge of declaring the CCF arrangements void and issuing share warrants to foreign telecom investors were catalysts for the CCF's unravelling. Theoretically, it also offered a vivid example of how transnational financial capital cooperated with an effective authoritarian regime against industrial capital.

Beijing's brutal dismantling of the CCF projects and its nationalization of CCF assets had long-term impacts on foreign industrial investors that had hoped to enter the Chinese telecommunications market through FDI. As Chapter 6 will illustrate, foreign investors were startled by the abrupt end of the CCF plan and thus reluctant to form joint ventures with Chinese partners, despite the fact that Beijing had made many formal equity ownership commitments and concessions for its WTO membership in 2001. But what model of foreign investment did Unicom opt for after abandoning the CCF strategy? Why did the new model of accessing foreign capital make Beijing and Unicom so eager to abandon the CCF plan despite fierce resistance from foreign telecom investors? How did this new model help to channel foreign investment into Chinese companies while filtering out foreign corporate control at the same time? Let us find the answers in the next chapter.

Chapter 4: The “Red Chip” Foreign Listing Strategy as the Second Variant of Capital Filtration

This chapter presents the second mode of foreign capital filtration adopted by China’s state-owned telecom oligopolies. Known as the “Red Chip” foreign listing strategy,¹ it emerged in 1997 and was still in use as late as 2020, which is the end of this project’s time scope. The following four sections demonstrate the improvements that the “Red Chip” strategy made as a replacement for the China-China-Foreign (CCF) strategy of filtering foreign corporate influence associated with inward foreign capital flow. First, I introduce how the “Red Chip” model represented a new form of financial acquisition from international capital markets and heralded a partnership between Chinese telecom giants and global financial elites who taught, supported, and financed the overseas fundraising of Chinese telecom state-owned enterprises (SOEs). Second, I show how the funds raised by the “Red Chip” plan, in the form of offshore domesticated foreign finance (ODFF), helped to eliminate foreign investors’ corporate influence inside China, which the CCF plan had failed to do effectively. Third, in addition to having larger sums of funding than the CCF strategy and little foreign corporate influence, I show that the “Red Chip” strategy also served as a catalyst for the central Chinese government to consolidate the once locally assorted and controlled telecom assets into unified national champions. Fourth and finally, I argue that an additional advantage of the “Red Chip” model was that it offered a lucrative “exit” for political elites from the Ministry of Post and Telecommunications (MPT) to become “red” entrepreneurs of the newly corporatized

¹ Hong Kong economist Alex Tang coined the term in 1992 in reference to China-based and Chinese state-controlled enterprises that were incorporated and listed outside of Mainland China. “Red” was picked because of the colour of the Communist Party. For more information, see Market Business News, “What are red chip shares? Definition and meaning,” <https://marketbusinessnews.com/financial-glossary/red-chip-shares/>, accessed January 10, 2021.

telecom SOEs who are rewarded with share option schemes granted by the listed state-owned assets.

A close-up case study of China Mobile's 1997 IPO is offered in the last section. This case is singled out primarily because it was the first transaction to pioneer the "Red Chip" model that the other three telecom SOEs copied in the following years. By zooming in on this trailblazing deal, I provide company-level evidence and answer the following questions: How was the "Red Chip" mode of capital filtration designed? Why did it emerge in 1997? Who was involved in this process? What specific measures were taken to guarantee that foreign sales of mainland telecom assets did not challenge state control over them?

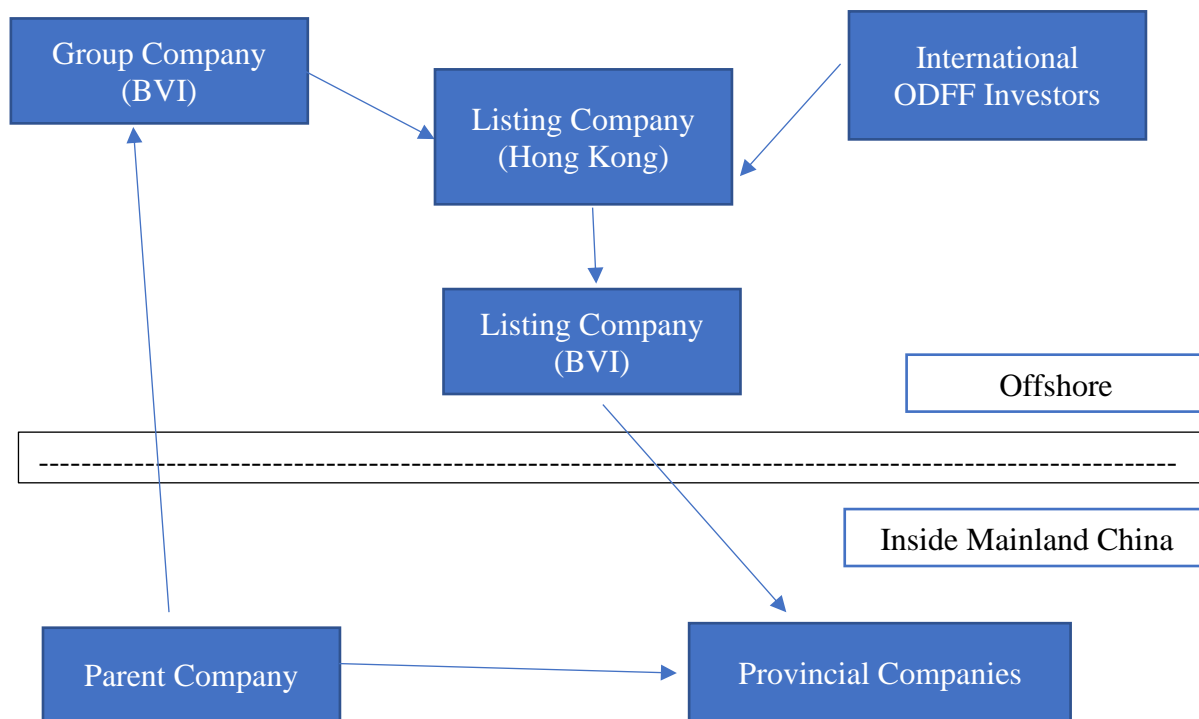
4.1 Incorporating and Listing Mainland Assets Overseas: Beijing's New Partnership with Global Financial Elites

Unlike the CCF model's passive inward absorption of foreign direct investment (FDI) through double joint ventures inside China, the "Red Chip" foreign listing model allowed China-based and state-controlled companies to "step out" and access financial investment from capital markets in the Global North. Generally speaking, three steps were involved in constructing a "Red Chip" foreign listing. As Diagram 4.1 below shows, the Beijing-based parent telecom oligopoly would first register a shell and limited company in Hong Kong that served as a listing vehicle on the securities exchanges in Hong Kong and New York. This Hong Kong-based company would be owned and controlled by an intermediary group company domiciled in the British Virgin Islands (BVI) that existed only on paper and did not run any business but held the listed company's shares. In turn, the BVI-registered group company was owned and controlled by the parent company in Mainland China. In other words, the China-based parent company exerted control over the Hong Kong-based listed company *indirectly* through this affiliation in the BVI. The BVI registration offered advantages such as not requiring any disclosure of shareholder information and having

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non-corporate tax to facilitate later asset transfers that would otherwise be subjected to financial regulations in the listing places.

Diagram 4.1 Conceptual Structure of China's "Red Chip" Foreign Listed Telecom SOEs



Source: Shareholding structures of China Mobile, China Unicom, China Netcom IPO Prospectus

Although existing only in spreadsheets, the Hong Kong-registered listing vehicle would then receive assets injected from the mainland provincial companies. These would be sold to international investors through a dual initial public offering (IPO) on the stock exchanges in Hong Kong and New York. Notably, this IPO was unconventional in the sense that it was not an established company with convincing financial records that aimed to expand through public capital input. Rather, it was an empty and notional company that was only nominally owned and operated telecom assets in Mainland China which it planned to sell to overseas investors. In other words, what foreign investors would pay for was a premium of the projected *future* value of the listed

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company's earnings and cash flow. And the deal was, in the words of two financial experts, "truly pulling capital out of air!"² As Table 4.1 below shows, all of China's telecom services oligopolies followed the same path, using assets from the better-off eastern and coastal provinces for their IPO to appeal to international investors.

Table 4.1 IPO Assets, Proceeds, and Publicly Issued Share Percentages of China's Four Telecom Services Companies

Listing Vehicle	Composition of IPO Assets	Percentage of Total Shares Issued	Funding Raised (US\$ millions)	IPO Underwriters	IPO Time & Issuing Exchange
China Mobile (Hong Kong) Ltd.	Mobile assets from two coastal provinces**	23.52%	4,220	Goldman Sachs, China International Capital Corporation (CICC)	1997.10.23 Hong Kong Stock Exchange (HKSE), New York Stock Exchange (NYSE)
China Unicom (Hong Kong) Ltd.	Mobile assets from twelve provinces***; and nationwide pager, fixed-line, IP telephone, and long-distance data assets	22.53%	5,650	Morgan Stanley, CICC	2000.06.22 HKSE, NYSE
China Telecom (Hong Kong) Ltd. ³	Fixed-line, data, and Internet connection assets from four provinces****	10.62%	1,520	Morgan Stanley, Merrill Lynch, CICC	2002.11.08 HKSE, NYSE
China NetCom (Hong Kong)	Netcom International, Asia Netcom, and Internet access assets	16.2%	1,140	Citigroup, Goldman	2004.11.18 HKSE, NYSE

² Walter, Carl and Fraser Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise*, 2nd Edition, Singapore: Wiley & Sons, 2012, p.182

³ China Telecom's 2002 listing did not qualify as "Red Chip" because it was incorporated in the mainland, but it shared many similarities with "Red Chip" in terms of corporate control and method of asset transfer. In this regard, China Telecom is an H-share company, i.e. one incorporated in Mainland China with listings in Hong Kong approved by the China Securities Regulatory Commission (CSRC). In contrast, "Red Chip" listed SOEs did not need the CSRC's approval. This chapter will empathically discuss the "Red Chip" model and use examples from the other three companies. For more on Chinese share types, see FTSE Russell, "Guide to Chinese Share Classes," https://research.ftserussell.com/products/downloads/Guide_to_Chinese_Share_Classes.pdf, published December 2021, accessed December 22, 2021.

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Kong) Ltd.	from provinces*****	eight		Sachs, CICC	
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** Guangdong and Zhejiang

*** Beijing, Shanghai, Tianjin, Guangdong, Jiangsu, Zhejiang, Fujian, Liaoning, Shandong, Anhui, Hebei, Hubei; nine coastal provinces)

**** Shanghai, Guangdong, Jiangsu, Zhejiang (all coastal provinces)

***** Beijing, Liaoning, Tianjin, Hebei, Shandong, Henan, Shanghai, Guangdong (six coastal provinces)

Source: IPO Prospectus of the four listed companies

This complex transborder corporate organization required ideational and technical support from savvy global financial capitalists, who were also rewarded handsomely for their services. A successful IPO requires three intermediaries: investment banks, legal consultancies, and accountancy firms. Accordingly, an overseas IPO calls for such actors with international exposure and expertise. In this process, the investment banks serve a lynchpin role by providing a value assessment of the target company, giving advice on the issue price range, drafting prospects, promoting the issuance to potential investors, and purchasing any unsold shares back at a predetermined price.⁴ The roles of lawyers and accountants are more auxiliary – the former ensure the new issuing company’s legal compliance with regulations in target stock markets; and the latter make sure that the issuer’s financial statement in the prospectus is true and meets the host market’s accounting standards. Table 4.2 below provides an example of the leading global investment banks, legal firms, and accountancies involved in China Netcom’s IPO in 2004.

Table 4.2 Transnational Financial Elites and their Gains from China Netcom’s 2004 “Red Chip” IPO

IPO-generated expenses	US\$
Underwriting fees*	70,000,000
U.S. Securities and Exchange Commission registration fee	190,050

⁴ Investment banks are mostly headquartered in New York, such as Goldman Sachs, Morgan Stanley, JP Morgan Chase, Merrill Lynch, and Lehman Brothers before its bankruptcy in 2008. They also include the investment banking arm of some commercial banks, such as Bank of America or Deutsch Bank. For more introductory information, see, Hargrave, Marshall. Investment Bank. Investopedia. <https://www.investopedia.com/terms/i/investmentbank.asp> updated October 23, 2020, accessed December 22, 2021.

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National Association of Securities Dealers filing fee	30,500
Listing fees**	280,000
Legal fees and expenses ***	3,400,000
Accounting fees and expenses ****	5,000,000
Printing fees	2,000,000
Other fees and expenses	19,469,950
Total	100,370,500

* Payable to its three underwriters: New York-headquartered Goldman Sachs and Citigroup, and Morgan Stanley's joint venture in China CICC

** US\$ 200,000 payable to NYSE, US\$ 80,000 to HKSE

*** Payable to Beijing-based Haiwen & Partners, London-headquartered Linklaters, New York-headquartered Skadden, Arps, Slate, Meagher & Flom LLP.

**** Payable to London-headquartered PricewaterhouseCoopers

Sources: Securities and Exchange Commission (SEC), Form F-1 (IPO Prospectus of China Netcom Group Corporation (Hong Kong Limited), <https://www.sec.gov/Archives/edgar/data/1305755/000114554904001412/u99051a1fv1za.htm> October 26, 2004, accessed December 11, 2021. Ji Yuehang, "Wangtong qiaoding shangshi chengxiaoshang, jihua jingwai rongzi 20yu meiyuan" [Netcom Confirms IPO Underwriters, Planning to Raise Around US \$2 Billion Offshore], Guoji jinrong bao [International Financial Times], <https://tech.sina.com.cn/it/t/2004-01-15/0743282534.shtml>, reposted by Sina January 15, 2004, accessed December 11, 2021.

An overseas listing had the potential to bring huge economic benefits to the aforementioned international financial elites. Regarding the "Red Chip" listed SOEs, the underwriting fee on Hong Kong Stock Exchange (HKSE) was about 4% to 5% of the IPO proceeding, and other costs could reach HK\$ 10 to 30 million, together costing 6%-8% of the proceedings, according to a Chinese researcher from a think tank affiliated with China's telecom regulator.⁵ Information disclosed from the IPOs have largely corroborated these estimates. For instance, from the US\$ 4.2 billion that China Mobile managed to raise at its IPO in 1997, the underwriting fee reached US\$ 200 million.⁶ As Table 4.2 shows, China Netcom's expenses from its global offering in 2004 attained over US\$ 100 million, or roughly 8.8 % of the proceeds, with the underwriting fee taking the

⁵ Xiao, Yun. "Guonei Yunyingshang tigao rongzi nengli cheng dangwu zhiji" [Enhancing Fundraising Capacity Became a Top Priority for Domestic Operators], *Jingji guanli* [Economic Management], 30(2004): 21-23, p.22.

⁶ Walter and Fraser, *Red Capitalism*, p.178.

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majority of the expenses. The beneficiaries were largely U.S. or U.K.-headquartered and -based investment banks, legal firms, and the listing securities exchanges.

The fundraising process was not a one-off deal that ended with the IPO of several provinces' telecom assets. In the next step, as Table 4.3 below shows, the listed company, legally and geographically a foreign investor, would use the proceedings generated from the IPO to reverse "buy" those independently operating yet unmerged telecommunication assets and businesses that were located in the remaining mainland provinces. This "merger and acquisition" was usually conducted in batches within a time span of less than a decade until all the mainland-based assets from the thirty-one provincial administrations were transferred into the Hong Kong listing vehicle. To put it differently, the listed companies would eventually become "foreign" telecom operators that held nationwide telecom assets on the mainland through the merged and acquired provincial companies.

Table 4.3 Timeline, Roadmap, and Money Spent of Hong Kong-listing Vehicles' Post-IPO Reverse Asset Acquisition from Provincial Companies

Year of Transaction	China Mobile	China Unicom	China Telecom*	China Netcom*
1997	Two coastal provinces: Guangdong and Zhejiang (IPO)			
1998	One coastal province: Jiangsu (HK\$ 22.5 billion)			
1999	Three provinces: Henan, Hainan, Fujian (HK\$ 49.7 billion, consisting of HK\$ 19 billion from bond issuance and HK\$ 30.7 billion from new shares issuance)			
2000	Seven coastal provinces: Beijing, Tianjin, Hebei, Liaoning, Shanghai, Shandong, Guangxi	Twelve provinces (nine coastal): Beijing, Shanghai, Tianjin,		

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	(HK\$ 256 billion, consisting of HK 74.6 billion in cash from bond issuance and HK\$ 181.4 billion from new share issuance)	Guangdong, Jiangsu, Zhejiang, Fujian, Liaoning, Shandong, Anhui, Hebei, Hubei (IPO)		
2002	Eight central provinces: Anhui, Jiangxi, Chongqing, Sichuan, Hubei, Hunan, Shaanxi, Shanxi. (US\$ 8.573 billion)	Nine central and western provinces: Jilin, Heilongjiang, Jiangxi, Henan, Guangxi, Chongqing, Sichuan, Shaanxi, Xinjiang (HK\$ 4.523 billion)	Four coastal provinces: Guangdong, Zhejiang, Jiangsu, Shanghai (IPO)	
2003		Nine central and western provinces: Shanxi, Inner Mongolia, Hunan, Hainan, Yunnan, Gansu, Qinghai, Ningxia, Tibet (HK\$ 3.01 billion)	Six provinces: Anhui, Fujian, Jiangxi, Guangxi, Chongqing, Sichuan (RMB 46 billion)	
2004	Ten central and western provinces: Inner Mongolia, Jilin, Heilongjiang, Guizhou, Yunnan, Tibet, Gansu, Qinghai, Ningxia, Xinjian. Two companies: Beijing P&T Consulting & Design Institute Company Limited, China Mobile Communication Company Limited (US\$ 3.65 billion)		Nine provinces: Hubei, Hunan, Hainan, Guizhou, Yunnan, Shaanxi, Gansu, Ningxia, Xinjiang (RMB 27.8 billion)	Eight provinces (Seven coastal): Beijing, Liaoning, Hebei, Tianjin, Shandong, Henan, Shanghai, Guangdong (IPO)
2005				Four central provinces: Shanxi,

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				Inner Mongolia, Jilin, Heilongjiang (RMB 12.8 billion)
2007		One western province: Guizhou (RMB 880 million)		

* In 2002, Beijing reorganized assets in China Netcom and China Telecom, with the former operating in twelve provinces north of the Yangtze River and the latter in nineteen southern provinces.

Source: SEC, Form 20-F (annual report of 2004) of China Mobile (Hong Kong) Limited, https://www.chinamobileltd.com/en/ir/reports/ar2004/2004_20f.pdf, accessed December 11, 2021. SEC, Form 20-F (annual report of 2007) of China Unicom Limited, <https://www.sec.gov/Archives/edgar/data/1113866/000114554908001097/h02212e20vf.htm>, accessed December 11, 2021; China Telecom, Annual Report of 2004, <https://www.chinatelecom-h.com/en/ir/report/annual2004.pdf>, accessed December 11, 2021; SEC, Form 6-K of China Netcom Group Corp (Hong Kong) Ltd., <https://sec.report/Document/0001341004-06-000791/>, published March 21, 2006, accessed December 10, 2021.

Two reasons explain why the Hong Kong listing vehicle would purchase provincial assets in batches instead of injecting the assets from all thirty-one provinces at once for an IPO. The first reason came from the regional and interprovincial disparities in asset quality. Compared with the economically better-off eastern and southern coastal provinces, the central and western inland provinces usually lagged behind in economic development and infrastructural build-up. Therefore, shoehorning low-quality and non-profitable assets into a holistic IPO would not only delay the entire process, but also lower the overall asset evaluation, which would inevitably reduce the amount of money the IPO could draw.⁷ For instance, as Table 4.3 above shows, China Unicom's Hong Kong IPO was completed in 2000, but its last reverse merger and acquisition was not until 2007 when assets from the inland province of Guizhou were injected into the listing vehicle. In fact, after the previous batch of asset transfers in 2003, China Unicom disclosed to international

⁷ Ibid. pp. 54-5.

investors that the Guizhou-based company was expected to run losses, so it was excluded from the acquisition until it was profitable.⁸

The second reason was related to the regulatory rules governing listed companies on the HKSE. According to regulations, IPO-generated funding had to be retained in the listed company for at least six months before being transfer away.⁹ To channel the IPO proceeds back to the mainland, the Hong Kong listing vehicles would use the money to “buy” the remaining assets of the mainland provinces. For instance, China Mobile incorporated mobile assets from Guangdong and Zhejiang, initiated its IPO in October 1997 and generated US\$ 4.2 billion. The proceeds had to be retained in the Hong Kong listing vehicle until April 23, 1998.¹⁰ To “withdraw” the proceeds, China Mobile (Hong Kong) “dispensed” US\$ 2.9 billion of its US\$ 4.2 billion proceedings on June 4, 1998 to “acquire” complete ownership interest of Jiangsu Mobile. The same strategy was adopted again two years later. In 2000, China Mobile raised another US\$ 32.8 billion using share placements worth US\$ 10.2 billion and the issuance of new shares from global investors, which was worth US\$ 22.6 billion.¹¹ This money was subsequently used to “merge” mobile assets from seven provinces, as shown in the table above. Through these two transactions, China Mobile (Hong Kong) reassembled and controlled the mobile business in China’s thirteen most prosperous provinces.

⁸ Gu, Ying. “Liantong 8.8yi zhuanrang zuihou yisheng zichan, zhengtishangshi xuangao wancheng” [Unicom spent 880 million to transfer the last province’s assets, a holistic listing is complete], *Sohu*, <https://it.sohu.com/20071117/n253307352.shtml>, published November 17, 2007; accessed December 11, 2021.

⁹ Despite being a dual listing, the HKSE is the major listing destination, and shares traded in NYSE were based on the American depositary receipt (ADR), which allowed American investors to buy stock in overseas listed companies.

¹⁰ Benshu Bianxie Zu (BSBXZ), *Yangqi haiwaishangshi diyigu – 0941.HK shangshi shimo* [No.1 of the Central-state owned and Overseas Listed Stock – A history of 0941.HK’s IPO], Beijing: Renmin Youdian Chubanshe, 2012. p.88

¹¹ China Mobile, Annual Report of 2000, <https://www.chinamobileltd.com/en/ir/reports/ar2000.pdf>, accessed December 11, 2021.

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As Table 4.3 shows, all four of China's state-owned telecom services providers had adopted the strategy of post-IPO mergers and acquisitions. In that way, the ODFF contributed much to the corporatization reforms of China's telecom SOEs. As one telecom journalist insightfully pointed out,

[t]he post-IPO Chinese telecom oligopolies [...] basically all used the funding they raised to purchase their parent company's core assets, and then the parent company used the money to settle down laid-off personnel and deal with non-performing assets. This has become a new cycle in China's SOE restructuring.¹²

Notably, how exactly the colossal amount of funding raised from international financial investors was spent was unknown to the public because, as Diagram 4.1 shows, the funding was channeled back to mainland parent companies through BVI-registered shell companies – private and unlisted entities that were not required to disclose its financial statements.¹³ In other words, the China-based parent company could use the funding for purposes that were not always consistent with what had been openly stated in the IPO Prospectus. For instance, before its 1997 IPO, China Mobile (Hong Kong) told international investors that approximately US\$ 2 billion from the IPO proceeds would be used to “fund a portion of the planned expansion of the group's cellular networks in Guangdong and Zhejiang,” with the development of a “new management information system and billing, as well as new clearance and collection systems,” meaning the funding needs could eventually increase to “US\$ 3.4 billion from 1997 until the end of 2000”.¹⁴ However, as the case study on this IPO deal will show, the US\$ 2 billion was actually spent for a political mission that the company was entrusted with.

¹² Xing, Linchi. “Zhongguo dianxin IPO Shijian Zhihou” [After China Telecom's IPO Event], *Jingji Guancha Bao* [Economic Observer], reposted by Sina, <https://tech.sina.com.cn/it/t/2002-11-18/1139150447.shtml>, published November 18, 2002, accessed December 10, 2021.

¹³ Walter and Fraser, *Red Capitalism*, p.181.

¹⁴ SEC, China Mobile IPO Prospectus, 1997, Section “Capital Expenditure Program” p.5, and “Use of Proceeds,” p.9.

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4.2 Filtering Out Foreign Control: The Usage of the Numerical Equity Cap and Personnel Appointment

So how did the “Red Chip” strategy guarantee that foreign investors would not gain control of the legally and nominally “foreign” listed company? Two mechanisms were designed to achieve this goal. The first mechanism was the numerical equity cap. As Table 4.1 shows, only a maximum of 25% of the total shares were publicly circulated for international purchase, with the rest being held by the Chinese central state. This design effectively made none of the financial investors strong enough to influence corporate decision-making. The numerical equity cap was particularly effective at restraining multinational telecom companies that attempted to seep into the Chinese market by gradually increasing their holdings in “Red Chip” companies.

Let us take China Mobile’s share issuance in 2000 to global investors as an example. As they were not exclusive to industrial investors, China Mobile’s newly issued stocks attracted interest from foreign telecom operators such as Nippon Telegraph and Telephone (NTT), the Japanese multinational that left China Unicom’s CCF project earlier that year, and Deutsche Telecom, the German industrial giant. However, a much heavier deal came from Vodafone, the world’s largest mobile phone services company at that time, which invested US\$ 2.5 billion and acquired 2.5% of China Mobile’s (Hong Kong) aggregate stocks. This ambitious move, as revealed by the British telecom giant’s Chief Executive Officer (CEO) Chris Gent, was that in the future Vodafone wished to get more shares if Chinese regulators approved them, and could gradually increase its holdings to as much as 15-20%,¹⁵ thus eventually making itself a more influential player in the Chinese telecom market. Reflecting on this strategy, Vodafone doubled down its

¹⁵ Landler, Mark. “Vodafone in \$2.5 Billion Deal with Chinese Mobile Concern.” *New York Times*, <https://www.nytimes.com/2000/10/05/business/world-business-vodafone-in-2.5-billion-deal-with-chinese-mobile-concern.html>, published October 5, 2000, accessed December 11, 2021.

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ambitions and efforts in May 2002 by spending another US\$ 750 million to further its holdings, thus increasing its stocks in China Mobile (Hong Kong) to 3.3%.¹⁶

In fact, the decision to hold a minority stake in its Chinese competitor's listing vehicle and gradually increase the holdings already reflected Vodafone's pessimistic outlook on entering China through FDI and obtaining an operating license in China – an issue that will be more thoroughly discussed in Chapter 6. For the British telecom giant, state-owned oligopolistic operators would still control the Chinese market in the mid-term or even the long-term.¹⁷ But even casting itself as a “junior partner” by holding minority shares in China Mobile (Hong Kong) still did not earn Vodafone any influence in corporate matters. The British company was not entitled to nominate or appoint board members,¹⁸ and inside Mainland China, this strategic partnership was limited to the “swapping of research and technical expertise.”¹⁹ When Vodafone decided to sell all its shares in China Mobile (Hong Kong) in 2010, its holdings still hovered around 3.3%, far less than the 15-20% that it had hoped for.²⁰ However, as a financial investor that held China Mobile (Hong Kong)'s stocks for a decade, Vodafone's gains had doubled.²¹

Additionally, the state control over the listed assets and the Hong Kong listing vehicle was doubly secured by the stipulations of company charters, to the effect that the composition of the listed Hong Kong company's board of directors would be entirely nominated by the parent

¹⁶ Hayday, Graham. “Vodafone ups take in China Mobile”, *ZD Net*, <https://www.zdnet.com/article/vodafone-ups-stake-in-china-mobile/>, published May 17, 2002, accessed December 11, 2021.

¹⁷ *ChinaByte*, “Zhongguo yidong bangshang wodafeng yiyuweihe?” [What motivated China Mobile to work with Vodafone], <http://tech.sina.com.cn/it/telecom/2000-10-08/38374.shtml>, reposted by Sina October 8, 2000, accessed December 12 2021.

¹⁸ China Mobile, Annual Report of 2000, p.13

¹⁹ BBC News, “Vodafone gains China foothold,” <http://news.bbc.co.uk/2/hi/business/956131.stm>, published October 4, 2000, accessed December 12, 2021.

²⁰ Wu, Min. and Cong Tian, “Wodafeng paoshou zhongyidong gupiao, touzi shinian shouyi fanbei” [Vodafone sold its stocks in China Mobile, doubling gains after ten years' investment], *Xinjing Bao* [The Beijing News], <http://news.sohu.com/20100909/n274810197.shtml>, reposted by Sohu September 09, 2010, accessed December 12, 2021. The price that Vodafone sold its holdings at was between HK\$ 79.2 and 80 per share in 2010, while the purchasing prices were much lower at only HK\$ 48 in 2000, and HK\$ 24.7 in 2002.

²¹ Ibid.

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company in Beijing, and that the parent company could also “indirectly influence the selection” of the listed company’s management.²² In this regard, all “Red Chip” listed telecom oligopolies exhibited a similar twin-governing structure, with the board members of the Beijing-based parent corporations concomitantly serving in the Hong Kong listings’ board of directors and occupying the position of executive director(s).

Let us take China Netcom as an example. As Table 4.4 shows, executive directors in the Hong Kong-based company simultaneously held leadership positions at the Beijing headquarter. Although the Hong Kong-listed company had nine non-executive directors, some of whom were not Chinese nationals,²³ the IPO Prospectus made it clear that the “board of directors would function independently of China Netcom,” and that “the senior management of the operating subsidiaries within China Netcom and us [China Netcom’s Hong Kong listing] would be independent of each other.”²⁴ In other words, the operation and management of Netcom’s mainland assets were still controlled by the group company.

Table 4.4 Executive Directors of China Netcom’s Hong Kong Listing and their Positions in the Beijing Parent Company at the Time of IPO

	Position in the Listed Company	Position in the Parent Company
Zhang Chunjiang	Executive Chairman of the Board of Directors, Executive Director	President
Leng Rongquan	Vice Chairman, Non-Executive Director	Vice President
Tian Su’ning	Executive Director, Chief Executive Officer	Vice President
Zhang Xiaotie	Executive Director and Joint Company Secretary	Vice President
Miao Jianhua	Executive Director	Assistant to President

Source: SEC, Form F-1 (China Netcom’s IPO Prospectus), p.129

²² China Mobile, Annual Report of 2000, p.123

²³ Two notable figures are Keith Rupert Murdoch, the Australian-American billionaire and media mogul, and John Thornton, a veteran investment banker at Goldman Sachs from 1980 to 2003. SEC, Form F-1 (China Netcom’s IPO Prospectus).

²⁴ Ibid.

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Due to such stipulations, non-executive directors from investing foreign businesses who bought Netcom's shares could not influence corporate decisions. In June and September 2005, the Spanish telecom company Telefonica twice acquired a total of 4.97% of China Unicom's shares.²⁵ The transactions made Telefonica CEO Jose Maria Alvarez-Pallete a non-executive director and a member of the Strategic Planning Committee of China Netcom's Hong Kong listing vehicle.²⁶ However, non-executive members of the Hong Kong listing vehicle, unlike executive members, were not considered directors of the mainland-based China Netcom, and therefore, corporate control remained in Beijing.

4.3 Capitalist Instruments in Authoritarian Hands: Forging Centralized Telecom National Champions

Another benefit of having the partial overseas listing followed up by a reverse merger and asset acquisition from the mainland was that Beijing could, with the help of foreign cash, consolidate the previously provincially-owned and -operated industrial assets into centralized national champions that were owned and controlled by the central authority. In this regard, the central state's interests were aligned with those of the global financial elites. Since the valuation of a company that had yet to be listed was a determining factor of how much money an IPO could bring back, the central state's involvement in the pre-IPO recapitalization and reorganization stage was essential and even desirable. State-initiated asset reorganization could turn a company's losses into something much more promising for international investors.

For instance, China Unicom bringing back US\$ 5.6 billion in its 2000 IPO was inseparable from Beijing's asset reallocation. As Chapter 3 showed, China Unicom was

²⁵ Sun, Jin. "Xibanya dianxin yu zengchi zhongguowangtong zhi 10%" [Telefonica intends to increase holding in China Netcom to 10%], *Diyi Caijing Ribao* [China Business Network Daily], <http://tech.sina.com.cn/t/2007-11-01/02371825720.shtml>, posted by Sina November 1, 2007, accessed December 12, 2021.

²⁶ HKSE, Annual Report of China Netcom Group Corporation (Hong Kong) Limited in 2005, <https://www1.hkexnews.hk/listedco/listconews/sehk/2006/0403/00906/ewf108.pdf>, accessed December 12, 2021.

weak and debt-ridden during its CCF epoch when it was co-owned by sixteen ministries, SOEs, and local governments, but the situation quickly changed when China's central state intervened and became the major shareholder. On April 14, 1999, Vice Premier Wu Bangguo, who oversaw China's SOE reform and the telecommunications sector, chaired a special meeting on Unicom's restructuring as instructed by his boss Zhu Rongji. The meeting decided to transfer RMB 1 billion of the 100 billion in state treasury bonds issued in 1998 as the central state's share in Unicom.²⁷ At the same time, Wu Jichuan, head of the Ministry of Information Industry (MII), ordered China Mobile (Hong Kong) chairman Wang Xiaochu to collect US\$ 500 million, the equivalent of RMB 4 billion, for Unicom by selling his company's shares in Hong Kong Telecom. Wu then handed China Mobile's money over to the Ministry of Finance (MoF) as the central state's stake in Unicom. Beijing also merged Guoxin, China's largest paging company and a China Telecom subsidiary with a net asset of RMB 6.9 billion, into China Unicom.²⁸ With the injection of Guoxin's paging assets, Unicom's nationwide paging services market share "boomed" from 3.2% to 63.2% – the result of just one policy document. Additionally, China Telecom was ordered to hand its Code Division Multiple Access (CDMA) 2G cellular program over to Unicom, and the military was asked to hand over all its commercial networks, numbers, and frequencies to Unicom.²⁹

As Table 4.5 shows below, the CCF assets, along with the other fifteen ministries, local governments, and SOEs' shares were no longer the core Unicom asset after this state-

²⁷ Wang, Shuangxi. "Huigu zhongguo liantong de gaige he shangshi" [Revisiting China Unicom's Reform and IPO], *You dian jing ji* [Economics of Post and Telecom], 4(2017), 54-64. p.55.

²⁸ Running China's pager business, China Guoxin Paging Corporation was stripped from China Telecom in September 1998. By the end of 1998, it had a total assts of RMB 16.8 billion, net assts worth RMB 6.9 billion, RMB 9 billion in revenue, and a total profit of 1.36 billion. *Ibid.*, p.55.

²⁹ *Ibid.*, pp.55-6

initiated re-capitalization. According to Unicom’s chairman at the time of IPO, “after the recapitalization, the debt-asset ratio was significantly lowered from 86% to 75% with the net profit rising to RMB 840 million, thus paving the road for fundraising through listing.”³⁰ Unicom’s headquarters used the IPO raised funds to buy all the CCF assets and reorganize the company structure. Under the new system, the local affiliated companies were weakened. Major decision-making and the power to personnel appointment was instead taken to the Beijing headquarter, thus granting the parent company a “concentrated, unified, and highly efficient governing framework.”³¹ In addition to the concentration of ownership from local to central level, fragmented local shareholders were diluted with central state ownership under the MoF.

Table 4.5 Unicom’s Post-Recapitalization Ownership Structure by the End of 1999

Owner	Assets	Cash Equivalence	Percentage of Shareholding
Central state investment through Ministry of Finance	Merger of Guoxin’s net asset	RMB 6.9 billion	79%
	Gains from selling China Telecom’s share in Hong Kong Telecom	US\$ 500 million	
	State treasury bond	RMB 1 billion	
	Return of Unicom’s connection fees	RMB 700 million	
Original sixteen shareholders’ owning		RMB 3.3 billion ***	21%
Total		RMB 15.9 billion	100%

³⁰ Hu, Shuli and Jiwei Zhang. “Shangshi Guilai Hualiantong – Zhuanfang Zhongguo Liantong Gufen Youxian Gongsi Dongshizhang Yang Xianzu” [Talking About Unicom after Its Initial Public Offering – Special Interview with China Unicom Joint-Stock Company’s Chairman Yang Xianzu], *Caijing*, <https://magazine.caixin.com/2000-07-05/100562756.html?sourceEntityId=100567967>, published July 5, 2000, assessed April 27 2020.

³¹ Ibid.

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Source: Hu and Zhang, “Shangshi guilai hua liantong,” July 5, 2000; Liao, Wenyan. “Liantong ruhe Tupo Ziben Guanzhi” [How did Unicom break “Capital Control], *Keji Zhinang* [Science and Technology Think Tank], 6(2005), 76-9.

*** This number was increased from the original sixteen shareholders’ investments of RMB 1.34 billion in 1994 when China Unicom was established.

The centralization of corporate management to Beijing headquarters was also achieved through *personnel* appointment. Let us take China Mobile as an example. As the case study below will show in more detail, the Hong Kong-domiciled company that China Mobile listed in 1997 was more of a public face and fundraising vehicle. Since the listed mobile assets were still managed by post and telecommunications administrations (PTAs) in Guangdong and Zhejiang, Vice Chairmen Cui Xun and Hu Wangshan were also the Director Generals of the Guangdong and Zhejiang provincial post and telecom administrations.³² At the time of the IPO in 1997, the Beijing-based parent company was in a weak position as mobile assets had been largely decentralized into the hands of provincial PT authorities.

With the further corporatization of the PT system and more provincial telecom assets being injected into China Mobile (Hong Kong) in the following years, the listed company took over certain parts of the management of provincial assets, even eclipsing the parent company’s power. This split into two separate leadership frameworks between the listed Hong Kong company and the parent company enticed power grabbing as the listed company’s leadership could convene with the heads of provincial companies to make corporate decisions, thus reducing the power of the parent company in Beijing. In fact, after the 2002 round of reverse acquisitions in provincial assets, about 70-80% of mobile businesses owned by China Mobile were transferred to the listed one in Hong Kong, with the remaining low-profit businesses in the western and inner regions of China still nominally reporting to Beijing headquarters. This scenario practically made Wang Xiaochu,

³² SEC, China Mobile’s IPO Prospectus, pp.86-7.

the chairman and CEO of China Mobile (Hong Kong) and vice deputy manager of the parent company, more powerful than his boss Zhang Ligui, who was general manager and party secretary of China Mobile in Beijing. But due to the Beijing-based parent company's power in appointing personnel, Zhang Ligui and two of China Mobile's deputy managers entered their Hong Kong listed company's board of directors in March 2003, replacing three members who were the chairmen and general managers of provincial companies in Fujian, Henan, and Hainan, where provincial assets had been acquired in 1999.³³

Telecom analysts interpreted the personnel reshuffle as a reorganization of the institutional relationship between the listed company and the parent one, which reduced the Hong Kong company's management over mainland assets and substituted it with control from the Beijing-based parent company.³⁴ It was found that chairman and CEO Wang Xiaochu's portfolios were broken down into each deputy's hands. Vice president and executive director Li Yue was in charge of assisting Wang in network planning, while vice president and executive director Lu Xiangdong assisted Wang in market operations, data management, billing and settlement and corporate cooperation matters.³⁵ With this personnel reshuffle, financial statements from the provincial companies were hence delivered to the Beijing rather than Hong Kong, and major decisions on corporate strategy and personnel appointment were also retained by the parent company. The Hong Kong company thus went back to being the public face of its parent company, although financially speaking, it was an independent company.

³³ Zhang Liang. "Zhongyidong 'jiquan'" [China Mobile's "Power Centralization"], *Caijing*, April 20, 2003, <https://magazine.caixin.com/m/2003-04-20/100080840.html>, reposted in *Caixin*, accessed December 13, 2021.

³⁴ *Ibid.*

³⁵ China Mobile, Annual Report of 2003, <https://www.chinamobileltd.com/en/ir/reports/ar2003.pdf>, accessed December 14, 2021. p.6

4.4 When Socialist Technocrats Became “Red” Millionaires: Overseas Listing for Personal Wealth Accumulation

The section above shows that “Red Chip” listing helped to forge unified national champions. Even though, issuing stocks overseas was a time-consuming and expensive process. Even Wu Jichuan, minister of the MPT and its successor the MII, once said that he did not encourage all telecom operators to initiate IPO overseas.³⁶ According to Wu, China’s changing domestic stock market was a good alternative, as high-growth telecom shares would also be available for investors inside China.³⁷ But in addition to creating a unified national champion, the “Red Chip” foreign listing strategy offered another benefit that the underdeveloped Chinese domestic capital market lacked, which was allowing socialist cadres in Chinese telecom regulators to become entrepreneurs remunerated on a capitalist standard through incentive share/stock options (ISOs).

Share option is a financial strategy that provides the holder the *right* (but not the obligation) to buy company shares at a *certain* price during a *certain* period of time in the future. Allowing holders to buy company-issued shares at a discounted price with additional benefits such as possible tax breaks, ISOs are widely used as a corporate benefit offered to key managers and employees, motivating them to work harder, boost company performances, jack up stock prices, and reward themselves on top of salaries. In return, the gains will be the gap between the discounted exercise/buying price and selling price. However, as the paragraphs below will show, unlike a well-established company with proven managing records, the leaders of Chinese “Red

³⁶ *Sohu News*, “Wu Jichuan renwei zhongguo dianxin yunyingshang yinggai zai guonei shangshi” [Wu Jichuan thinks that Chinese telecom operators should initiate IPO domestically], <https://business.sohu.com/05/80/article13828005.shtml>, published January 11, 2002, accessed December 15, 2021.

³⁷ Chen, Xunyan. “Zijin quekou yuelayueda, rongzi jiancheng dianxin redian” [Funding gap became larger and larger, fundraising became a hot issue for telecom industry], *Tongxin Xinxin Bao* [*Communication and Information Daily*], February 27, 2002, <http://tech.sina.com.cn/it/t/2002-02-27/104442.shtml>, reposted in Sina, accessed December 15, 2021.

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Chip” listed telecom national champions, who were appointed by the Chinese state, discretionally used ISOs as a self-rewarding tool. As all of the four Hong Kong-listed companies’ IPO Prospectuses revealed, no performance targets were specifically stipulated under the share option plan. The listed company’s board had the liberty to specify performance targets that could be achieved before an option could be exercised, while the period during which an option could be exercised was also determined by the directors at their discretion.

Let us use a concrete example from China Mobile (Hong Kong) to show how the ISOs helped to turn socialist technocrats to “red” millionaires. The ISO scheme was first introduced in China Mobile’s November 1997 dual listing on HKSE and NYSE. According to its IPO Prospectus, the company’s directors had the discretion to invite “employees, including executive directors of the company or any of its subsidiaries, to take up options to subscribe for shares,”³⁸ and the maximum percentage of shares that they could subscribe to was 10% of the total issuance, or at a price of HK\$ 1.00 per share, which was far lower than the IPO issuing price of HK\$ 11.80.³⁹ To put it differently, the directors were able to decide who could buy the issued shares and when they could buy it. Moreover, the exercising of the share option plan did not have any conditions on the company’s performance.

As Table 4.6 below shows, officials from the PT system predominantly manned China Mobile’s Hong Kong listing vehicle. They were assigned to “lead” the empty vehicle after a decision made by the MPT leadership. In March 1998, options exercisable for an aggregate of 12 million shares were unevenly self-granted to six board members of the Hong Kong-listed company based on the ISO scheme established in the 1997 IPO. Such options would be exercisable at a price

³⁸ SEC, China Mobile’s IPO Prospectus, p.88.

³⁹ Ibid.

of HK\$ 11.10 per share over a six-year period between March 9, 1998 and March 8, 2006.⁴⁰ No grantees exercised their rights in 1998, but on April 20, 1999, barely a year and a half after their appointments to China Mobile's Hong Kong listing, Shi Cuiming and Chen Zhaobin were assigned to other positions by the newly restructured MII.⁴¹ Before their departures, both exercised options to purchase 2.9 million and 2.6 million in ordinary shares respectively. They had been self-granted in 1998 at the exercise price of HK\$ 11.10 per share, but the market value had reached HK\$ 15.15 at the time of selling. As a result, Shi and Chen managed to put HK\$ 11.745 million and HK\$ 10.53 million into their own pockets respectively and became millionaires despite having held leadership positions for a mere 18 months at a shell company primarily established for fundraising purposes.⁴²

Table 4.6 Selective List of Top Leadership in China Mobile's Hong Kong Listing Vehicle (1997) *

	Administrative Positions held before joining China Mobile (Hong Kong)	Positions at China Mobile (Hong Kong)
Shi Cuiming	Director of the Department of Finance of the MPT	Chairman, CEO
Chen Zhaobin	Director and Vice President of the MPT-owned Telpo Communications Group Ltd.	Vice Chairman, President
Li Ping	Deputy Director General of the Directorate General of Telecommunications (DGT)**, in charge of the DGTs' international, cellular mobile and satellite business sectors	Vice Chairman, Executive Vice President, Chief Operating Officer
Cui Xun	Director General of the Guangdong PTA	Vice Chairman
Hu Wangshan	Director General of the Zhejiang PTA	Vice Chairman
Ding Donghua	Chief Economist and Chief Accountant of the Guangdong PTA	Director, Chief Financial Officer
Lu Errui	General Manager of Guangdong Mobile	Director, Vice President in charge of Guangdong Mobile
Zhu Jianhua	General Manager of Zhejiang Mobile	Director, Vice President in charge of Zhejiang Mobile

⁴⁰ SEC, Form 20-F of China Mobile, 1997, https://www.chinamobileltd.com/en/ir/reports/ar1997/1997_20f.pdf, accessed December 15, 2021.

⁴¹ As Chapter 3 showed, Shi Cuiming was assigned to help with China Unicom's overseas IPO.

⁴² The math is: (HK \$ 15.15-11.10) * number of shares

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Zhu Min	Director of the Corporate Finance Division of the MPT's Finance Department	Controller, Accounting Officer	Principal
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* Two Hong Kong citizens, Antony Leung Kam Chung and Arthur Li Kwok Cheung also held the roles of directors. Both came from the banking industry and held roles in preparatory committees of the Hong Kong Special Administrative Region's government that was to be officially formed after the July 1, 1997 retrocession

** DGT and China Telecom was one organization with two names. They were established by and under the control of MPT in 1995.

Source: SEC, IPO Prospectus of China Mobile, p.87

For those who stayed longer and exercised their options when the stock price of China Mobile (Hong Kong) was higher, the gains were much more staggering, as was the case of Li Ping. As Table 4.7 below shows, Li was granted a total of 38 million shares of option three times and at three prices from March 1998 to April 2000. In August 2000, shortly before being transferred to a new leadership position at the restructured China Telecom, he exercised all his options when the company's market prices skyrocketed to HK\$ 58.75 per share. Li spent a total of HK\$ 76.34 million to exercise the rights of granted shares worth HK\$ 223.4 million -- although it is unknown where this colossal amount of money that far surpassed his salary came from. We do not know what the legal salary of an MPT official was in the late 1990s, but a shadow comparison is that at the eve of Unicom's overseas IPO in June 2000, according to Unicom's Chairman Yang Xianzu, a top executive's salary was less than RMB 10,000 (roughly US\$ 1,208 and HK \$ 9,346) per month.⁴³ The transaction brought Li back a startling personal gain of HK\$ 147 million (US\$ 27.93 million) – an amount ten times higher than what Shi Cuiming and Chen Zhaobin had reaped a year ago.⁴⁴ From an annual income of roughly US\$ 12 thousand in the capacity of a telecom bureaucrat

⁴³ Wen, Xiu. and Shuliang Ming. "Dingjia hongse qiyejia" [Pricing the "red entrepreneurs"], *Caijing*, June 23, 2008, <https://magazine.caixin.com/m/2008-06-23/100080499.html>, reposted by *Caixin*, assessed December 14, 2021

⁴⁴ The math is: HK\$ 58.75*3,800,000 - [HK\$ 11.10*2,400,000 + HK\$ 33.91*(600,000*2) + HK\$ 45.04*(100,000*2)]

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to a one-off reward of US\$ 27.93 million, all thanks to the position of a capitalist manager of a shell company.

Table 4.7 Li Ping's Granted and Exercised Share Options in China Mobile (Hong Kong)

Date of option grant	Period during which options are exercisable	Price per share to be paid on exercise of options (HK \$)	Number of shares granted
March 9, 1999	March 9, 1998 to March 8, 2006	11.10	2,400,000*
November 26, 1999	November 26, 1999 to October 7, 2007	33.91	600,000
	November 26, 2002 to October 7, 2007		600,000
April 25, 2000	April 25, 2002 to October 7, 2007	45.04	100,000
	April 25, 2002 to October 7, 2007		100,000

* In addition, at 30 June, 1998, Li Ping held 100 ADRs (2000 ordinary shares) that are not included in the granted option.

Source: China Mobile's IPO Prospectus and annual reports in 1998, 1999, 2000.

Li's "inspiring" story and the lust of the ISO was not unique, as it was prevalent in all of the "Red Chip" listed telecom SOEs. Many of Li's former MPT comrades followed his steps and benefitted from the ISOs. One of them was Wang Jianzhou. Having served as the Director General of the Department of Planning and Construction in the MPT since 1996 and later as the Director General of the Department of General Planning in the MII starting in 1998, Wang was one of the two hundred MPT cadres that Yang Xianzu brought to Unicom. As Chapter 3 mentioned, Wang led the brutal terminations of CCF projects and the harsh treatments of their foreign investors. In November 2004, after working in China Unicom for three years, Wang was transferred by the Organizational Department of the Central Committee of the Chinese Communist Party (CCP) to China Mobile, holding three roles in the Beijing parent company as General Manager, Party Group Secretary, and Chairman of the listed Hong Kong company. A month later, Wang obtained 600 thousand shares of options through China Mobile's share option incentive plan, and then acquired more in the following year. He exercised the rights twice on a small scale and gained HK\$ 3.3

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million.⁴⁵ On October 29, 2007, Wang's accumulated share options on paper climbed to a colossal HK\$ 173.99 million when China Mobile's share price reached a historical zenith of HK\$ 158.9 per share.⁴⁶

China's top leadership was fully aware of the socialist technocrats, or politicians-turned-capitalists, being rewarded handsomely by self-granted ISOs from empty listing vehicles on international capitalist markets. However, Beijing endorsed and encouraged the use of ISOs as a lubricant to speed up reforms in its state-owned enterprises. In 1999, the Fourth Plenary of the Fifteenth Central Committee of the CCP convened and passed a clearly worded endorsement of the SOEs' ISO, with the meeting resolution stating that "managers should not only get due material rewards, but also receive due honors for their dedication. A small number of companies have experimented with an annual manager salary system that includes share options. This can be carried out further on a trial basis, but should not be encouraged for nationwide application for the time being."⁴⁷ This document was hence extensively referenced in share option incentive plans designed by centrally state-owned enterprises.⁴⁸ A policy document issued by three ministries in 2001 further promoted the issuance of stock options in "Red Chip" foreign listed companies by stipulating that "technological personnel with special contributions could be incentivized with shareholding through technical achievements, share awards, and share options." For business observers, the policy document seemed to only stipulate "scientific and technical personnel" (*keji renyuan*), but in reality, it "made an overall breakthrough for the implementation and consolidation

⁴⁵ Wen and Ming, "Dingjia hongse qiyejia," 2008.

⁴⁶ Ibid.

⁴⁷ CCP Central Committee, "Gaunyu guoyou qiye gaige he fazhan ruogan zhongda wenti de jue ding" [The Decision of the Central Committee of the CCP on Major Issues Concerning The Reform and Development of SOEs]. <http://english.mofcom.gov.cn/aarticle/lawsdata/chineselaw/200211/20021100053897.html> published September 22, 1999, accessed December 15, 2021.

⁴⁸ Wen and Ming, "Dingjia hongse qiyejia," 2008.

of share options.”⁴⁹ The political report from the CCP’s Sixteenth National Congress in 2002⁵⁰ stipulated that “factors of production, such as technology and management, could also be considered as a means of distribution.”⁵¹ However, the truth is that, according to an official from the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), a ministry-level agency created in 2003 to oversee state assets, “the standard of incentive compensation/pay was largely decided by the SOEs’ leadership.”⁵²

The green light from China’s top leadership enticed rampant ISO exercising in “Red Chip” listed companies. As for China Mobile (Hong Kong), no board members and high executives exercised their share options in 2001, but an unspecified number of employees spent more than HK\$ 346 million on exercising their option rights, which had a market value of HK\$ 396 million and thus gained them a total of HK\$ 50 million.⁵³ The same trend continued in 2002 when 210 million shares of option were exercised at a price of HK\$ 11.10 each and sold at the market price of HK\$ 28.85, bringing back HK\$ 24.67 million for employees granted with such privileges.⁵⁴

The ISOs introduced through “Red Chip” listed telecom SOEs were essentially the company-provided perks that were allocated in a top-down authoritarian way. According to a business journalist, share options were “a topic that concerned every person in the Chinese SOEs

⁴⁹ The State Council of the People’s Republic of China, “Guanyu Shenhua Guoyouqiye Neibu Renshi Laodong Fenpei Zhidu Gaige de Yijian” [Opinions on Deepening Personnel, Labour, and Distribution Reforms in State-owned Enterprises], http://www.gov.cn/gongbao/content/2002/content_61946.htm, published March 13, 2001, accessed December 15 2021.

⁵⁰ The CCP Party Congress was usually where the platform for the next five years was laid out. For more information on the importance of the political report and CCP’s Congress, see Wu, Guoguang. *China’s Party Congress: Power, Legitimacy, and Institutional Manipulation*. Cambridge, United Kingdom: Cambridge University Press, 2015.

⁵¹ Jiang Zemin, Full Text of Jiang Zemin’s Report at 16th Party Congress on November 8, 2002., *China Daily*, http://language.chinadaily.com.cn/news/2013-11/26/content_17132209.htm published November 26, 2013, accessed December 15 2021.

⁵² Wen and Ming, “Dingjia hongse qiyejia,” 2008.

⁵³ Ibid.

⁵⁴ Ibid.

listed overseas, but was a huge taboo in public.”⁵⁵ When and how to distribute share options was “highly classified”, and one new recruit in China Mobile was warned by their superiors not to discuss the issue -- “when the time is right, the company leadership will talk to you. Before that, do not concern yourself with it, and do not prick about others’ share option situation.”⁵⁶ In the annual shareholder meeting of June 2002, China Mobile repealed the old option incentive plan from 1997 and promoted a new one that met the new HKSE listing requirements from 2001. Compared to the previous one, the new plan involved more beneficiaries and put fewer constraints on exercisable periods. The beneficiaries of ISO expanded from top directors and executives to leaders and employees in provincial companies. For instance, options were enlarged to local affiliates based on three hierarchical levels: the first level applied to general managers in local companies, the second level referred to these local companies’ departmental heads, and the third level applied to project managers.⁵⁷

Opaque and hierarchical ISO allocation can also be found in other telecom SOEs. The State Council set China Unicom’s IPO in 2000 as a pilot program on ISOs. Around 200 people, including board members, executives, and heads of provincial affiliates, were given share options worth US\$ 156 million, or 0.6% of the total shares, for a lock-up period of two years, after which share options could be fully exercised in five years.⁵⁸ However, the generous and exclusive perks reserved for high executives did not spill over to Unicom’s 30 thousand employees at the eve of its IPO, for the State Council had denied the proposed employee stock ownership plan (*Quanyuan Chigu Jihua*). Instead, Unicom used “virtual options” for general employees, creating a savings plan that

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ Ibid.

⁵⁸ Hu and Zhang, “Shangshi guilai hua liantong,” July 5, 2000. According to the HKSE’s regulations, the percentage of share option should not exceed 10% of the total capitalization, and the first allocation should not exceed 2%.

allowed employees to save no more than 40% of their monthly pay into a two-year savings account that the company opened for them. Like its two predecessors, China Netcom, which initiated the IPO in 2004, further enlarged the beneficiaries of the ISO by granting 2.46% of the issued share capital to 456 grantees that included “directors and members of our middle-to-senior management,” with the post-IPO share option price being “determined by our board directors in its discretion.”⁵⁹

The SASAC disallowed SOEs under its purview to grant share options in 2006. However, it did not even know how many share options the state-controlled and “Red Chip”-listed companies had issued and exercised. Thus, SASAC launched an investigation in China Mobile. According to a media report, the entire company used HK\$ 1.66 billion in 2007 for exercising ISOs, and if sold immediately, the total gains could reach HK\$ 4.23 billion.⁶⁰ According to sources inside China Mobile, the company had been touching base with the SASAC throughout 2006 and lobbied on its ISO-related policies. It also demanded employees to muzzle themselves and not to divulge the SASAC’s attitude towards or practice on the issue in order to avoid any impromptu remarks that would cause “everyone to lose their money in the end.”⁶¹

Allowing “red” capitalists to put profits generated from nominally state-owned assets floated on international stock markets into their own pockets, this is the magic of incentive share option.

4.5 Case Study: Four Birds with One Stone, China Mobile’s 1997 Pioneering IPO⁶²

As mentioned in Chapter Three, China’s telecommunications industry was monopolized by the MPT and its local affiliates as both regulators and operators until the mid-1990s. However,

⁵⁹ SEC, Form F-1, China Netcom IPO Prospectus, 2004. p.136.

⁶⁰ Wen and Ming, “Dingjia hongse qiyejia,” 2008.

⁶¹ Ibid.

⁶² When listed in October 1997, the company was still called China Telecom, but with mobile assets from two

Zhu Rongji's rising influence in the economic portfolio and his acceleration of SOE reforms in 1993 challenged these privileges. Beijing carried out fiscal and taxation reforms that rescinded many favorable policies the MPT had enjoyed support from for decades, substantially disturbing the MPT system's financing composition. Meanwhile, the provincial telecom authority's surcharge was gradually cancelled, with loan quotas and foreign loans in particular being subjected to the state's overall external debt limit.⁶³ At the other end, mounting competitive pressures came from the newly founded SOE China Unicom, which used the CCF model to mobilize foreign investment and build the most advanced 2G cellular technologies.

On the foreign front, the MPT established Telpo Communications Group Ltd. in July 1993, registering it as a private company in Hong Kong to attract foreign equipment vendors for China's telecommunications network in coastal provinces.⁶⁴ But by August 1996, three years after its foundation, Telpo had only collected US\$ 170 million for China's telecom infrastructure build-up, a miniscule amount for a massive country like China. Additionally, approvals from multiple ministries were required for approval, and many supporting documents had to be submitted; collecting signatures would sometimes take an entire day.⁶⁵

Domestically, the MPT persuaded local PTAs to allow other domestic entities to participate in joint financing for the construction of networks, recover its costs, and share a certain return on the condition that the investors did not operate the network.⁶⁶ In September 1994, the MPT advised

provinces. It was only in 1999 that the name was changed to China Mobile. However, to authentically represent historical facts, this section uses China Telecom.

⁶³ Shi Cuiming, "Shixing Lianhe Touzi, Jiakuai Tongxin Fazhan" [Carrying out joint handed investments, speeding up telecommunication development], *"Tongxin Qiye Guanli"* [Management of Telecommunication Companies], 2(1997), pp.5-7

⁶⁴ Hong Kong Business Directory, Telpo Communications (Group) Limited, assessed December 19, 2021, <https://www.hkgbusiness.com/en/company/Telpo-Communications-Group-Limited>.

⁶⁵ BSBXZ, 0941.HK shangshi shimo p.63.

⁶⁶ MPT, "Guanyu Shixing Lianhe Touzi Jinyibu Jiakuai Tongxin Fazhan de Tongzhi," [Notification on Trailing United Investment to Speed Up Telecom Development],

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provincial PTEs to co-finance telecom infrastructure build-up with local governments, state-owned enterprises, and other governmental agencies that were operating networks for specialized purposes, so long as their foreign funding, if any, abided by state regulations and shared the costs and return. However, the provincial PT authorities that actually controlled telecom assets were largely lukewarm in their response. As Wu Jichuan commented:

The steps to united investment (*lianhe touzi*) were not big for two possible reasons. One was that the provincial PTAs had money and were thus unwilling to borrow others' money. The second was the unrealistic expectation that the interest rates could be lower than the banks' rates. But who is willing to lend you money at an interest rate lower than those of the banks? [...] The accumulation of funding for telecom infrastructure from favourable policies to united investment was a large and profound change.⁶⁷

4.5.1 Safeguarding Chinese Telecom Sovereignty in Hong Kong: The Cable & Wireless Incident

The impetus that eventually drove the local PTAs to resort to external capital was not economic. Rather, it was an accidental and political event in 1996 that presented as much of a crisis as an opportunity for the MPT and its local affiliates, eventually directing their attention towards foreign financial markets. In March 1996, about a year and a half before sovereignty over Hong Kong was transferred from London to Beijing, British Telecom, the largest telecom services company in the U.K., planned to purchase the shares in Hong Kong Telecom that Cable & Wireless, another U.K.-based telecom services company owned. The deal, if completed, would have given the British full control over Hong Kong Telecom. Policy-makers in Beijing deemed that the scenario would “jeopardize China’s telecommunications sovereignty.”⁶⁸ Beijing was informed of British Telecom’s acquisition attempt indirectly through Morgan Stanley,⁶⁹ which co-owned a Foreign-Sino joint venture investment bank named China International Capital

<http://www.elinklaw.com/zsglmobile/lawView.aspx?id=20491>, effective from September 29, 1994, assessed April 20, 2020.

⁶⁷ Shi, “Shixing Lianhe Touzi, Jiakuai Tongxin Fazhan,” p.6.

⁶⁸ BSBXZ, 0941.HK shangshi shimo, p.25.

⁶⁹ Bi Mingjian, “Zhongguo Dianxin Gupiao Faxing Yu Shangshi Anli Fenxi,” [Case Study of China Telecom’s Share Issuance and Listing], *Touzi Yu Hezuo* [Investment and Cooperation], 1998(7):69-72. p.70

Corporation (CICC) with China Construction Bank (CCB), one of the largest state-owned banks in China. CICC was founded barely a year ago in 1995 and had been tasked with assisting China's SOE reforms. As an investment bank with global exposure, Morgan Stanley maintained a large business network and was thus acutely attentive and sensitive to such business moves like British Telecom's.

Lu Ping, director of the Hong Kong and Macau Affairs Office (HK&M Affairs Office), a ministry-level agency under the State Council, immediately reported the news of British Telecom's deal and its potential political risk to China's top leadership. In a meeting chaired by Premier Li Peng, China's top leadership decided that the HK&M Affairs Office and the MPT should organize a consortium with mainland-headquartered companies operating in Hong Kong (*zaigang huazi lianhe caituan*) to bid for shares in Hong Kong Telecom and prevent the Hong Kong-based telecom operator from being controlled by British capital. China's top leadership reiterated that the acquisition needed to be done "in accordance with market rules", which demonstrated "Beijing's support of Hong Kong's telecom restructuring," and guaranteed that Hong Kong's "telecom sovereignty would be returned to Hong Kong."⁷⁰

On July 24, 1996, Lu Ping discussed the share acquisition issue with Wu Jichuan, and insisted that both the funding and the buyer must be from Hong Kong as a demonstration of the principle of "Hong Kong people administering Hong Kong (*gangren zhigang*)" – a legal and official commitment that Beijing had made in Hong Kong Basic Law, the de facto Constitution of the British colony that would become a special administrative region of the PRC in less than a year. Meanwhile, Lu Ping proposed that MPT work with CCB and let CICC work out the business and financial details. After consulting with Zhang Liangdong, the Chief of the HK&M Affairs

⁷⁰ Ibid. p.27

Office's Department of Economic Affairs, Fang Fenglei, the Vice President of CICC, the MPT and the HK&M Affairs Office decided to use China Telecom to set up an affiliate in Hong Kong and buy at least 13% of the shares issued by Hong Kong Telecom and obtain a seat on Hong Kong Telecom's board of directors.

The MPT subsequently requested permission from the Ministry of Foreign Trade and Economic Cooperation (MoFTEC), the agency that oversaw China's external economic relations, to establish China Telecom Corporation in Hong Kong, stating that Telpo would control 51% of the Hong Kong-based company and the remaining 49% would be controlled by the newly corporatized China Telecom/DGT from Beijing. In this way, the MPT would indirectly possess complete control of the Hong Kong company through two entities. The MoFTEC approved the request on September 5, 1996, cautiously delimiting the operational scope of China Telecom (Hong Kong) Corporation as "proper participation in operating telecommunications business in the Hong Kong region (*shidang jingying xianggang diqyu de dianxin yewu*)."⁷¹ By the following month, the corporation was officially established with China Telecom's deputy head Gao Huigang as Chairman and Telpo's deputy general manager Chen Zhaobin as CEO.⁷²

At the same time in the fall of 1996, a special task force set up by the MPT and CICC embarked on negotiations with Cable & Wireless to buy the shares it held in Hong Kong Telecom. As Wu recalled 15 years later, this task was "initiated in a strictly confidential way and carried out in an unusual manner. The mission was split into parts, and participants were contacted separately, with each only knowing a part of this mission, and very few being aware of the entire picture."⁷³ For the purpose of secrecy, negotiations with Cable & Wireless took place outside of Mainland

⁷¹ BSBXZ, 0941.HK shangshi shimo, p.30

⁷² Ibid. pp. 30-1.

⁷³ Ibid. p.6.

China and Hong Kong. At an interval of one meeting every two weeks, negotiators from the MPT met their counterparts from Cable & Wireless in the U.K., the Netherlands, and Thailand. The process was difficult because the British company was unwilling to give up corporate control of Hong Kong Telecom and was firm on its prices. The British representatives also made the MPT promise that Cable & Wireless would have future stock rights in China Telecom (Hong Kong) and that they would also have priority for market entry into China.⁷⁴

In addition to negotiating with Cable & Wireless, the MPT also tried to acquire shares issued by Hong Kong Telecom from other holders. In early 1997, China International Trust Investment Corporation (CITIC) Pacific (*Zhongxin Taifu*), a Hong Kong-headquartered business conglomerate with a mainland background, planned to sell 8% of its Hong Kong Telecom's shares to Singapore Telecom. On February 27, Lu Ping informed Rong Zhijian, Chairman of CITIC Pacific's board of directors, that without approval from the State Council, their shares could not be sold, at least not to foreign-owned and controlled companies. Following Lu's heed, CITIC Pacific sold 900 million of its Hong Kong Telecom shares, or 7.74% of the total issuance, to Everbright and CITIC, two Chinese state-invested and Hong Kong-registered companies on May 9 at a market price of HK\$ 12.62 per share and a total of HK\$ 11.399 billion. The shares were immediately resold to China Telecom (Hong Kong) Corporation.⁷⁵

Elsewhere, the stalemate with Cable & Wireless finally broke in early June 1997 during the seventh round of negotiations that took place at Beijing. Cable & Wireless agreed to two demands from the MPT: to sell 644 million shares to China Telecom (Hong Kong) – equivalent to 5.5% of Hong Kong Telecom's total issuance – at the price of US\$ 1.185 billion; and to give one member of China Telecom (Hong Kong) a place on Hong Kong Telecom's board of directors.

⁷⁴ Ibid. p.33.

⁷⁵ Ibid. p.32.

Meanwhile, China Telecom (Hong Kong) Corporation indicated that it would continue to acquire Cable & Wireless' shares in Hong Kong Telecom until both companies' shareholding proportions in Hong Kong Telecom were "more balanced."⁷⁶ However, Cable & Wireless was not to sell its holdings to other entities and it must consult with the MPT-controlled China Telecom if any changes occurred in its shareholding rights.⁷⁷

With the 7.74% of shares acquired indirectly from CITIC Pacific and Everbright in May 1996 and the 5.5% gained from Cable & Wireless in June 1997, the MPT successfully placed one of their representatives in Hong Kong Telecom's board of directors. However, the two transactions incurred a colossal amount of debt. The US\$ 2.11 billion dollars paid – equal to the revenue generated from China's entire telecom industry in one year – came from international loans arranged by CICC that would be due in summer 1998.⁷⁸ Furthermore, China Telecom (Hong Kong) only existed on paper, and provincial and municipal authorities managed the MPT's telecom assets locally. How to repay the loans became a headache for the MPT.

4.5.2 Stock Market Proceeds for National Security Purposes: A Joint Operation Between Chinese Communists and Wall Street Bankers

Where they would find the money to buy shares from Hong Kong Telecom had troubled the MPT's leadership well before its acquisition attempt. After the loans were arranged, Chen Zhaobin asked minister Wu Jichuan what would happen if the loans could not be repaid. Wu replied, "I will sack you first and then resign."⁷⁹ In summer 1996, Chen proposed a plan to use the MPT's Hong Kong-registered Telpo as a listing entity to initiate an IPO and then use the proceeds to pay off the debt. Chen proposed that if assets worth RMB 1 billion could be injected into the

⁷⁶ Ibid. p.37.

⁷⁷ Ibid. p.37.

⁷⁸ Ibid. p.47.

⁷⁹ Ibid. p.47.

listing vehicle, the Telpo IPO on Hong Kong could raise RMB 10 billion. But despite Wu Jichuan's endorsement, his hour-long presentation at the MPT's party group meeting in the following day did not earn the support of other ministerial leaders. The majority of them deemed the plan "too difficult and infeasible".⁸⁰ However, Chen was instructed by Wu to continue pondering and exploring possibilities along the lines of an IPO, and to exchange with other comrades in Hong Kong, particularly the HK&M Affairs Office's Zhang Liangdong, Xinhua News Agency's Hong Kong Bureau chief Liu Zhiqiang, and CICC's vice president Fang Fenglei. When Chen brought the news of Wu's implicit endorsement of an IPO to Hong Kong, Fang "jumped from his chair" in excitement.⁸¹

Shortly after the establishment of CICC in 1995, Fang was assigned by his boss Wang Qishan, the President of CCB, to explore the possibility of listing Chinese SOEs in Hong Kong. Fang invited Morgan Stanley four times to touch base and explore China Telecom's foreign listings, but was turned down each time. During one of his lobbying trips to Morgan Stanley in New York, he was even called a "dumbshit" by his American business partners.⁸² The reason for American dismissiveness towards Fang was that the MPT was the only significant authority in China, as China Telecom was effectively empty and its telecom assets were decentralized in the hands of provincial authorities. The American investment bank was more interested in helping Guangdong Telecom to issue bonds in Hong Kong.⁸³ The strategic discord between CCB and Morgan Stanley escalated into a standoff in March 1997 between Wang Qishan and Morgan

⁸⁰ Ibid. p.48.

⁸¹ Ibid. p.50.

⁸² McGregor, James. *One Billion Customers: Lessons from the Front Lines of Doing Business in China*, Free Press, 2005, p.78.

⁸³ Fang Fenglei, "Zhongguo Yidong Shangshi Naxieshi'er," [Those Stories on China Mobile's IPO], *Zhongguo Zhengquan*, [Chinese Securities], 2018(12), https://www.cs.com.cn/xwzx/zt2017/20190115/01/201901/t20190115_5915136.html, published January 15 2019, assessed February 25, 2020.

Stanley Asia's chairman Jack Wadsworth. In CCB's boardroom, Wadsworth claimed to possess the expertise and technology indispensable for foreign listing, but Wang Qishan dismissively rebutted him, claiming that "you can do the technology, but for direction and strategy, you should listen to me... [You have the expertise] so does Goldman Sachs, and I have the market!"⁸⁴

Wang was absolutely right about Goldman Sachs. In fact, as early as six months before this spat, Wang, distrustful of Morgan Stanley, had already started to look for a new partner and "flirted with" Goldman Sachs, Morgan Stanley's archrival in investment banking. In September 1996, Wang Qishan paid a personal visit to the office of then-President and Chief Operating Officer (COO) Henry Paulson at Goldman Sachs in New York, seeking his help in making China Telecom public.⁸⁵ The entire process took place behind Morgan Stanley's back. Paulson was presented with Wang's plan to "reform China's telecom sector and sell shares through an IPO,"⁸⁶ which would not only herald the modernization of China's information and communication infrastructure, but also pave the road for other large SOEs to enter global capital markets.

Weeks later, in early winter 1996, Wu Jichuan received an invitation from Goldman Sachs to observe Deutsche Telecom's IPO on November 18, 1996.⁸⁷ Wu sent Shi Cuiming, Chen Zhaobin, and Li Ping, the three chief negotiators in the acquisition of Hong Kong Telecom's shares from Cable & Wireless, as representatives of the MPT to observe the IPO deal in Frankfurt. The German telecom giant's success to raise US\$ 13 billion was reported to the MPT, which led to

⁸⁴ McGregor, *One Billion Customers*, pp. 58-59. In his memoir, Paulson frankly and correctly pointed out how Chinese understanding of partnership in a joint venture differed from the western conventional one. According to him, the Chinese side perceived the foreign partner as a minority investment that help to "train Chinese counterparts and receive a few privileges in return. But the Chinese side had total control and wanted to be deferred to and treated as almost as if it were a client." And the root cause of the disaccord between Morgan Stanley and CCB was due to the former "understandably thought of CICC as a partner that would rely largely on it to manage the JV despite its having only a minority position." Paulson Henry, *Dealing with China: An Insider Unmasks the New Economic Superpower*, New York: Twelve, 2015, p.47.

⁸⁵ Paulson, *Dealing with China*, p.8.

⁸⁶ Ibid. p.45.

⁸⁷ Fang, "Zhongguo Yidong Shangshi Naxieshi'er."; Paulson, *Dealing with China*, p.49.

Wu's meeting with Paulson in December 1996 in Beijing. With Wu's approval, the MPT subsequently brought together dozens of accounting and financial leaders from provincial telecommunications administrations to a secret meeting at a hotel owned by the MPT in Sanya, China's southernmost beach resort city in Hainan. Goldman Sachs was invited as the chief "lecturer" to teach the MPT how to make plans for China Telecom's overseas IPO.⁸⁸ But because Paulson could not make it, Bob Hormats, a vice chairman of Goldman Sachs International, was invited as a replacement. Hormats had previously participated in the normalization of relations between China and the U.S. in the 1970s as Henry Kissinger's advisor, meaning he also served as a living demonstration of long-term American connections with China that matched Wu Jichuan's stature.⁸⁹ Fang Fenglei informed Goldman Sachs in advance that, "I don't know much about finance or the rules and regulations of IPOs, and if I don't, you can be sure the MPT doesn't either."⁹⁰

To win the deal, Goldman Sachs made laborious efforts to ensure that the capitalist idea of an overseas IPO was inked in the minds of the invited MPT officials and bureaucrats. Teams from Goldman Sachs used Deutsche Telecom's offering, which was completed weeks ago, as a template. Deutsche Telecom's Chief Financial Officer (CFO) was also invited. With the help of two interpreters, his remarks were conveyed, first from German to English, and then from English to Chinese.⁹¹ According to Fang Fenglei, it was at this seminar that rudimentary concepts like the IPO Prospectus draft, the IPO process, corporate restructuring, accounting requirements, and global road trips were introduced to the Chinese participants for the first time, and where the

⁸⁸ The MPT's records indicate that their secret meeting with Goldman Sachs took place at the end of December 1996, while Paulson recalled that a meeting with MPT was held in early January 1997. But it can be inferred that both accounts referred to the same meeting. BSBXZ, *0941.HK shangshi shimo*, p.52; Paulson, *Dealing with China*, p.52

⁸⁹ Paulson, *Dealing with China*, p.5; Fang, "Zhongguo Yidong Shangshi Naxieshi'er."

⁹⁰ Paulson, *Dealing with China*, p.53.

⁹¹ Fang, "Zhongguo Yidong Shangshi Naxieshi'er."

MPT's party group reached a consensus on using China Telecom (Hong Kong) as a vehicle to issue shares on the HKSE.⁹² It was also at that secret meeting where Goldman Sachs was told that raising a minimum of \$2 billion was a political goal -- not based on economic analysis, but rather based on a practical need to finance debts incurred from the MPT's Hong Kong Telecom acquisition deal.⁹³

The MPT's willingness was not enough. To float Chinese telecoms assets internationally, endorsement from the top leadership was also necessary. Goldman Sachs and MPT first obtained a verbal approval to proceed further in an overseas IPO during a meeting with Zhu Rongji in Beijing on February 25, 1997 that was brokered by Zhu's lieutenant Wang Qishan. On March 5, 1997, the MPT and the HK&M Affairs Office officially reported the idea of listing China Telecom to the State Council and received a go-ahead. On March 21, 1997, China Telecom (Hong Kong) Ltd. was formed in Hong Kong as a full subsidiary of China Telecom (Hong Kong) Corporation, which was created a year earlier to acquire Hong Kong Telecom's shares. According to the MPT's official account, this design guaranteed that China Telecom (Hong Kong) Corporation could always "perform its duties as a firm that was fully controlled by the MPT, and facilitate the future transfer of assets and personnel control."⁹⁴ The official document came much later than all these preparatory works. On May 20, 1997, the MPT officially awarded Goldman Sachs and CICC with the mandate to operate as the deal's joint global coordinators. They would take primary responsibility in making China Telecom (Hong Kong) a public company and coordinate the marketing and pricing of its shares.

⁹² BSBXZ, *0941.HK shangshi shimo*, p.52.

⁹³ Paulson, *Dealing with China*, p.53.

⁹⁴ BSBXZ, *0941.HK shangshi shimo*.

4.5.3 “Marrying Out the Hottest Daughter First (*sic*)”: Selling Mobile Assets in an unconventional Way

But China’s gigantesque and old-fashioned state-owned enterprises proved daunting for Goldman Sachs to float on international capital markets. China Telecom was far from a conventional company by capitalist standards. As Paulson recounted, “there were customers, there were phones, there were exchanges, there was a small but rapidly growing mobile telephony business, but it was all scattered throughout the country in the village, township, city, country and provincial outposts and headquarters of the MPT.”⁹⁵ As a socialist hangover, the MPT was a creaky bureaucratic operator and regulator lacking any modern corporate management system or capital structure. The deal that Goldman Sachs agreed to undertake was an unconventional underwriting, for an operating company as conventionally understood simply did not exist with the MPT; assets were unknown, cash flows and revenues were unclear, and audited books were unavailable. Therefore, Goldman Sachs had to create a company from scratch that not only met the listing requirements of hosting securities exchanges, but could also convince international investors to spend US\$ 2 billion. As two experts on the capital market in Hong Kong insightfully pointed out, “this was not the IPO of an existing company with a proven management team in place and a strategic plan to expand operations. It would be much closer to the truth to say that this was an IPO of the MPT itself!”⁹⁶

Eventually, a strategy that Fang called “marry out the hottest daughter first (*sic*)” (*liangnyu xianjia*) was adopted. To paraphrase, rather than putting all their telecom assets into the Hong Kong company for sale, Goldman Sachs and the MPT decided to pluck, inject, and list mobile

⁹⁵ Paulson, *Dealing with China*. p.8.

⁹⁶ Walter and Fraser, *Red Capitalism*, p.181.

assets from two coastal and better-off provinces first. As revealed by two financial experts, the “magic” behind the strategy was that:

The value of the provincial assets, as far as the IPO goes, was based on projected estimates of their future profitability as part of a *notional* [emphasis added] company that was compared to the financial performance of *existing* [emphasis added] national telecom companies operating elsewhere in the world. In other words, the estimates were based on the assumption that China Telecom (Hong Kong) was already a unitary operating company comparable to international telecom companies elsewhere.⁹⁷

To put it differently, Goldman Sachs would sell the *future* of China’s mobile services market to international investors. It was a future based on estimations by leading global business consultant Arthur Anderson that China’s 10 million mobile users in 1997 would increase to 100 million by 2007.⁹⁸ Therefore, the MPT decided to use 25% of the mobile assets from Zhejiang and Guangdong, two rich coastal provinces, as its first batch of assets to inject into China Telecom (Hong Kong) Ltd. for listing. These two provinces together had about 30% of all mobile subscribers in China at that time. Additionally, both had independent provincial mobile companies with relatively cleaner asset management, thus making it easier to package their assets for an IPO. According to Goldman Sachs’ estimations, mobile assets from the two provinces could earn China Telecom (Hong Kong) Ltd. a valuation of \$8 billion and that listing 25% of the shares could bring \$2 billion, thus meeting the political target.⁹⁹

The MPT fully mobilized all the forces it could muster in order to get the company listed before the maturation of loans to pay for the Hong Kong Telecom acquisition deal. An IPO task force was set up at the MPT leadership level, with Wu Jichuan as its head and vice ministers Yang Xianzu and Zhou Deqiang as its deputy leaders. The three ministers oversaw a working team that

⁹⁷ Ibid.

⁹⁸ In reality, the total number of Chinese using mobile phones in 2007 reached a staggering 547 million, five times more than the 1997 estimate. Fang, “Zhongguo Yidong Shangshi Naxieshi’er.”

⁹⁹ Paulson, *Dealing with China*, p.55

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included personnel from a wide range of departments, including telecom business, accounting, logistics, and legal affairs. In total, three thousand employees from the MPT and provincial PT administrations in Zhejiang and Guangdong were mobilized.¹⁰⁰

One of the thorniest challenges was to sort out mobile assets that were intermingled with fixed-line ones and to reorganize or even “polish” them if necessary. In fact, separating mobile assets and repackaging them into a stand-alone corporation with clear property rights was an arduous task for Goldman Sachs because China’s socialist legacy did not have any sense of property rights under state ownership. Server rooms, power-generation systems, base stations, and office buildings were all built on land provided by local governments free of charge. To meet the requirements of international capital markets, task forces in Zhejiang and Guangdong worked day and night collecting or “reapplying” any proof of property that did not exist before, while the MPT had its envoys hunkered down in other ministries where administrative approval or the issuance of property certificates would be needed. Being placed at the MPT’s temporary outposts, the envoys passed information back to the MPT with the least delay whenever an issue arose, and when idle, they did chores or ran errands for the ministries where they were stationed.¹⁰¹

A well-written, convincing, and appealing IPO Prospectus was indispensable for the listing. Under the guidance and supervision of international accounting and legal firms, the MPT took months to draft the Prospectus before handing it to Wu Jichuan, who then spent two full days revising it word by word, with special focus on important issues such as interconnection, accounting standards, and corporate structure.¹⁰² To make sure the prospectus appealed to foreign

¹⁰⁰ Wu Jichuan, “Xuyan: Chongwen Lishi, Zhanwang Weilai -- 0941.HK Shangshi de Huigu yu Sikao,” [Preface: Reviewing History, Looking into the Future – Retrospect and Reflections on 0941. HK’s Listing], pp.5-17, in BSBXZ, *0941.HK shangshi shimo*. p.8.

¹⁰¹ BSBXZ, *0941.HK shangshi shimo*, p.72.

¹⁰² Hu Shuli, “Zhongguo Dianxinye Zhidu Chuangxin de Zhongda Changshi: Zhongguo Dianxin (Xianggang) Shangshi Shimo,” [Huge and Innovative Trail in China’s Telecom Institutions: The Beginning and End of China Telecom (Hong Kong)’s Listing], *Juece yu Xinxu*, [Decision and Information], 1998(3):16-7, p.17.

investors, MPT personnel “took the Boeing Taxi” and commuted the 2000 kilometers (1200 miles) between Beijing and Hong Kong 5-6 times a week. The team took flights at 6 a.m. in the morning to negotiate with potential investors in Hong Kong, and then caught the return flight to Beijing in the late afternoon.¹⁰³ The evenings were passed with drafters from the MPT’s finance section, general office, and policy section, with feedback from potential investors being synthesized and then submitted to Wu at night. The only rest they got was on the flights to and from Hong Kong.¹⁰⁴

Assistance from global financial elites was also indispensable to the MPT’s rapid corporatization progress.¹⁰⁵ At Goldman Sachs’ recommendation, its long-term business partners, New-York headquartered Sullivan & Cromwell and London-headquartered Linklaters, were hired to conduct compliance checks with American and Hong Kong legal requirements. To pluck out the mobile assets that were intermingled with fixed-line ones, Goldman invited Amsterdam-headquartered Klynveld Peat Marwick Goerdeler (KPMG), a globally renowned accounting firm, to sort out the accounting work. KPMG (Hong Kong) sent 350 full-time accountants to work through books, check numbers, and “interrogate” MPT bureaucrats day and night.¹⁰⁶ In this way, personnel, equipment, and assets related to mobile business in Zhejiang and Guangdong were carved out. Fifteen interconnection and analog trunk rental agreements were signed. On paper, they “clarified” the contractual relationship between the to-be-listed corporation and the municipal and county-level regulators. Within only a few months, the opaque telecom provincial administration was transformed into a modern company operating by international business norms.

¹⁰³ Wu, “Xuyan,” p.8.

¹⁰⁴ Ibid.

¹⁰⁵ Wójcik Dariusz and James Camilleri, “‘Capitalist Tools in Socialist Hands’? China Mobile in Global Financial Networks.” *Transactions of the Institute of British Geographers* 40, no. 4 (2015): 464–78. p.465.

¹⁰⁶ Paulson, *Dealing with China*, pp.54-5.

4.5.4 Forging a Unified National Champion: Centralization of Provincial Assets Through the Overseas IPO

However, the overseas listing did meet some resistance from provincial authorities. In July 1997, the provincial government of Guangdong, which exercised control over local telecom businesses, argued that Guangdong's mobile assets should be registered locally as a provincial company. As mentioned before, telecom assets were managed under local PTAs when the corporatization process kicked off. As early as 1988, the Guangdong PTA formed and operated Guangdong Mobile with support from the provincial authority but without the MPT's approval. Similarly, the Zhejiang PTA operated mobile assets in Zhejiang, with minor local state-owned stakeholders co-operating with lower municipal or county-level telecom administrations. In the early 1990s, provincial-level companies took charge of operational strategy and network construction, while municipal and county-level companies took care of operation, maintenance, and fee collecting, although detailed work distribution differed between provinces.¹⁰⁷ From the perspective of Guangdong's leaders, incorporating and listing their provincial mobile assets individually could benefit local interests more, especially since network construction and financing had been mostly undertaken by provincial authorities rather than the central one.

The central authority however thought otherwise. First and foremost, the funding raised by a provincial standalone IPO would likely be lower. Strategically speaking, the future of one or two provinces' mobile assets was more lackluster compared to the idea of a unified national market. More importantly, allowing Guangdong to go first would encourage others to follow their example, which would lead to about three dozen individual IPOs from provincially-owned companies. Such fragmentation could challenge the very idea of a national network. The structure

¹⁰⁷ Shu, Jing. "Tianjiangjiang Daren Yusi – Zhongguo Dianxin Xianggang Youxian Gongsi Shangshi Shimo" [When the Heaven Bestows a Great Responsibility on You: The Beginning and Ending of China Telecom (Hong Kong) Limited's Listing], *Ziben Shichang* [Capital Markets], 1997 (Z1):10-15. pp.11-2.

of a single China Telecom represented Beijing's strategic planning to consolidate provincially-owned-and-run assets into a unified national champion.¹⁰⁸ Phasing other provinces' mobile assets into the listed company would send global investors the message that, in Wu Jichuan's own words, "this is just an appetizer, the main course is yet to come."¹⁰⁹

Practically, the rationale behind choosing two provinces rather than a national overhaul was also imposed by circumstance. As telecommunications assets were scattered at various local levels, a national overhaul would slow down the entire IPO process, and the MPT did have a deadline to repay their debts. Moreover, the regional disparity of the number of mobile phone users and the profitability of mobile services varied significantly between provinces, with poorer inland provinces having the potential to drag down the overall asset evaluation's quality.

To resolve local resistance, Wang Qishan and Wu Jichuan co-submitted a report and sought the State Council's adjudication on August 7, 1997.¹¹⁰ A week later, Wu displaced to Guangdong and delivered a report to the Guangdong PTA, reiterating that:

Although in terms of overall condition and short-term profit, the IPO is not necessary, the handover of Hong Kong's telecom sovereignty and the national telecom SOE reforms need us to perform this task. An equity-based IPO is not simply an economic action, and neither is it merely a means of fundraising, but it is a process to modernize corporate management. The overseas IPO of China Telecom (Hong Kong) presents a good opportunity and thinking on deepening corporate reform.¹¹¹

In a terse reply issued on September 17, the State Council sided with the CICC and MPT and declared that the provincial SOE status did not conform with the principle of centralized and unified telecommunications administration. Thus, it urged the MPT to work with the Guangdong government to elevate local state ownership into central state ownership.¹¹²

¹⁰⁸ Walter and Howie, *Red Capitalism*, p. 178.

¹⁰⁹ Fang, "Zhongguo Yidong Shangshi Naxieshi'er."

¹¹⁰ BSBXZ, *0941.HK shangshi shimo*, p.69.

¹¹¹ Ibid. p.49.

¹¹² The State Council of the People's Republic of China, "Guowuyuan Guanyu Guangdong Yidong Tongxin Guanli

4.5.5 “Foreign Investors Must Not Operate the Assets”: Top Leadership’s Reiteration and the Final Approval

The placement of provincial mobile assets into a Hong Kong-incorporated company for an IPO and the company’s setup of subsidiaries in China for telecom business with foreign investors is, legally speaking, a contravention of the State Council’s prohibition against the participation and operation of foreign investors in telecom assets. To do so would require the State Council’s special permission, which was not easy to acquire.¹¹³ So the next step was to convince the Party-State’s other top decision-makers, particularly the more conservative ones, that an overseas listing would not challenge the Chinese state’s control over foreign listed assets.

In July 1997, Wu Jichuan and Wang Qishan together informed the top leadership of the IPO’s *de jure* challenge of corporate control and sought their special approval.¹¹⁴ China’s top leadership did express concerns over foreign participation, and Zou Jiahua, the vice premier overseeing the telecommunications sectors, raised questions on the post-IPO percentage of state ownership and control. Zou emphatically remarked that “[this transaction] will break the principle that foreign business cannot operate telecom businesses within China, so you must be very cautious, because it concerns a long-term state security issue.”¹¹⁵ Premier Li Peng, a well-known hardliner, specifically commented that “the principle that foreign companies do not directly participate in the operation and management of telecommunications businesses” must be adhered to. As a cautionary measure, he proposed that the IPO deal be discussed again with other top leaders. Therefore, it was not until August 10, 1997, at a special meeting about the IPO deal

Tizhi de Pifu, [The State Council’s Reply on Questions Regarding Guangdong Mobile’s Administration Structure], http://www.gov.cn/zhengce/content/2010-11/12/content_3477.htm issued September 17, 1997, accessed March 22, 2020.

¹¹³ Bi, “Zhongguo Dianxin Gupiao Faxing Yu Shangshi Anli Fenxi,” p.71.

¹¹⁴ BSBXZ, 0941.HK shangshi shimo p.67.

¹¹⁵ Ibid. p.69.

convened by Li Peng, that the MPT's foreign listing and capital injection plan was finally and consensually approved. In the meantime, the MPT was demanded again to stick to the principle that "foreign investors do not participate in telecommunications business management" and to "work out a more detailed regulatory plan and enhance supervision over China Telecom (Hong Kong) Ltd.'s business activity."¹¹⁶ More specifically, the top leadership gave their consent to the centralization plan, which stated that mobile assets in Guangdong and Zhejiang would be injected for a dual listing in Hong Kong and New York, and that the percentage of floated shares would not go beyond 25%.

On the same day, the general office of the State Council convened a meeting at the instruction of Zhu Rongji. The meeting demanded that eleven ministry-level agencies to assist the IPO and "bear the political and economic significance of this deal in mind." In return, all participants alleged that the "special case would be handled with special methods" (*teshi teban*) to make it a success. Because the deadline of the planned IPO was barely two months away, China's securities regulators lacked the time to issue and fax an official document to the HKSE. Instead, they made a phone call informing their counterparts in Hong Kong that Beijing had approved all the documents for China Telecom (Hong Kong) Ltd.'s listing and requested for the HKSE to proceed further.¹¹⁷

On the other front, as per Diagram 4.2 below, the asset restructuring and corporate redesigning were also completed. On September 3, 1997, China Telecom (Hong Kong) Ltd. was incorporated under Hong Kong law as the listing entity. As stated in the IPO Prospectus, the

¹¹⁶ The State Council of the People's Republic of China, "Guowuyuan Guanyu Zhongguo Dianxin (Xianggang) Gongsì Jingwai Shangshi Youguan Wenti de Pifu" [the State Council's Reply on Questions Regarding China Telecom (Hong Kong)'s Overseas Listing], http://www.gov.cn/zhengce/content/2010-11/12/content_3487.htm, issued August 10, 1997, accessed March 18, 2020.

¹¹⁷ Wu, "Xuyan," p.7.

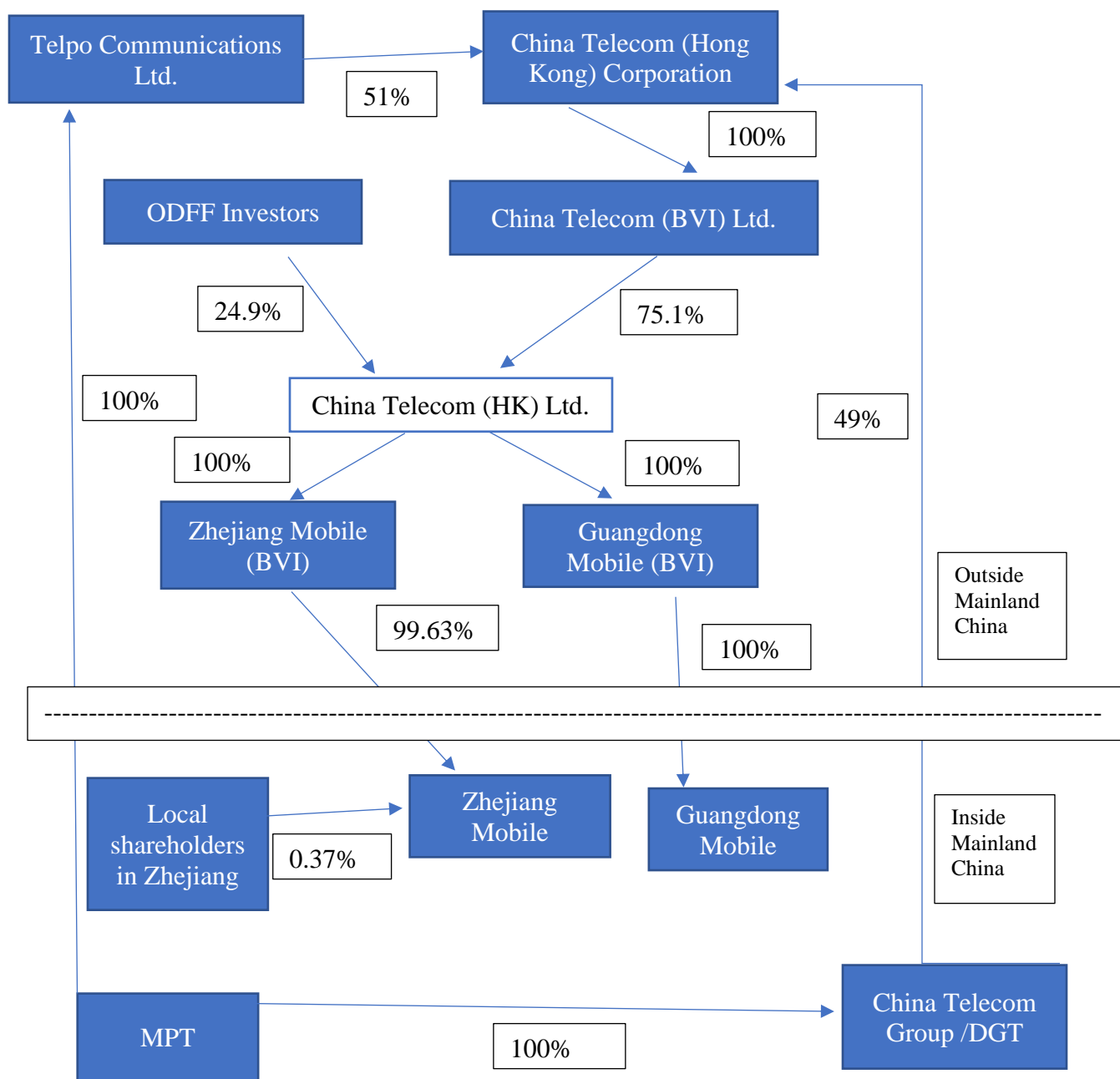
company had been granted “a special authorization from the State Council to affect the restructuring and the global offering,” although at the moment of listing, written Chinese regulations prohibited non-PRC entities or persons from owning or participating in the operation of telecommunications services in China.¹¹⁸ In the meantime, a fully owned subsidiary of China Telecom (Hong Kong) Ltd. was registered in the British Virgin Islands.¹¹⁹ Because the new BVI entity was a non-public and unlisted company, it was not required to disclose its financial statements. As a result, the whereabouts of the money it had raised and transferred from Hong Kong would be unknowable and untraceable. To prepare for the listing, the MPT transferred all of its interests in Guangdong Mobile and 99.63% of its interest in Zhejiang Mobile to the listing vehicle. Therefore, China Telecom (Hong Kong) Ltd., which was a foreign investor in geographical and legal terms, owned Guangdong Mobile and Zhejiang Mobile on paper, and would thus “operate” mobile phone services in the two provinces, thus making Guangdong Mobile a fully foreign-owned company and Zhejiang Mobile a Sino-Foreign joint venture. Out of all of China Telecom (Hong Kong)’s equity interests – actually the mobile assets of Guangdong and Zhejiang – 24.9% of them were issued to global investors via the HKSE and NYSE. The remaining majority of 75.1% belonged to China Telecom’s BVI subsidiary, and indirectly, the MPT.¹²⁰

¹¹⁸ SEC, China Mobile IPO Prospectus, 1997, p.3.

¹¹⁹ Ibid. p.26.

¹²⁰ Ibid. p.26.

Diagram 4.2 China Mobile's IPO Structure



Source: Synthesized from China Mobile's IPO Prospectus and various annual reports and SEC filings; Walter and Fraser, *Red Capitalism*, p.180

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4.5.6 Who Benefits? Hong Kong Business Tycoons as the Strategic Investors of Mainland State-Owned Telecom Assets

China Telecom was rarely heard of outside China, so the question was how to convince international investors to spend US\$2 billion on it. With the State Council's approval, CICC reached out to a cohort of twelve business groups, including Hong Kong's largest local tycoons, their extended families, and two Hong Kong-registered conglomerates from the mainland that helped the MPT purchase Hong Kong Telecom.¹²¹ According to an expert on the HKSE, the proceeding would have fared much worse without them.¹²²

A total of 44.6% of the issuance (worth US\$ 1.96 billion) was evenly allocated for the twelve entities, or so-called corporate investors, among which, as Table 4.7 below shows, ten of them were companies owned and controlled by families of Hong Kong business tycoons who had agreed to lock in their shares for a minimum of one year.¹²³ According to a stock market expert, locking up the shares "helped the deal transcend prevailing market conditions to stoke oversubscription from individuals and sustain interest from global institutional investors."¹²⁴ To the contrary, public investors in Hong Kong were only allocated 5.54% of the total issuance.¹²⁵

Table 4.8 List of Cornerstone Hong Kong-Based Financial Investors in China Mobile's IPO in 1997

China Mobile's Cornerstone Investors	Controlling Hong Kong Tycoons
Cheung Kong Ltd.	Li Ka-shing
Henderson Investment Ltd.	Lee Shau-kee

¹²¹ Enlisting Hong Kong's local large business conglomerates to buy new shares has been increasingly common among companies with Chinese background that initiated an IPO on Hong Kong stock market since then. Such corporate investors were called cornerstone investors (*Jishi Touziren*). For a detailed description of cornerstone investors, see Philippe Espinasse, *Cornerstone Investors: A Practical Guide for Asian IPOs*. Hong Kong University Press.

¹²² Koepp, Rob. *Betting on China: Chinese Stocks, American Stock Markets, and the Wagers on a New Dynamic in Global Capitalism* (Singapore: John Wiley & Sons 2012), p.58.

¹²³ The other two companies were the mainland-based and Hong Kong-operating China Everbright and CITIC.

¹²⁴ Linebaugh Kate, "Hong Kong Elite Score on IPOs," *Wall Street Journal*, June 2, 2006, quoted in Koepp, *Betting on China*, p.59.

¹²⁵ The author's calculation based on information from Ibid. p.7-8.

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Hutchison Whampoa Ltd.	Li Ka-shing
Hysan Development Co. Ltd.	Li Hon-chiu
Kerry Holdings Ltd.	Kuok Hock-nien
The Mingly Corporation Ltd.	Cha Chi Ming
New World Development Co. Ltd.	Cheng Yu-tung
Chow Tai Fook Jewellery Co. Ltd.	Cheng Yu-tung
Sun Hung Kai Properties Ltd.	Lee Shau-kee and Kwok Ping-sheung
The Wharf Ltd.	Woo Kwong-ching

Source: SEC, China Mobile IPO Prospectus, 1997, p. 89; Fang, “Zhongguo Yidong Shangshi Naxieshi’er.”

However, the unfolding of a financial crisis in East Asia in the fall of 1997 shackled the confidence of many Hong Kong business tycoons, who hesitated and complained about the overpricing of shares and even threatened to quit.¹²⁶ Following Goldman Sachs’ suggestion, Wu Jichuan convened an emergency meeting with them in Shenzhen, a mainland city adjacent to Hong Kong, and assured the tycoons that “buying stocks is buying the company and its future; China’s mobile communication will explode. The assets listed now are from only two provinces, and thirty more will follow when the time is mature. Isn’t such a company worth investing?”¹²⁷ In fact, choosing to list mobile assets holistically but in batches through China Telecom’s Hong Kong listing vehicle rather than fragmentally by province meant that the MPT had promised that future mobile assets injection would not cause interprovincial competition. As an investment banker commented, “this visionary idea of China’s rapidly expanding mobile communications sector as an integrated market in the future meant a huge value for investors. China’s mobile phone rate was barely at 6%, while most developed countries were at 30%, meaning there was huge potential for investors to tap into.”¹²⁸

¹²⁶ Su, Na. “Zhongdianxin Yuanhe Cuoshi 200yi Peigu Liangji? Lijian Xuankong Gushi,” [Why did China Telecom miss the good opportunity to a 20 billion stock allotment? A sword of Damocles over the stock market], *Caijing Shibao*, [Financial and Economics Times], <https://business.sohu.com/2004/05/16/19/article220141944.shtml> reposted by Sohu May 16, 2004, accessed March 24, 2020.

¹²⁷ BSBXZ, *0941.HK shangshi shimo*, p.78.

¹²⁸ Bi, “Zhongguo Dianxin Gupiao Faxing Yu Shangshi Anli Fenxi,” p.71

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Because China Telecom (Hong Kong) was the only “foreign” mobile phone services company operating in mainland China,¹²⁹ an expert on the Chinese economy insightfully pointed out that “given the prohibition of foreign ownership of Chinese communications operating companies, that effectively makes it the only investment vehicle for foreigners who want to invest in the world’s third largest and fastest growing cellular telephone market free from inter-provincial competition.¹³⁰ Additionally, the State Council approved of an equity percentage that was specially exempted from foreign investment restrictions, and used it as a major selling point.¹³¹

On September 29, 1997, China Telecom (Hong Kong) kicked off its road trip. Goldman Sachs and CICC had made the price range available to investors – HK\$ 7.75 to HK\$ 10.00 per share for 2.6 billion shares – before embarking on a two-week road show to 2,200 investors in Europe, North America, and Asia.¹³² Due to the rising interest and demand, Wu Jichuan and Wang Qishan had a midnight phone call after their first stop at New York on October 8, during which a decision was made to “maximize the state-owned interests” by lifting the price range by 26%, or between HK\$ 9.39 and HK\$ 12.48 per share – a move that caused dissatisfaction among cornerstone investors.¹³³ But CICC and Goldman Sachs encountered friction when settling the final offering price. The ongoing East Asian financial crisis had ripples all over the HKSE, with the Hang Seng index plunging by 10% during the two road trips. The head of Goldman Sachs’ equity markets, Michael Evans, who had rich experience in privatizing SOEs in Europe, proposed a moderate mid-range price at around HK\$ 11.00 per share. CICC and the MPT had hoped for a higher price of HK\$ 11.88, not only to drive off speculators, but also because 88 is an auspicious

¹²⁹ SEC, China Mobile IPO Prospectus, 1997, p.3.

¹³⁰ Lardy, Nicholas. *China’s Unfinished Economic Revolution* (Washington D.C.: Brookings Institution, 1998), p.154.

¹³¹ Bi, “Zhongguo Dianxin Gupiao Faxing Yu Shangshi Anli Fenxi,” p.71.

¹³² Fang, “Zhongguo Yidong Shangshi Naxieshi’er.”

¹³³ Su, “Zhongdianxin Yuanhe Cuoshi 200yi Peigu Liangji.”

number in Chinese culture that symbolizes the doubling of good luck and wealth.¹³⁴ Despite Evans' reasons and financial expertise, Wang Qishan and Wu Jichuan finalized the price at HK\$ 11.80. In retrospect, Evans recalled that, "I was not being asked, I was being told."¹³⁵ According to Fang Fenglei, Wang and Wu's finalization of HK\$ 11.80 as the offering price, rather than surrendering to Goldman Sachs' proposed HK\$ 11.00 per share, actually brought China Telecom US\$ 300 million more back.¹³⁶ Goldman Sachs was rewarded handsomely as well – the underwriting fees were said to surpass US\$ 200 million.¹³⁷

The IPO trading date came on October 23, 1997, one week after the price announcement. However, Hong Kong was not immune from the ongoing financial crisis that had engulfed most of East and Southeast Asia. On October 22, one day before the IPO, the Hong Kong stock market plunged by 14%. The next day, a further nosedive by more than 1200 points (10.4%) occurred – a day that came to be known as Black Thursday. Despite that setback, the price of China Telecom Ltd. (0941. HK) was HK \$ 10.55 by the end of its first trading day. Simultaneously listed on the New York and Hong Kong Stock Exchanges, the IPO brought back \$4.22 billion, making it about 25 times larger than the total 47 Chinese companies that had previously been listed overseas since 1993.¹³⁸ China Telecom (Hong Kong) also marked the first time that a major Chinese SOE partially listed its shares on the NYSE (albeit indirectly through American Depository Rights).¹³⁹ Considering their listing occurred just after the Asian Financial Crisis erupted, the success of this landmark offering was even more remarkable.¹⁴⁰

¹³⁴ Paulson, *Dealing with China*, p.61

¹³⁵ Ibid. p. 62

¹³⁶ Fang, "Zhongguo Yidong Shangshi Naxieshi'er."

¹³⁷ Walter and Howie, *Red Capitalism*, p.178

¹³⁸ Ibid.

¹³⁹ For more introductory information on American Depository Rights (ADR), see <https://www.investopedia.com/terms/a/adr.asp>

¹⁴⁰ Goldman Sachs, "China Telecom Privatization Shines through the Shadow of the Asian Financial Crisis," <https://www.goldmansachs.com/our-firm/history/moments/1997-china-telecom-privatization.html>, assessed March

In April 1998, MPT's request to inject mobile assets from Jiangsu into China Telecom (Hong Kong) corporation, and then let China Telecom (Hong Kong) Ltd. "acquire" it with the IPO proceedings was approved by the MoFTEC and the China Securities Regulatory Commission (CSRC) respectively, the two ministries that oversaw China's foreign economic exchanges and securities market at that time. On June 4, 1998, China Telecom (Hong Kong) Ltd. "dispensed" \$2.9 billion of the \$4.2 billion in proceedings from the October 1997 IPO to "acquire" a complete ownership interest of Jiangsu Mobile from China Telecom (Hong Kong) Corporation. Upon completion, the target provincial company became a wholly-owned subsidiary of China Telecom Ltd. The funding was then immediately used to repay the \$1.91 billion in loans and interests used to acquire the 13.3% of shares from Hong Kong Telecom in 1997.¹⁴¹ The remaining \$1.3 billion, according to the MPT, was then used for telecom network construction in Mainland China and the further acquisition of shares from Hong Kong Telecom.¹⁴²

4.6 Concluding Remarks

Despite the State Council's opposition towards foreign operation in China's telecom services sector on paper, China Mobile gained a special approval and initiated an overseas IPO that brought back US\$ 4.2 billion in real gains. The deal ushered in a new way for Chinese state-owned telecom companies to obtain foreign investment without incurring FDI's physical presence or relinquishing political and managerial control. Soon, the other three oligopolistic operators and state-controlled networks, China Unicom, China Telecom, and China Netcom, adopted this method and initiated their respective IPOs in the early 2000s.¹⁴³ Following the same path, all four

14, 2020.

¹⁴¹ \$1.05 billion was due by June 4, 1998; and \$860 million was due by July 24, 1998. BSBXZ, *0941.HK shangshi shimo*, p.90.

¹⁴² Although the IPO Prospectus stated that the purpose of the proceeds was "to use approximately US\$ 2 billion [...] to fund a portion of the planned expansion of the Group's cellular networks in Guangdong and Zhejiang." SEC, China Mobile IPO Prospectus, 1997, p.9.

¹⁴³ China Netcom Group purchased the entire equity interest in Jitong Communications Co. Ltd. on May 28, 2003.

SOEs injected their most profitable assets for sale on Hong Kong and American stock markets, and the Chinese state retained corporate control, with more than 75% of all their shares in its hands. Using capital raised from international securities markets, the parent companies managed to centralize provincially-owned mobile assets under its ownership and control, consolidate the regionally fragmented industrial sector, and fashion themselves into national champions of gargantuan sizes that could be globally competitive.

It must be emphasized that this process was no doubt impossible without the financial instruments, accounting standards, and company laws that modern corporations and the entire capitalist system are based on. Even Henry Paulson, who participated closely in the IPO of China Mobile that heralded the “Red Chip” model of capital filtration, acknowledged that western investment bankers were the “Promethean figures in this process that jetted in and competed to show the Chinese how to kindle the fire of capital markets.”¹⁴⁴ Indeed, these international investment bankers “have worked so well to build its image so that minority stakes in its companies could be sold at high prices, with the Party and its friends and families profiting handsomely.”¹⁴⁵ It was through close collaboration between Beijing’s politicians and international financial elites that the network of four leading telecommunications services operators were forged and strengthened, and they *created* a nationalized telecom market that did not exist before.

Absorbing foreign capital in this way was a vital step in the deeper integration of China’s national champions into the global financial market. Funds raised in this way offered four advantages that the CCF strategy could not. First, foreign capital in the form of ODFF came without any local and physical presence from foreign telecom competitors; second, how and when the acquired funds would be used was far less constrained by foreign investors; third, listing assets

¹⁴⁴ Paulson, *Dealing with China*, p.5.

¹⁴⁵ Walter and Howie, *Red Capitalism*, p.182.

overseas paved the road for the global expansion of Chinese national champions; and fourth, the personal wealth of China's telecom elites increased exponentially via the incentive share option scheme.

One particularly thought-provoking issue regarding the political motivations and impact associated with the "Red Chip" foreign listing strategy was that the navigation of this mode of capital filtration came from how the partial privatization of state-owned telecom assets was not purely out of economic rationale, but also for political and strategic purposes. The direct pushing factor behind China Mobile's IPO deal was, as blankly stated by Wu Jichuan, to "stabilize Hong Kong Telecom by holding its shares, and to help facilitate the handover of telecommunications sovereignty."¹⁴⁶ As CICC's general manager acknowledged, many telecom SOEs initiated IPOs at a worldwide scale as part of the neoliberal privatization reforms of the mid-1990s. This historical backdrop and its *ideational* inspiration contributed to Chinese politicians' interest in using IPOs as a way to further reform Chinese SOEs. But in the Chinese context, privatization did not and was not intended to reduce the state's role. On the contrary, it required and even strengthened intervention from the central state. Provincial authorities were allowed to build but not own telecommunication networks. As correctly pointed out by a China expert, "even as foreign investors celebrated what they saw as the first step in privatization of China's telecom networks, Wu had craftily reasserted his control over the country's fast-growing mobile networks."¹⁴⁷

As the China Mobile IPO deal showed, the creation and debut of China Mobile (Hong Kong) in international capital markets took barely five months, with no consultation from the general public who nominally owned these assets under state ownership. In contrast, floating a

¹⁴⁶ Wu, "Xuyan," p.9.

¹⁴⁷ McGregor, *One Billion Customers*, p.242.

SOE on the stock market in a democracy requires changes to the law and complex bargaining among the various stakeholders – a process that can take years or even decades.¹⁴⁸

Behind such “Chinese speed” was the all-round support of the entire state apparatus. Two ministry-level politicians, Wang Qishan and Wu Jichuan, had been overseeing the deal from the beginning. They had “jointly pondered over decisions on major issues and problems”.¹⁴⁹ The State Council leadership had convened two meetings, both involving attention and instructions from four (vice) premier-level politicians such as Li Peng, Zhu Rongji (at that time the vice-premier who oversaw economic affairs), Zou Jiahua and his successor Wu Bangguo (who oversaw telecommunications), and Qian Qichen (who oversaw affairs involving Hong Kong and Macau).¹⁵⁰ Additionally, thousands of civil servants from a dozen ministry-level agencies were mobilized to facilitate this process. In this regard, state participation in corporate privatization was not only desirable, but also indispensable.

However, the “Red Chip” foreign listing plan’s profound impact was not limited to the four state-owned telecom oligopolies. The idea of using ODFF raised from international financial markets to fund China-based and Chinese-controlled businesses was quickly drawn on and improved upon by a large number of companies, all of which were founded by private Chinese entrepreneurs that specialized in Internet-based services. So why did the Chinese start-ups turn to international capital markets rather than the domestic ones? How did Beijing guarantee that these companies (which had scant or non-state ownership) and their quest for ODFF did not bring in the influence of foreign investors? What modifications were made to existing CCF and “Red Chip”

¹⁴⁸ In contrast, Goldman Sachs had been consulting Deutsche Telecom for eight years before its IPO in 1996. Fang, “Zhongguo Yidong Shangshi Naxieshi’er.”

¹⁴⁹ Wu, “Xuyan,” p.7.

¹⁵⁰ Ibid.

strategies to achieve that end and what parts of these strategies remained unchanged? I will answer these questions in the next chapter.

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Chapter 5: Variable Interest Entity as the Third Variant of Capital

Filtration

Since the second half of the 1990s, the commercialization of the Internet in China has presented another business bonanza for global investors eager to tap into this vast market's enormous potential. It was against this backdrop that the third variant of capital filtration, variable interest entity (VIE), emerged as the major financing channel adopted by China-based and Chinese-controlled Internet firms. The VIE strategy also fuelled the rise of certain Internet firms that later became globally renowned giants in this sector. To what extent does the VIE strategy resemble or differ from the "China-China-foreign" (CCF) and "Red Chip" strategies? How was the Chinese regime involved in its design and governance? What mechanisms were placed to guarantee that foreign financial absorption did not incur non-Chinese corporate control?

To answer these questions, this chapter proceeds in the following order. The first section describes the general features of the VIE strategy with an emphasis on the continuities and changes that this model possessed in relation to its two predecessors. Additionally, I provide empirical evidence on China-based and Chinese-controlled Internet firms that used this model and the amount of funding that they managed to raise. Then, I investigate the financial rationale behind why Chinese Internet-based start-ups, all of them privately held, were motivated to access finance from capital markets based in the Global North rather than domestic ones. Next, using a mini-case study that will trace the historical trajectory of how Sina (*xinlang wang*) created and adopted the VIE strategy, I show how this mechanism was a direct result of policy preferences dictated by China's Internet regulators. The fourth section demonstrates how the VIE strategy was governed by a coalition of ministries that shared power over this convoluted transnational corporate structure. Emphatically, I show how Chinese regulators vet and treat VIE-using companies as

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domestic ones based on *de facto* corporate control rather than the investment inflow's place of origin and the mechanisms put in place to guarantee Chinese control without abuse by foreign investors. In the fifth section, I explain why this model of capital filtration was carried out with fragmented ministry-level policies instead of a common national or legal approach. Then, a case study on the VIE-supported corporate structure of world-renowned Internet giant Alibaba is investigated in detail, highlighting its globally funded and Chinese-controlled nature. The last section compares and contrasts the VIE strategy with the CCF and "Red Chip" strategies.

5.1 C'est la "VIE": General Features of the Variable Interest Entity

VIE was originally an accounting standard used for corporate financing. The term first appeared in the 2003 interpretation given by the U.S. Financial Accounting Standards Board in response to the Enron scandal. It served as a confirmation that if one entity had *controlling* financial interest over the other, then the financial statements should be merged, regardless of whether the control was exercised in majority voting.¹ And the controlled company was considered as the controller's VIE. This accounting concept has been widely used by China-based Internet companies to "dress up" their corporate governance structure and acquire offshore domesticated foreign finance (ODFF) from global financial markets.

As Diagram 5.1 below shows, Chinese entrepreneurs and founders of Internet companies would build a VIE structure by first registering a parent holding company (HoCo) in an offshore financial center (OFC). Many OFCs are archipelago states in the Caribbean region, with the Cayman Islands being a particularly popular destination, not only because of its tax-free status, but because its common legal framework and recognition by international investors and American

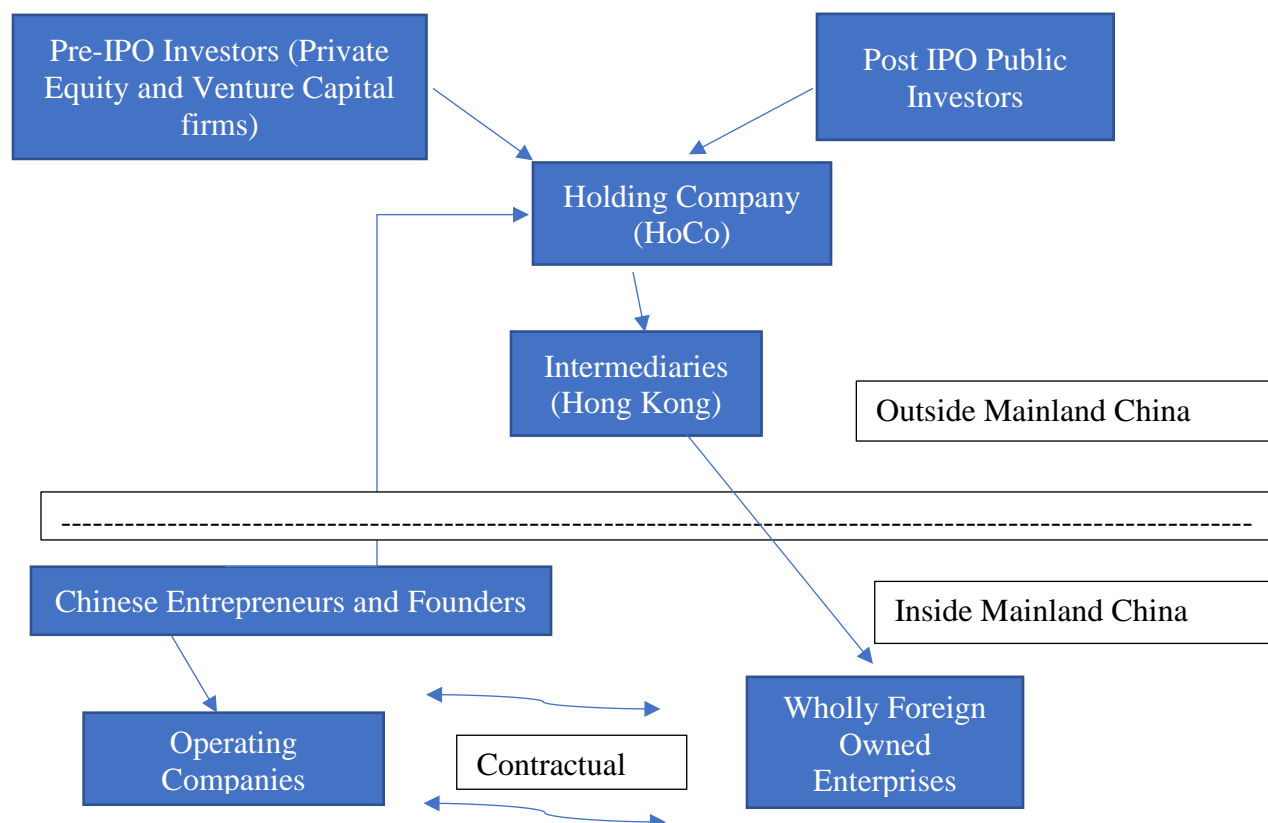
¹ Financial Accounting Standards Board. 2008. Interpretation No.46: Consolidation of Variable Interest Entities, https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1175801627792&acceptedDisclaimer=true, accessed on September 14, 2020.

stock exchanges facilitates the HoCo's later IPOs on major securities exchanges of the Global North, especially in the U.S. As the fundraising vehicle, the HoCo would draw global investments, usually starting with several rounds of venture capital or private equity investments before seeking public investment after initiating an IPO. This HoCo existed mainly on paper and would "establish" a wholly foreign-owned enterprise (WFOE) inside China, sometimes through an additional intermediary registered in Hong Kong to take advantage of favourable policies granted by Beijing to Hong Kong-registered investments.² However, these WFOEs do not directly operate in China-based Internet assets and businesses because the state prohibits foreign ownership in this sector. To get around this, these WFOEs would provide funding, technology, and managerial expertise through *commercial contracts*, instead of direct equity ownership, to real operating companies (OpCo). These OpCos that manage Internet assets in China are owned and controlled by the very Chinese entrepreneurs who created the HoCo offshore. Under such construction, the OpCo would become a VIE whose financial statements were merged with those of the WFOE and the HoCo, thus being legally considered an affiliation of the listed company by securities regulators from the listed destination in the Global North. In reality, however, a VIE allowed Chinese founders and managers to wield *de facto* control and management of China-based Internet assets and businesses despite the *de jure* majority ownership of foreign investors.

² Under certain conditions, the investments from Hong Kong-registered companies in Mainland China can benefit from a 5% tax deduction. The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) signed in 2003 granted qualifying products, companies, and residents of Hong Kong preferential access to the Mainland.

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Diagram 5.1 Conceptual Organizational Chart of the VIE Structure



Sources: The author's composition based on various VIE using Internet companies' prospectuses and Gills Paul, "Explaining VIE Structures," *China Accounting Blog*, <https://www.chinaaccountingblog.com/weblog/explaining-vie-structures.html>, published March 20 2011, assessed September 22, 2020.

So what contracts are needed to establish this indirect non-equity relationship between the WFOE and the OpCo and to bundle them as one company in an accounting and legal sense? Generally speaking, despite case-by-case variations, the contractual arrangements typically require five essential elements. The first is a *technical cooperation agreement* that makes the WFOE the provider of services, technologies, and intellectual property rights to the OpCo and the recipient of the OpCo's revenue and profits in the form of service or franchise fees. The economic gains are then repatriated to the offshore-established HoCo, which holds investments from outside China. Secondly, a *loan agreement* allows the OpCo to borrow interest-free funds from the WFOE that

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would be used exclusively for capital accumulation by the OpCo. Third, a *voting proxy* will be signed, granting the HoCo and its offshore affiliates the rights to directly involve themselves in the board's decision-making and to send board members to the OpCo. Fourth, an *equity pledge agreement* then grants the WFOE first-priority security interests in all shares owned by the OpCo's shareholders, serving as a collateral for the proper performance of contractual arrangements.³ Last but not least, a *call option agreement* promises that, on the condition that the Chinese authorities allow non-Chinese direct ownership in the information services sector, the HoCo will be allowed to acquire the equity interests and assets of the OpCo at a pre-negotiated price.

But why bother to use such a convoluted corporate structure? The VIE model represents an ingenious compromise between China-based and Chinese-controlled Internet businesses in their quest for ODFD, the requirements of American and Hong Kong securities regulators, and Beijing's prohibition of foreign operation in China's Internet-related assets. To fulfill American and Hong Kong securities regulations, on paper, the OFC-domiciled parent HoCo, in the capacity of a foreign investor, would establish a WFOE inside China and maintain corporate control over the OpCo through multiple contracts. As the VIE of the WFOE, this OpCo would be considered an affiliation of the HoCo in accounting and legal matters.

In reality, however, the power dynamic that plays out between the OpCo inside China and the HoCo owned by foreign investors is quite the opposite. Although foreign investors own the offshore-domiciled HoCo through the majority equity shares they hold, their influence on assets inside China is seriously limited because they do not wield effective control over the entity that operates assets.⁴ In practice, the WFOE and the OpCo are a single institution with two names

³ Among all the contracts, the equity-pledge agreement must be reported to the Chinese regulator; two parties sign the others on a voluntary basis.

⁴ This risk is articulated in the IPO prospectus of all foreign-incorporated and -listed companies based in China. For instance, Alibaba's prospectus for the NYSE listing in 2014 stated that "The Company [Alibaba Group Holding

controlled by the same group of Chinese entrepreneurs and company founders. Their company names, office locations, and the composition of board members and chief executives overlap and may even be the exact same.⁵ In other words, even though the WFOE is legally and geographically a completely foreign-invested company, it is *de facto* owned and controlled by the Chinese entrepreneurs and managers that set up the entire complex structure. Through the proxy voting agreements signed between the WFOE and the OpCo, the offshore HoCo delegates its voting power to Chinese entrepreneurs for the daily operation and management of businesses inside China on their behalf.

As Table 5.1 shows, VIE has helped several dozens of Chinese Internet companies to fundraise from the American and Hong Kong securities markets. As of October 2020, 51 of the 217 China-based and Chinese-controlled companies listed on U.S. exchanges operated in the Internet services sector, together bringing home US\$ 35,631 million.⁶ Measured by either market valuation or revenue, one-third of the world's top thirty Internet firms are based in China,⁷ many

Limited] is incorporated in the Cayman Islands and considered as a foreign entity under PRC laws. Due to the restrictions on foreign investment and ownership on the business related to Internet content provision, telecom value-added services, financial services and others, the Company conducts its business through various contractual arrangements with VIEs that are generally owned and controlled by management members of the Company. The VIEs hold the licenses and approvals that are essential for their business operations in the PRC and the Company has entered into various agreements with the VIEs and their equity holders such that the Company has the right to benefit from their licenses and approvals and generally has control of the VIEs." Securities and Exchange Commission (SEC), Form-1 (Alibaba IPO Prospectus), <https://www.sec.gov/Archives/edgar/data/1577552/000119312514184994/d709111df1.htm>, published May 6 2014, accessed September 7 2019.

⁵ Ding Yiyi and Zhao Sun, "Sadan VIE (Satan VIE)," *IT Shidai Zhoukan*, [IT Times Weekly] <https://www.163.com/tech/article/7IQGT5340009387K.html>, reposted by 163.com November 14, 2011, accessed September 22 2020.

⁶ Based on the author's own count from U.S.-China Economic and Security Review Commission (USCC), 2021, Chinese Companies Listed on Major U.S. Stock Exchanges, https://www.uscc.gov/sites/default/files/2021-05/Chinese_Companies_on_US_Stock_Exchanges_5-2021.pdf, last updated May 5, 2021, accessed on 15 February 2022. Regarding the definition of information service, see chapter one.

⁷ China Academy of Information and Communications Technology (CAICT), "Zhongguo Hulianwang Hangye Fazhan Taishi ji Jingqi Zhishu Baogao (2019)," [Report on the Momentum and Prosperity Index of China's Internet Industry in 2019], <http://www.caict.ac.cn/kxyj/qwfb/bps/201907/P020190711358461846647.pdf>, accessed September 22, 2020.

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of which are rapidly gaining in revenue,⁸ voraciously expanding overseas,⁹ assuming leadership roles in certain technologies, and setting global industrial standards.¹⁰ Because of Beijing's restrictions against foreign corporate control in this sector, all of them used the VIE structure.¹¹

Table 5.1 Top 21 VIE-structured Chinese Internet Companies that Trade on U.S. and Hong Kong Stock Exchanges with an IPO Value Surpassing US\$ 100 million before October 2020

Company	IPO Value US \$ million	IPO Time	Primary Service(s)	Listed Exchange	Lead Underwriters
Alibaba*	\$1,700	2007.11	B2B E-Commerce	HKSE	Goldman Sachs, Morgan Stanley, Deutsche Bank
	\$21,767	2014.09	E-Commerce, Third Party Payment	NYSE	Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan Chase, Morgan Stanley, Citigroup
	\$13,000	2019.11	E-Commerce, Cloud Computing, Digital Media and Entertainment	HKSE	CICC, Credit Suisse, Citi Group, J.P. Morgan, Morgan Stanley
iQiYi	\$2,250	2018.03	Online Video	NASDAQ	Goldman Sachs, Merrill Lynch, Credit Suisse
JD.com	\$1,800	2014.05	E-Commerce	NASDAQ	Merrill Lynch, UBS
Pinduoduo	\$1,626	2018.08	E-Commerce	NASDAQ	CICC, Credit Suisse, Deutsche Bank

⁸ To name a few examples, the *Fortune* Global 500's revenue-based rankings in 2020 counted four China-based and Chinese-controlled Internet companies, Jingdong (102), Alibaba (132), Tencent (197), and Xiaomi (422). For more information, see *Fortune*, <https://fortune.com/global500/2020/search/>.

⁹ For instance, TikTok, a video-focused social networking mobile phone application owned by the Beijing-headquartered Byte Dance respectively counted 100 million and 700 million active users in the U.S. and worldwide in August 2020. <https://www.cnn.com/2020/08/24/tiktok-reveals-us-global-user-growth-numbers-for-first-time.html>

¹⁰ See, for instance, Rebecca Fannin, "China's Tech Upgrade Challenges the West For Leadership, Plenty Could Go Wrong," *Forbes*, <https://www.forbes.com/sites/rebeccafannin/2019/07/14/chinas-tech-upgrade-challenges-the-west-for-leadership-what-could-go-wrong/>, posted and accessed July 14, 2019. For more information on China's burgeoning Internet industry, see, for instance, *South China Morning Post's* China Internet Report at <https://multimedia.scmp.com/infographics/china-internet-2021/>.

¹¹ USCC, "Chinese Companies Listed on Major U.S. Stock Exchanges." Also, based on a survey conducted in March 2019, of the 182 surveyed Chinese companies that were listed on NASDAQ and NYSE, 125 (69%) of them used the VIE structure. Gills Paul and Fredrik Oqvist, Variable Interest Entities in China, <https://www.chinaaccountingblog.com/weblog/2019-03-vie-gillis.pdf>, published March 13, 2019; assessed February 16, 2022.

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Tencent Music	\$1,100	2018.12	Online Music	NYSE	Bank of America, Deutsche Bank, Goldman Sachs, JP Morgan, Morgan Stanley
Douyu	\$775	2019.07	Video Live Streaming	NASDAQ	Morgan Stanley, JP Morgan, Bank of America, Merrill Lynch, CMB International
Renren	\$743	2011.05	Social Networking	NYSE	Merrill Lynch, Deutsche Bank, Morgan Stanley
Sougou.com	\$585	2017.11	Internet Search	NYSE	JP Morgan, Credit Suisse, Goldman Sachs, CICC
ChinData	\$540	2020.09	Data Center	NASDAQ	Morgan Stanley, CitiGroup
Kingsoft Cloud	\$510	2020.05	Cloud Service	NASDAQ	JP Morgan, UBS, Credit Suisse, CICC
Bilibili	\$483	2018.03	Online Video	NASDAQ	Merrill Lynch, JP Morgan Chase, Morgan Stanley
Dada Nexus	\$320	2020.06	Online Retail and Delivery	NASDAQ	Goldman Sachs, Bank of America, Jefferies
One Connect	\$312	2019.12	Financial Data	NYSE	Morgan Stanley, Goldman Sachs, J.P. Morgan, Ping An
Weibo	\$286	2018.03	Microblog	NASDAQ	Credit Suisse, Goldman Sachs
Momo	\$216	2014.12	Instant Messaging	NASDAQ	Morgan Stanley, Credit Suisse, J.P. Morgan, China Renaissance Securities
Tencent	\$200	2004.06	Instant Messaging	HKSE	Goldman Sachs
21 Vianet	\$195	2011.04	Internet Data Center	NASDAQ	Deutsche Bank, Goldman Sachs, Barclays
GDS Holdings	\$193	2016.11	Internet Data Center	NASDAQ	Credit Suisse, JP Morgan
Huya	\$180	2018.05	Game Livestreaming	NYSE	Credit Suisse, Goldman Sachs, CitiGroup, Jefferies
Cheetah Mobile	\$168	2014.05	Mobile Phone Application	NYSE	Morgan Stanley, JP Morgan, Credit Suisse
Autohome	\$133	2013.05	Automobile Information	NYSE	Deutsche Bank, Goldman Sachs,
Yunji	\$121	2019.05	E-Commerce	NASDAQ	Morgan Stanley, Credit Suisse, JP Morgan, CICC
Baidu	\$109	2005.08	Internet Search	NASDAQ	Goldman Sachs, Piper Jaffray, Credit Suisse

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* Alibaba delisted the B2B branch in 2012. For more information on Alibaba’s financial acquisition history, see Section 5.6

Source: USCC, “Chinese Companies Listed on Major U.S. Stock Exchanges;” Alibaba, “Alibaba Wangluo Gongsi Shouri Guapai Jiaoyi,” [Alibaba Internet Ltd. Started Its First Day Trade], https://www.alibabagroup.com/en/news/press_pdf/p071106.pdf , published November 6, 2007, accessed September 17, 2021.

Market Watch, “Tencent 158 Times Oversubscribed,”

<https://www.marketwatch.com/story/china-tencent-ipo-158-times-oversubscribed-afx>, published June 14, 2004, accessed February 15, 2022.

Hong Kong Stock Exchange, Global Offering of Alibaba Group, <https://www1.hkexnews.hk/listedco/listconews/sehk/2019/1115/2019111500039.pdf> , November 15, 2019, accessed February 15, 2022.

5.2 Funding Shortage, Financial Repression, and the Economic Rationale of VIE

Whereas the state-owned “Red Chip” users sought ODFD to help advance Chinese telecom reforms, the difficulty of accessing capital from China’s discriminatory domestic banking system and capital market motivated Chinese Internet start-ups founded by private entrepreneurs with scant state ownership to look to overseas capital markets. It is widely acknowledged that China’s domestic financial market is inefficient because of excessive state intervention. Its bank-centric financial system – dominated by four giant central state-owned banks – is plagued by a morass of nonperforming loans.¹² State-ownership means state-owned companies with a closer relationship with the party-state and an artificially made low-cost capital structure, causing loans to be used and wasted more than necessary.¹³ Moreover, neither of the two domestic stock exchanges function as an alternative source of funding channel for privately held companies. Both established in 1990, the Shanghai and Shenzhen exchanges are incomparable with the banking sector in terms of scale and importance.¹⁴ As many studies have found, the development of stock markets was

¹² Allen Franklin, Jun Qian, and Meijun Qian. “China’s Financial System: Past, Present, and Future.” In *China’s Great Economic Transformation*, edited by Loren Brandt and Thomas G. Rawski, 506–68. Naughton Barry, *The Chinese Economy: Transitions and Growth*. Cambridge, MA: MIT Press, 2007. p.449.

¹³ Pettis Michael, *Avoiding the Fall: China’s Economic Restructuring*. Washington, DC: Carnegie Endowment of Peace, 2013, p.57.

¹⁴ For the history of China’s stock market, see Green Stephen, *The Development of China’s Stock Market, 1984-2002: Equity and Market Institutions*. Routledge, 2004. Walter Carl and Fraser Howie, *Privatizing China: The Stock*

intended to serve the political ends of the party state in general and the reform of state-owned enterprises in particular, instead of providing an alternative financing channel for Chinese businesses.¹⁵

Internet-related businesses are not counted under the basic telecom services monopolized by state capital, neither are they part of the seven fundamental industries that Beijing wants “absolute control,”¹⁶ meaning there are few direct investments from the state or policy incentives at the beginning of their development.¹⁷ This disadvantage is only aggravated by the nature of the Internet services sector. Many Internet companies, starting from scratch with only ideas and computers, had few assets that could be recognized as collaterals for bank loans, and the high likelihood of failure in the Internet industry also made commercial banks reluctant to lend to such risky endeavours. So, like many of their American predecessors, China-based Internet companies were obliged to resort to equity markets. However, listing China-based assets on either the domestic or international stock exchanges faced multiple administrative hurdles from the China Securities Regulatory Commission (CSRC).

According to CSRC’s regulation in 2006, for a non-state-held company to initiate an IPO on the small and median enterprise board in China’s domestic A-share market, the applicant must maintain a net profit of at least RMB 30 million, an annual cash flow from operating activities (or a three-year aggregate of RMB 300 million) worth at least RMB 50 million, and a total share

Markets and Their Role in Corporate Reform, John Wiley & Sons Incorporated, 2003. Yong Kwek Ping. *Private Equity in China: Challenges and Opportunities*. Singapore: Wiley, 2012.

¹⁵ Naughton, *The Chinese Economy: Transitions and Growth*, p.469. Green, *The Development of China’s Stock Market, 1984-2002*, p.225. Bell Stephen and Hui Feng, “Reforming China’s Stock Market: Institutional Change Chinese Style.” *Political Studies* 57, no.1 (2009):117-140. p.125.

¹⁶ *Xinhua*, “Guoziwei: Guoyou Jingji Yingbaochi dui Qige Hangye de Juedui Kongzhili,” [SASAC: State-owned Enterprises Should Maintain Absolute Control over Seven Industries,] published December 18, 2006, accessed May 08, 2022.

¹⁷ He Xia, *Xinxi Chanye de Touzi yu Rongzi* [Investment and Financing in the Information Industry], Beijing: Renmin Youdian Chubanshe, 2001, p. 34.

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capital of no less than RMB 30 million in the last three fiscal years.¹⁸ Even for the second board market, one primarily made for innovation-driven firms, this strict profit-generating threshold still applies. The applicant also must fulfil any of the following conditions. First, the company must have made accumulative net profits of at least RMB 10 million with continued increases in the last two years. Second, the company must have made net profits surpassing RMB 5 million in the latest fiscal year. Thirdly, its business income in the latest year must be RMB 50 million or more. Finally, the growth rate of its business income in the latest two years must be 30% or more.¹⁹

CSRC's regulation creates systematic barriers for non-state-owned firms or those without strong political connections to raise capital, who meet extra challenges such as tougher requirements on conditions for credit or initiating IPO at home.²⁰ The state regulator holds the ultimate authority over which firms can list and when they can do so. As one expert has noted, firms are not listed based on the best rate of return acceptable to investors, but at the Chinese authorities' discretion over the quota and selection.²¹ In 2013 and 2015, the IPO market was shut down twice for months, causing a backlog of domestic firms to be listed. Such an administrative

¹⁸ China Securities Regulatory Commission (CSRC), "Shouci Gongkai Faxing Gupiao bing Shangshi Guanli Banfa" [Measures for the Administration of Initial Public Offering and Listing of Stocks]

http://www.gov.cn/ziliao/flfg/2006-05/18/content_283660.htm, published May 17, 2006, effective from May 18, 2006. According to Article 33, other non-pecuniary thresholds include intangible assets (after deducting the rights of land use, water culture and mining) that account for no more than 20% of the net assets at the end of the most recent accounting period and no uncovered losses exist at the end of the most recent accounting period. Moreover, despite two revisions in 2015, 2018, and 2020, the aforementioned requirements were retained.

¹⁹ CSRC, "Shouci Gongkai Faxing Gupiao Bingzai Chuangyeban Shangshi Guanli Zanxing Banfa," [Administrative Measures for Initial Public Offerings and Listing on the Second Board,]

<http://www.csrc.gov.cn/csrc/c105889/c1015337/content.shtml>, published March 31, 2009, effective from May 1, 2009. Specific requirements were laid out in Article 10. For more information on China's IPO requirement, see Goldschmidt David (ed.), "The Initial Public Offerings Law Review," third edition, 2019: The Law Reviews, available online:

<https://www.hankunlaw.com/downloadfile/newsAndInsights/159a0437a4d786fd49a0da53437d7bd2.pdf>.

²⁰ Steinberg, David. "The Domestic Political Sources of China's International Financial Policies," in *Enter the Dragon: China in the International Financial System*, edited by Domenico Lombardi and Hongying Wang, 223-58 McGill-Queen's University Press, 2016, p.239. Li Hongbin, Lingsheng Meng, Qian Wang, and Li-An Zhou. "Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms." *Journal of Development Economics*, 87, no. 2 (2008): 283-299.

²¹ Lavelle, Kathryn. *The Politics of Equity Finance in Emerging Markets*, Oxford: Oxford University Press. 2004. p.131

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monopoly favours firms with strong connections with government officials, but also means that listings become a time-consuming evaluation process with onerous bureaucratic red-tapes which encourage firms to engage in bribery.²² Moreover, as both regulator and major shareholder of many listed companies, the state has to reconcile the conflicting objectives of maximizing profit and social welfare,²³ which further distorts the valuation and performance of listed companies,²⁴ but also makes it much more responsive to government policy changes rather than individual companies' values and performance.²⁵

Difficulty in obtaining funding in domestic financial markets have obliged Chinese firms to turn to informal financial means such as shadow banking which is based on reputation and relationship.²⁶ However, they are too little and are costly for capital-intensive sectors such as information services. Venture capital, a proven and helpful way for high-risk and high-reward investments because it instills risk capital into new business and nurtures its growth till profits are seen,²⁷ also suffers from state disruption in China. Although China's efforts to mimic foreign venture capital dated back to 1984, this sector is inhibited by legal and tax-related obstacles.²⁸ Heavy state-ownership has made venture capital firms not a solution to market failure,²⁹ but "politicized mechanisms for subsidizing non-viable activities."³⁰ As two influential China

²² Naughton, *The Chinese Economy: Transitions and Growth*, p.474

²³ Pistor, Katharina. "The governance of China's finance" in Fan Joseph, Randall Morck, and National Bureau of Economic Research (eds). *Capitalizing China*, University of Chicago Press: 2012, pp.35-60.

²⁴ Naughton, *The Chinese Economy: Transitions and Growth*, p. 471

²⁵ Morck, Randall. Bernard Yeung, and Wayne Yu, "The Information Content of Stock Markets: Why do Emerging Markets have Synchronous Stock Price Movements?" *Journal of Financial Economics* 58, no. 1 (2000): 215-260.

²⁶ Tsai, Kellee. *Back-Alley Banking: Private Entrepreneurs in China*, Ithaca, NY: Cornell University Press, 2002

²⁷ Kunze, Robert. *Nothing Ventured: The Perils and Payoffs of the Great American Venture Capital Game*, Harper Collins, 1991. p.1

²⁸ Gompers, Paul. and Josh Lerner, *The Venture Capital Cycle*, Cambridge, MA: MIT Press, 2002.

²⁹ Lerner, Josh. *Boulevard of Broken Dreams: Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed – and What to Do about it*, Princeton, NJ: Princeton University Press, 2009.

³⁰ Wright Mike, "Venture Capital in China: A View from Europe." *Asia Pacific Journal of Management*, 24(3):269-81, p.272.

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scholars observed, inefficient home institutions and predatory governments in China oblige Chinese firms to raise finance through more efficient institutions abroad as an alternative.³¹

The rules for applying to a direct foreign listing are just as, if not more, cumbersome. For instance, until 2013, listing a China-incorporated company directly on the Hong Kong Stock Exchange (HKSE) required the candidate to fulfill a so-called “4-5-6 benchmark” imposed by CSRC. The company must have a net asset of at least RMB 400 million, issue proceeds of more than US\$ 50 million, and earn net profits greater than RMB 60 million in the previous year before they are allowed to apply for an overseas IPO.³² Let us take Sina, the predecessor of VIE that will be introduced in detail in the next section, as an example of how such requirements could substantially delay the funding acquisitions of an Internet-based company. In 1999, one year before the overseas listing of its Cayman Islands-registered SPV, Sina recorded revenues of US\$ 2.827 million and a net loss of US \$939.400 million.³³ In 2000, the year of its IPO, the company’s net loss accrued to US\$ 51 million even though its revenue rose to US\$ 14.170 million.³⁴ To reach the “4-5-6 benchmark” imposed by the CRSC, Sina’s IPO would have to be delayed until at least 2005, and that is without considering the bureaucratic red tapes.³⁵ Moreover, the listed firm’s post-

³¹ Huang Yasheng, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, Cambridge: Cambridge University Press, 2008; Pei Minxin, *China’s Trapped Transition: The Limits of Developmental Autocracy*, Cambridge, MA: Harvard University Press, 2006.

³² This “4-5-6” benchmark was first and formally introduced in July 1999 with CSRC’s issuance of “Guanyu Qiye Shenqing Jingwai Shangshi Youguan Wenti de Tongzhi,” [Notification on Questions Related to Enterprises Applying for Overseas Stock Issuance and Listing of Joint Stock Companies], http://www.csrc.gov.cn/pub/zjhpublic/G00306202/200804/t20080418_14674.htm, published and effective from July 14, 1999, accessed August 15, 2020. The benchmark was repealed in December 2012 with the introduction of CSRC’s Public Announcement No. 45, “Guanyu Gufen Youxian Gongsi Jingwai Faxing Gupiao he Shangshi Shenbao Wenjian ji Shenhe Chengxu de Jianguan Zhiyin,” [Guidelines for Supervising the Application Documents and Examination Procedures for the Overseas Stock Issuance and Listing of Joint Stock Companies,] <http://www.csrc.gov.cn/csrc/c101932/c1044478/content.shtml>, published December 20, 2012, effective from January 1, 2013.

³³ SEC, Form 10-K of Sina.com, <https://secfilings.nasdaq.com/filingFrameset.asp?FilingID=325474&RcvdDate=9/28/2000&CoName=SINA%20CO RP&FormType=10-K&View=html>, p.26

³⁴ Ibid.

³⁵ Liu Xiangning, “VIE: Moren Hefa shi Shixia Zuiyou Xuanze,” [VIE: Acquiescing It Being Legal is the Optimal Choice at the Moment],

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IPO refinancing and share options must be approved by the CSRC – a process even more cumbersome than an IPO. Additionally, the waiting time was completely at the discretion of the CSRC, which enticed rent-seeking.³⁶

It was against this historical and regulatory backdrop that China-based Internet companies turned to *indirect* listing in international financial markets as a remedy. The VIE structure offered an expedient solution. Setting up an offshore company in the Cayman Islands, according to one advertisement, only required ten business days.³⁷ And the next step of registering a WFOE in China and finalizing contractual agreements in Mainland China took around a month.³⁸ But despite the urgent need for foreign finance and the expediency to build such a structure, the complicit approval and involvement of Chinese regulators was indispensable to setting up the VIE corporate structure.

5.3 The Sina Model as a Predecessor and Template

The company that established the VIE model for its hundreds of followers was Sina (*Xin Lang*), which initiated its IPO in 2000 on the National Association of Securities Dealers Automated Quotations (NASDAQ), one of the world’s largest electronic securities exchanges favoured by technology and Internet start-ups.³⁹ The company was originally named Stone Rich Sight

http://pg.jrj.com.cn/acc/Res%5CCCN_RES%5CINVEST%5C2011%5C7%5C11%5C69586603-d1de-4e7d-978e-c32564eb62bc.pdf, published July 11, 2011, accessed August 20, 2020. p.8

³⁶ For example, in 1998, to get his company quickly listed on the Chinese domestic A-share, Gao Feng, the chairman of Chundu Corporation, came to the CSRC’s office building every morning at 7:00 am, boiled water, filled the thermal bottler in every office (Chinese people have a habit of drinking hot or lukewarm water), and swept the corridor clean. After doing so persistently for “quite a long time,” he eventually “established connections with high-level CSRC leadership (*shutong gaoceng guanxi*)” and obtained the approval to have his company listed. Huang Yikun and Tao Xu, “‘10 Haowen: Zhongguo Minqi Haiwai Shangshi Yuzu’,” [“No.10 Document: Chinese Private Enterprises’ Overseas Listing Met Obstruction”], *Caijing Shibao*, reposted in *Sohu*, <https://business.sohu.com/20070331/n249103930.shtml>, published March 31, 2007, accessed August 17, 2020.

³⁷ For instance, Haiwai Gongsi Zhuce Wang, “Lian Gongsi Sheli Jieshao,” [Introduction on Setting Up an Offshore Company] <http://www.company110.com/finance/setup.htm>.

³⁸ Ding and Sun, “Sadan VIE.”

³⁹ For more information on similarities and differences between Nasdaq and other American stock markets, see, Carlozo Lou, Nasdaq vs. NYSE: Why Companies Choose One Over the Other, *U.S. News*, <https://money.usnews.com/investing/articles/2016-08-05/nasdaq-vs-nyse-why-companies-choose-one-over-the->

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Information Technology Co. Ltd. (BSRS), a Beijing-based computer software company created in 1993 as a joint venture between the Hong Kong-based investor Rich Sight Investment Ltd. (RSIL) and Beijing Stone Electronic Technology Co., Ltd. With the rapid commercialization of the Internet in China, BSRS gradually shifted its business towards online information and launched an online network named SRSnet.com to offer Chinese-language news and information and community features like bulletin boards and chat services targeted at Chinese online users, even though only a miniscule 100 thousand out of the 1.2 billion people in Mainland China surfed the Internet in 1996.⁴⁰

To expand its business in China's nascent Internet market, BSRS turned to foreign venture capital investment. In July 1997, SRS International Ltd. was registered in the Cayman Islands as a fundraising vehicle. Three months later, BSRS received US\$ 6.5 million from California-headquartered Walden International, Bank of America, and Singapore- and London-based Ivanhoe Capital, marking the first foreign venture capital transaction in China's information services industry.⁴¹ Thanks to this transaction, the company promoted its business internationally. In March 1999, through its Cayman Islands-registered fundraising vehicle, BSRS acquired Sinanet.com, a leading Chinese-language online content company with offices in California and Taiwan that operated websites targeting Chinese-language users in North America and Taiwan. Subsequently, the name of Sinanet.com was changed to Sina.com, and the name of the holding company in the Cayman Islands was changed from SRS International Ltd. to Sina. In July 1999, Sina launched the

[other](#), published August 5, 2016, accessed September 23, 2020.

⁴⁰ *Xiaoxiang Chenbao* [Xiaoxiang Morning Post], "1996nian, Zhongguo Laobaixing Kaishi Shangwang," [The Year of 1996: Chinese People Started to Surf the Internet,] <http://news.sina.com.cn/c/2008-11-28/173716746013.shtml> reposted in *Sina*, published November 28, 2008, accessed September 23, 2020.

⁴¹ *Sohu*, "'Youle Weibo, Meile Xinlang', Shui Hai Jide Sitong Lifang?," [Microblog without Sina, Who Still Remembers Beijing Stone Rich Sight Technology?], https://www.sohu.com/a/127231518_582534, published February 25, 2017, accessed September 24, 2020.

Hong Kong destination website targeting Hong Kong-based Chinese-language users as part of a continued network expansion.

With a growing appetite for funding to support its expansion in the Mainland China market, Sina turned its eye to American stock markets. In August 1999, Wang Zhidong became the Chief Executive Officer (CEO) of Sina and soon embarked on an ambitious plan to attract investment by using the Cayman Islands-registered vehicle to float shares on NASDAQ. At that time, using a foreign-incorporated shell company to list Mainland China-based assets on the international securities market required a legal compliance letter (*falyu yijianshu*) issued by any one of the CSRC's recognized law firms.⁴² But after consulting with the CSRC, the law firm did not dare to issue that letter because it was unsure about whether Sina's overseas IPO conformed to the regulations set up by Chinese telecommunications authorities. For both the CSRC and its law firms, Internet-based content, the type of services that Sina provided and sought to attract foreign investment in, was regulated as a subsector of telecom value-added services (VASs) by the Ministry of Information Industry (MII).⁴³ On September 14, 1999, citing an MII-issued policy from 1993, Minister Wu Jichuan reiterated that Internet content services were telecom VASs, meaning they were part of a sector where foreign ownership (read as industrial ownership) and operation was strictly forbidden.⁴⁴

Feeling anxious about Wu's message, Wang Zhidong visited the MII in late September 1999, days before submitting Sina's IPO prospectus to NASDAQ. The feedback from the MII was startling: "Sina is a good company, but before the new policies are unveiled, we hope that Sina

⁴² Article 29 of China's Securities Law, effective from July 1 1999.

⁴³ As Chapters 3 and 4 have mentioned, the Ministry of Post and Telecommunications (MPT) and the Ministry of Electronic Industry (MEI) were merged in March 1998 into the MII.

⁴⁴ According to the WTO's definition, Internet content is separate from telecommunications. As the MPT was the chief negotiator and regulator of telecommunications services, and commercialized Internet was relatively new, Wu's statement should be construed as the MII's extension of regulatory power by incorporating Internet services as a type of telecom services against China's radio and television authorities.

can reorganize its corporate structure, which is now irregular.”⁴⁵ In fact, in September 1999, the ongoing US-China World Trade Organization (WTO) negotiations regarding the degree of openness in the telecommunications services sector was still unresolved, and both parties aimed to make some breakthrough during the next round of negotiations in Beijing in November 1999. Against this backdrop, the MII suspended Sina’s IPO plan and ordered the company to wait for further policy clarity.⁴⁶

Sina was not the only company whose IPO plans were halted by the MII. Sohu (*sou hu*) and NetEase (*wang yi*), two other China-based Internet content providers (ICPs) whose listing vehicles were already registered in Bermuda and Delaware state, faced the same problem. Both companies tried to reason with the MII by arguing that since the to-be-listed companies were geographically and legally incorporated outside of Mainland China, their IPO deal was thus out of the MII’s jurisdiction. But such arguments were met with a cold rebuttal from the MII: “Yes, of course you can list overseas, and you may not be subject to approval from the Chinese government, but please move your servers to the US. As long as your servers are located inside China, I am sorry, but you are subject to our administration (*shou wo ’men guan*)!”⁴⁷

As a result, all three companies fell into the same catch-22 involving conflicting interests from global investors, the MII, and the CSRC. To convince global investors to spend money on their company, Internet content inside of China had to be the core theme and assets floated on NASDAQ. However, that would contradict the MII’s zero tolerance policy towards any foreign ownership and operation of Internet assets in China. On the other hand, listing a China-incorporated and China-based company on international securities exchanges was unfeasible

⁴⁵ Lin, Jun. *Feiteng 15 Nian: Zhongguo Huihuanwang 1995-2009*, [15 years of Boiling: China’s Internet from 1995 to 2009,] Beijing: Zhongxin Chubanshe, 2009. p.208.

⁴⁶ Ibid. p.208.

⁴⁷ Ibid. p.209.

because the CSRC's stringent direct listing requirements and red tape still applied to them – something that China-based Internet companies tried to escape from. In this regard, a foreign-registered vehicle could help circumvent hassles with the CSRC, but still could not avoid the MII's regulatory jurisdiction.⁴⁸

Facing this “impossible trilemma”, Wang Zhidong and his lawyer Liu Gang wracked their brains to work out an acceptable solution for the MII, the CRSC, and their global investors. Bureaucrats from the MII in charge of examining and approving the IPO requests of Chinese Internet companies even told Wang that their daily job had largely been idle before, but “thanks to” the three companies' attempts at overseas listing, they had to “work into midnight everyday, review the proposed corporate structure reports attentively, analyze them clause by clause, and draft reports to the ministerial leadership. No one dared to make a mistake because the issue was tightly watched (*si dingzhe*) by the MII's top leaders.”⁴⁹

Eventually, an innovative idea from Liu Gang resolved the problem. After more than a dozen rounds of back-and-forth submissions and rejections with the MII, Sina became the first of the three companies to obtain approval from the MII in March 2000. The ingenious workaround is shown in Diagram 5.2 below. BSRS, the China-based company that operated Internet assets, became a WFOE of the Cayman Islands-domiciled listing vehicle on paper. Next, two China-based companies were created. One was Beijing Sina Interactive Advertising Co., Ltd., (Beijing Sina Ad.) a Sino-foreign joint advertising venture owned between the general manager of Sina's China operations Wang Yan and the BSRS, and split between the two at 75% and 25% respectively. The

⁴⁸ More precisely, the CSRC evaluates “foreignness” based on three criteria: whether the listed company is foreign-registered, whether Chinese shareholdings are below 20%, and whether the Chinese entity holds the most shares. Upon fulfilling all three criteria, the listing company will not be considered Chinese, and will thus become subject to stringent inspection and listing requirements. Ibid. pp.123-24.

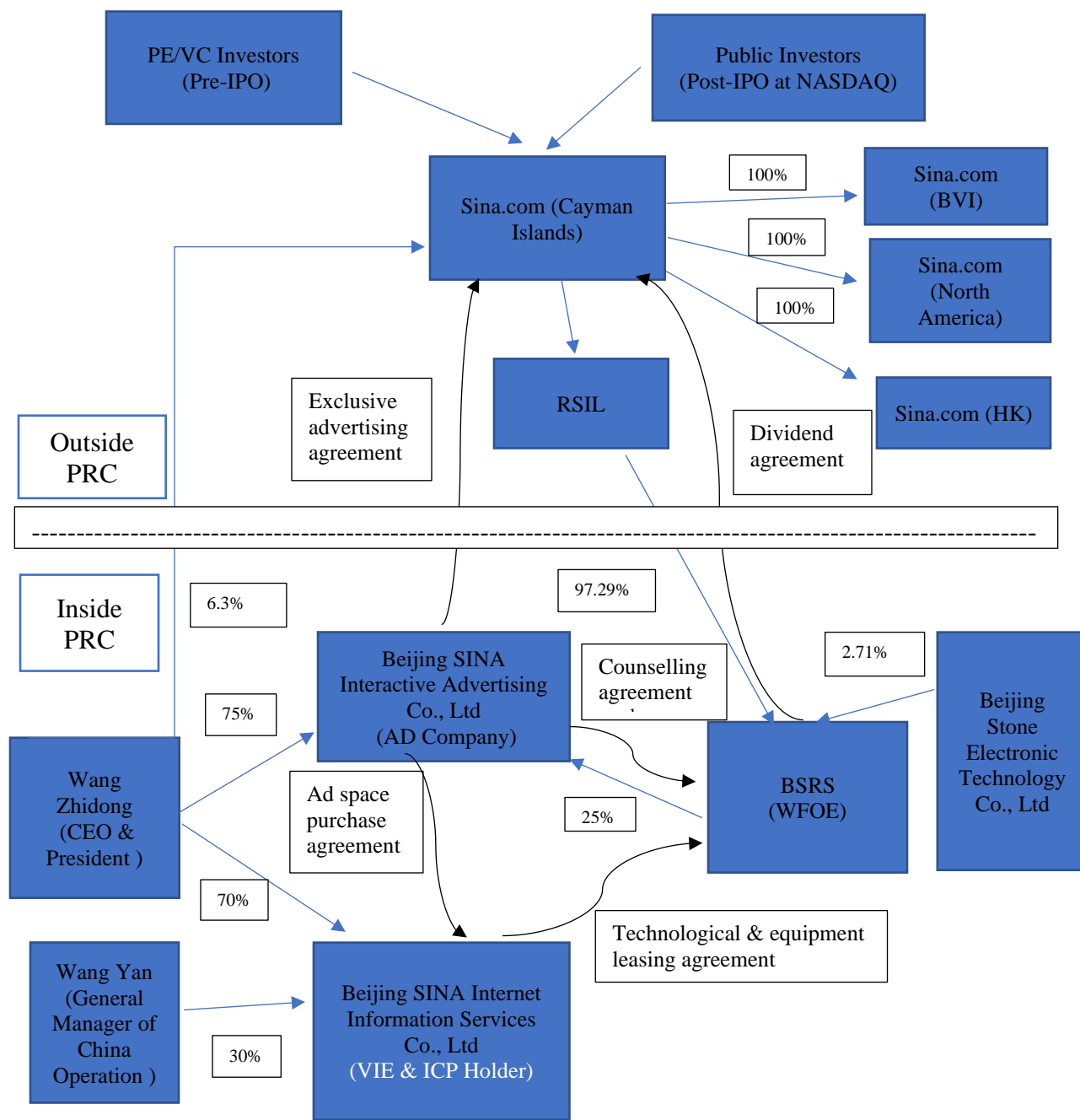
⁴⁹ Ibid. p.210.

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other company, Beijing Sina Internet Information Services Co., Ltd., (Beijing Sina Internet) was a fully Chinese-owned and controlled company, with 70% of it owned by Zhidong Wang and the remaining 30% owned by Wang Yan. To conform with the MII's prohibition against foreign ownership and foreign control of Internet assets, Beijing Sina Internet, thanks to its complete Chinese ownership, obtained the ICP license issued by the MII and was responsible for operating Sina.com.⁵⁰ Meanwhile, Sina.com, the Cayman Islands-domiciled parent company that global investors invested in, indirectly controlled Beijing Sina Internet using a number of commercial *contracts*, through which the wholly foreign-owned BSRS only provided intellectual property, equipment, and technical services to their license holder and operator Beijing Sina in exchange for profits. BSRS also served as a consultant and service provider to Beijing Sina Ad. for its domestic Chinese customers. This ICP-license holding company was the most profitable part of the entire convoluted structure, which appealed to overseas investors because of the high viewing and commercial revenues generated from selling advertising space. All of the income received from advertising sales was transferred to BSRS, and eventually, to the offshore parent company.

⁵⁰ The question of how difficult or possible it is for firms with foreign ownership to obtain licenses in providing Internet-related business will be elaborated more comprehensively in the next chapter.

Diagram 5.2 Sina's IPO Corporate Structure



* Blue Arrows indicate equity ownership, and black curved arrows indicate contractual arrangements

Source: Sina's IPO Prospectus and F-20 Filings; Lin, *Feiteng 15nian*, p.208.

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The corporate structure established by Sina has since been used by dozens of China-based Internet companies seeking ODFD from the global financial market. It has been updated and enhanced in accordance with changes in U.S. Securities and Exchange Commission (SEC) regulations and American accounting standards in the following years, but its essence remains the same. On paper, the fundraising shell company incorporated in offshore financial centers (OFCs) owned and controlled the VIE through contracts, meaning the China-based operating company was legally considered a subsidiary of the America-listed company. But in reality, the WFOE and the OpCo were the same institution under different names controlled by the same Chinese company founders and managers.⁵¹

In fact, not long after Sina's NASDAQ IPO, the MII institutionalized the rules of this type of capital filtration and instructed local MII-affiliated authorities to vet capital inflow according to the Sina case. In a notification issued to provincial-level regulators charged with inspecting and approving the foreign IPO applications of China-based Internet companies incorporated overseas, the MII emphatically mentioned that "ICP license applications submitted by companies with foreign capital should not be processed unless foreign ownership was entirely 'stripped' (*boli*)."⁵² The following two conditions were considered as a completed strip. One was that foreign stakeholders must have pulled out their investment or transferred it in totality to Chinese shareholders. The other, according to the document, was akin to the corporate structure of Sina that the MII approved, which was to "set up a new purely Chinese-owned and -controlled company that independently and autonomously operated and managed all ICP-related assets, personnel,

⁵¹ Amy Jie de Kuajing Jinrong Quan, "Shishui Chuangzaole VIE Jingwai Jiagou? Ta'he VIE Shi Ruhe Huxiang Chengjiude?" [Who Created the VIE Offshore Structure? How did he and VIE Accomplish Each Other?], <https://zhuanlan.zhihu.com/p/29220086>, published September 10, 2017, accessed September 25, 2020.

⁵² MII, "Guanyu Jinyibu Zuohao Hulianwang Xinxifuwu Dianzigonggao Fuwu Shenpi Guanli Gongzuo de Tongzhi," [Notification on Improving Administrative Approval on Internet-based Information Services and Bulletin Board Systems], issued March 7, 2001.

domains, trademarks, franchising, and users. The original company with foreign ownership cannot operate the website, and may only serve as a commercial partner in technological cooperation.”⁵³

5.4 Evaluating “Foreignness” Based on Corporate Control: The Ministerial Coalition’s Regulation of the VIE

Although the MII’s aforementioned screening mechanism helped to prohibit foreign industrial control in Chinese Internet-based companies at the moment of the IPO, a remaining question was how to guarantee that Chinese control of the company would not be gradually transferred to foreign investors. Theoretically speaking, they could acquire company management by purchasing floated shares from foreign stock markets and gradually gain corporate control. As this section will show, the MII was one of several regulators that shared authority over the monitoring of this model of capital flow. In other words, it was a coalition of Chinese ministries that guaranteed that the operation and management of China-based VIE firms did not slip into the hands of foreign investors.

To build a VIE structure, China-based companies first needed to establish a HoCo in OFCs. In other words, an ostensible “outbound” foreign direct investment (FDI) must be made first because Chinese nationals would set up a Chinese-invested company overseas. Although it only existed on paper, establishing such a firm overseas required notifying China’s two agencies or their local affiliates: the Ministry of Commerce (MoFCOM), which regulated foreign investment, and the State Administration of Foreign Exchange (SAFE), which regulated China’s foreign exchange markets.⁵⁴ Then, after receiving financial investment from global investors, the HoCo

⁵³ Ibid.

⁵⁴ MoFCOM et al. “Guanyu Waiguo Touzizhe Binggou Jingnei Qiye de Guiding (Circular No. 10),” [Provisions on the Acquisition of Domestic Enterprises by Foreign Investors,] <http://www.mofcom.gov.cn/article/b/c/200608/20060802839585.shtml>, issued August 8, 2006, effective from September 8, 2006. SAFE, “Guanyu Jingnei Jumin Tongguo Jingwai Teshu Mudi Gongsi Rongzi ji Fancheng Touzi Waihui Guanli Youguan Wenti de Tongzhi,” [Notice on Issues Concerning Foreign Exchange Administration for Domestic Residents to Engage in Financing and in Return Investment via Overseas Special Purpose Companies (Circular No. 75),] <http://m.safe.gov.cn/safe/2005/1021/5524.html>, issued October 21, 2005, effective from

would subsequently “invest” the proceedings back into Mainland China by establishing a WFOE that operated in industrial sectors permitted by Beijing. However, this process required approval from MofCOM and the National Development and Reform Commission (NDRC), which was China’s chief macroeconomic planner. These two agencies served as the gatekeepers of inward investment into China from foreign-registered and -located companies and regulated inward FDI by two means. The first was by co-issuing and managing a detailed sectoral blacklist that compartmentalized industrial sectors where overseas-originating investments had been encouraged, limited, or completely forbidden since 1995.⁵⁵ The second was by leading the inter-ministerial national security review mechanism.⁵⁶ Additionally, as the Chinese currency was not freely convertible, any foreign currency inflow had to be exchanged to Chinese Yuan through the SAFE. Last but not least, for any firms operating in China, a business license had to be obtained from the State Administration of Industry and Commerce (SAIC) or its local affiliates, and corporate tax was payable to the local affiliates of the State Administration of Taxation (SAT).⁵⁷ Therefore, all VIE-structured Internet companies fell under the regulatory prowess of these six ministries, and each agency required the company to submit their shareholding structure.

These ministries share a commonality of treating VIE-structured Internet companies as domestic ones. Such national treatment was based on the vetting of regulators over whether or not

November 1, 2005.

⁵⁵ Details on the information services sectors will be explored in a more detailed way in the next chapter, which is concerned with FDI restrictions. The list was inaugurated in 1995 and updated in 1997, 2002, 2007, 2011, 2015, and 2017 before being refurbished into a negative blacklist system. Encouraged sectors do not involve any foreign cap, and for limited sectors, an equity cap is usually applied specifying that the share portion of foreign investors shall not surpass a certain proportion, and zero foreign equity ownership is allowed in forbidden sectors.

⁵⁶ Similar to the blacklist system, the national security review mainly targets foreign controlled investors – a question on the restrictive role of Chinese regulators’ FDI that will be elaborated more closely in the next chapter. This section focuses on the facilitative role of Chinese regulators in ODFD, therefore highlighting the MoFCOM, SAFE, and SAT’s facilitative functions.

⁵⁷ In 2018, SAIC was renamed the State Administration for Market Regulation (SAMR) after an administrative reshuffle.

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it was the Chinese nationals that exerted corporate control despite the absence of a common national, legal, and written guide on regulating such companies – the reasons for which will be presented below and in the next section. Not long after the inception of the VIE channel by Sina in 2000, foreign-incorporated shell companies were rampantly used by corrupt officials and SOE managers to transfer newly privatized state-owned assets overseas. In response, Beijing launched a crackdown in 2004 on such capital flight which used the very channel the VIE depended on. Even though, the VIE's as a mechanism channeling in ODFD for homegrown Internet companies was left unscathed. In 2005, the SAFE even implicitly recognized this channel in its Circular 75 despite not directly mentioning the name of the VIE. The document not only acknowledged the existence of offshore companies as fundraising vehicles, but also clarified the registration procedures. It even streamlined the process by exempting Chinese firms from seeking administrative approval from MoFCOM when using “special purpose vehicles” (*teshu mudi gongsi*), a euphemism of the HoCo in the entire VIE structure. Rather, foreign currency-related processing with the SAFE or its provincial affiliates were sufficient for VIE companies to invest their proceedings back into China. The wording shows that the SAFE was not only aware of the VIE structures used to raise funds, but also supportive of them.

In 2014, the SAFE issued Circular 37, which replaced the Circular 75 and provided further support to Chinese companies. According to the new rule, SPVs could be constructed not only for fundraising purposes, but also for overseas investing.⁵⁸ For instance, SAFE defined a special purpose vehicle (SPV) as “an overseas enterprise directly established or indirectly *controlled*

⁵⁸ SAFE, “Guanyu Jingnei Jumin Tongguo Jingwai Teshu Mudi Gongsi Rongzi ji Fancheng Touzi Waihui Guanli Youguan Wenti de Tongzhi,” [Notice on Issues Concerning Foreign Exchange Administration for Domestic Residents to Engage in Financing and in Return Investment via Overseas Special Purpose Companies (Circular No. 37),] <http://m.safe.gov.cn/safe/2014/0714/5546.html>, issued on and effective from July 4, 2014. For a law firm’s interpretation of the change to Circular 37, see Wallace Walker, “China’s SAFE Issues Circular 37 to Replace Circular 75,” <https://www.omm.com/resources/alerts-and-publications/publications/safe-issued-circular-37-to-replace-circular-75/>.

[emphasis added] by a domestic resident legal person [read as an enterprise established inside the PRC] or domestic resident natural person [read as someone who wields a Chinese passport or residence permit] for the purpose of engaging in stock rights financing (including convertible bonds financing) abroad with the enterprise assets or interests it holds inside of China.”⁵⁹ Moreover, the document clarifies “return investment” as, among other activities, “the establishment of a foreign-funded enterprise inside China, the acquisition or *agreement-based* [emphasis added] control of assets inside China via this enterprise, the agreement-based acquisition of assets inside China, investments using the acquired assets to establish a foreign-funded enterprise, and increased capital to a domestic enterprise.”⁶⁰ Last but not least, it defined corporate control as “the operating rights, income rights, or decision-making rights of SPVs obtained by domestic residents through acquisitions, trusts, entrusted holdings, voting rights, buybacks, and convertible bonds.”⁶¹ Such definitions tell us that when processing ODFF, the SAFE’s evaluation and final decision was based on whether it was a return investment made by Chinese-controlled firms or not. In terms of practical enforcement, according to a venture capital investor in VIE-structured Chinese Internet firms, the SAFE “was absolutely aware that the VIE structure was used” although the word “VIE” or “contractual control” (*xieyi kongzhi*) did not appear in the application document.⁶²

The SAT also evaluated whether an overseas invested company was of Chinese or foreign origin based on where the “actual management was located.”⁶³ In 2009, the SAT emphatically instructed local tax authorities to evaluate investor identity based on whether the foreign investor

⁵⁹ SAFE, Circular 37, Article 1.

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Ding and Sun, “Sadan VIE.”

⁶³ SAT, “Qiyе Suodeshui Fa,” [Enterprise Income Tax Law], <http://www.chinatax.gov.cn/chinatax/n810341/n810825/c101434/c28479830/content.html>, effective from January 1, 2008. Article 2 and 50.

was controlled by Chinese or foreign entities. It defined a foreign-incorporated firm under Chinese control as “an enterprise formed and registered abroad by an enterprise or enterprise group *within* [emphasis added] China as the major *controlling* [emphasis added] investor under the law of a foreign country or region”, and thus instructed these companies “to be subjected to the corresponding tax administration and to pay enterprise income tax on incomes derived from both inside and outside China”⁶⁴ – a rate different from those of foreign-controlled and -invested companies made through FDI.

The SAT also taught its local affiliations the criteria in distinguishing foreign-incorporated companies under Chinese control from foreign-controlled ones. According to the same SAT-issued policy document, the evaluation and judgement of “actual control (*shiji kongzhi*)” should “look at the substance rather than the formality.” Evaluation should be conducted with consideration of four elements. First, the high-level management team and their office had to be located inside China. Second, corporate financing and personnel decisions had to be made or approved by China-based entities or persons. Third, the companies’ major assets, accounting documents, seals, and board or shareholder meeting records must be kept inside China. Fourth and finally, no less than half of all the board members or high-level executives must mainly reside in China.⁶⁵ As a result, although foreign-invested in name, VIE-structured Internet companies paid enterprise income tax to Beijing as domestic companies and were subject to a 25% rate to their entire global income, 5% higher than non-domestic ones.⁶⁶ They were also counted as key tax revenue contributors for the

⁶⁴ SAT, “Guanyu Jingwai Zhuce Zhongzi Konggu Qiye Genju Shiji Guanli Jigou Biaozhun Rendingwei Jumin Qiye Youguan Wenti de Tongzhi,” [Notice on Issues about the Determination of Chinese-Controlled Enterprises Registered Abroad as Resident Enterprises on the Basis of Their Body of Actual Management], <http://www.chinatax.gov.cn/chinatax/n810341/n810765/n812166/n812642/c1189294/content.html> published April 22, 2009, effective from January 1, 2008, amended on December 29, 2017. Article 1 and 2.

⁶⁵ Ibid. Article 2.

⁶⁶ SAT, Enterprise Income Law, Article 4.

Chinese government. For instance, Alibaba alone contributed RMB 51.6 billion (around US\$ 8 billion) to the state coffers in 2018.⁶⁷

5.5 Fragmented Regulation Without a National Legislation: The Political Necessities of Keeping VIE in the Legally Grey Zone

Unlike the “Red Chip” strategy which had an official written requirement to limit non-Chinese ownership to less than 25%, the VIE strategy’s *modus operandi* was largely performed informally in the absence of national-level legislation or even State Council-issued policy. As mentioned above, Chinese Internet, tax, foreign investment, and macroeconomic regulators distinguished “fake” VIE-structured and Chinese-controlled foreign investors from real foreign industrial investors by defining “foreign” based on their firm control rather than geographical origin. However, the Chinese state and legislation never formally acknowledged the legality of the VIE strategy. Why?

Two reasons could explain why Beijing intentionally dodged addressing the legality of the VIE issue head on and instead chose to let it remain a legally fuzzy area. The first reason may be due to the Chinese regime’s internal power structure and dynamics, which concern two aspects: inter-ministerial infighting and, at a higher level, the top leadership’s attitude and willingness. The coalition between Chinese Internet, investment, and tax regulators from the MII/MIIT, SAFE, NDRC, MoFCOM and SAT was cognizant and supportive of the VIE strategy on the condition that foreigners would not be given control of Internet-related assets and profits taxed inside China. However, the fervent use of offshore SPVs by Chinese Internet firms to tap into international capital markets meant the domestic ones were eschewed. Accordingly, the regulatory prowess of the CSRC was circumvented. As mentioned above, using the VIE to draw in global investment

⁶⁷ *Jiemian*, “Alibaba 2018 Nian Nashui 516yi Yuan,” [Alibaba Paid RMB 51.6 billion Tax in 2018], <https://www.jiemian.com/article/3002658.html>, published April 1, 2019, accessed September 25, 2020.

was originally conceived as a solution to “sidestep” and escape from China’s discriminatory and inefficient domestic securities exchange system and the CSRC’s repressive and discriminatory regulations for non-state owned companies – an endeavour that CSRC was aware of.

The CSRC attempted to expand its power over VIE-listed firms. As early as 2000, it issued a document demanding that non-state-owned firms submit a legal opinion letter signed by lawyers for its approval when using an offshore-registered SPV for an IPO – a process that would delay the overseas IPO by at least four months – for the purpose of preventing an “illegal transfer of assets inside China abroad.”⁶⁸ However, the CSRC’s inability to verify the ownership structure of applicant firms made this policy ineffective in practice, which led to its formal scrapping in April 2003.⁶⁹ As a result, non-state-owned companies using OFC-incorporated SPVs for overseas IPOs no longer needed approval from the CSRC, and many VIE-structured IPOs took place outside of the CSRC’s purview. In 2006 alone, a total of 98 Chinese firms used SPVs to indirectly initiate an IPO overseas, while the number on the CSRC’s record was only 20.⁷⁰ This huge discrepancy and loss of regulatory power over the increasing number of Internet firms that chose not to list in the Chinese stock market irked the CSRC, which attempted to find a proper way to increase its power by bringing the VIE-structured, foreign-listed, Chinese-controlled, and generally Internet-based companies back to Mainland China’s domestic securities exchanges, which were under its jurisdiction.

⁶⁸ CSRC, “Guanyu Sheji Jingnei Quanyi de Jingwai Gongsi zai Jingwai Faxing Gupiao he Shangshi Youguan Wenti de Tongzhi,” [Circular on Issues Concerning Stock Issuance and Public Offering Abroad of Overseas-Registered Companies which Involve Domestic Equity],

<http://www.mofcom.gov.cn/article/zcfb/zcjhz/200207/20020700031394.shtml>, issued June 9, 2000.

⁶⁹ He Chengying and Yuanyuan Weng, “Cong VIE Shijian Kan Haiwai Rongzi Xianxiang de Jian’guan Lujing,” [Viewing the Regulatory Path of Overseas Financial Acquisition in Light of the VIE Incident], *Jirong* [Finance], 2012(2): 76-82. p.78

⁷⁰ Feng Yuding, “Hongchou Shangshi Zaiyu Shihao wen Konghuang,” [Red Chip Listing Reencounters Panic Caused by Circular No.10], *Shangwu Zhoukan* [Business Weekly],

<http://finance.sina.com.cn/stock/t/20070425/14593540249.shtml>, reposted by *Sina* April 25, 2007, accessed September 28, 2020.

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The opportunity came in 2011, following Alibaba's Alipay incident which will be elaborated in the next section. In September 2011, various media outlets reported that the CSRC had recommended that the top leadership, among other things, correct the VIE structure. A policy report dated on August 17 and written in the tone of a lower-ranked bureaucrat or researcher affiliated with the CSRC was mysteriously leaked out to the media. The policy paper, citing fraudulent cases involved in the VIE structure, mentioned that there were national security challenges caused by a lack of regulatory control over firms using the VIE model and proposed that the CSRC should step in and take tighter measures against the VIE strategy. More precisely, the document recommended that existing VIEs should be allowed to continue to exist and function while new ones should be prohibited. It also suggested that well-performing enterprises should be granted special approval and "brought home" in Chinese stock exchange markets.⁷¹ This fanfare caused a plunge in the share prices of China-based and Chinese-controlled Internet companies listed on American securities markets via the VIE structure.⁷² All of this caught the attention of China's top leadership.⁷³

The VIE controversy was in essence an inter-ministerial competition initiated and publicized by the CSRC to expand regulatory power over VIE-structured firms. As one venture capitalist pointed out, "in the name of regularization (*guifan hua*), it is rather a way to collect more protection

⁷¹ Hu Zhongbin, "VIE Jianguan Dingtiao Xinlao Huaduan, Guowuyuan Fazhiban Yijieru," [New-old Separate Treatment Decided for VIE Regulation, the State Council's Office of Legal Affairs was Involved], *Jingji Guancha Bao*, [The Economic Observer], <http://tech.sina.com.cn/i/2011-09-22/00096094414.shtml>, reposted by Sina September 24, 2011, accessed September 28 2020.

⁷² On the very day the news was broadcasted, Sina's stock price nosedived by 15.15%, Sohu by 5.6%, and NetEase by 3.9%. For the next week, the aggregate value lost from companies that used VIE far surpassed the composite index. Hou Jiyong, "VIE Jingbian Zhenhan Wangluoye, Gangjiaosuo Yunniang 'Xinren Fagui'," [VIE Incident Shocked the Internet Industry, HKSE Ponders over 'New Rules for New Firms'], *21Shiji Jingji Baodao*, <http://www.21cbh.com/HTML/2011-9-22/zMMDY5XzM2NzMzMA.html>, published September 22, 2011, accessed September 28, 2020.

⁷³ Wang Ziwu, "VIE Zai Dizhen," [VIE Shakes Again], *Caixin Weekly*, <https://magazine.caixin.com/2011-10-08/100311649.html>, published October 10, 2011, accessed September 28, 2020.

rackets (*duo shoudian baohufei*),”⁷⁴ and “the disagreement among various ministries was huge, with diverging interests and considerations.”⁷⁵ In fact, the report’s wording was indicative of the CSRC’s intention to expand power, as it recommended VIE-related applications “should be subjected to both MoFCOM and the CSRC’s approval”, and urged “authorities overseeing foreign exchange control, taxation, and industry and commerce” – a euphemism for the SAFE, SAT, and SAIC – not to recognize contractual arrangements “without the CSRC’s consent.”⁷⁶

This event soon escalated to the State Council level. Vice Premier Wang Qishan, who oversaw China’s financial sector, commented that “we should respect the history and recognize the legitimacy (*hefaxing*) of the VIE strategy, but still regulate it to some degree (*yousuo guanli*).”⁷⁷ Although Wang did not explicitly state which part of history should be respected, he was clearly referring to the story of China Mobile’s “Red Chip” IPO event, a deal that Wang was closely involved in as explained in Chapter 4. It was the corporate structure set up by China Mobile that offered a template for the later VIE structures to learn from, copy, and modify.

As the CSRC’s own policy recommendation acknowledged, the fate of the VIE model concerned the interests of multiple ministries. Compared with the CSRC’s hardline stance in outlawing the VIE model, MoFCoM, whose approval was indispensable to setting up the VIE model, was “pragmatic” in its attitude and “mild” in its proposed solution.⁷⁸ From MoFCOM’s perspective, the CSRC’s national-security fearmongering could be warded off within the existing regulatory framework. Reflecting such spirit and with the political blessing of Wang, MoFCOM

⁷⁴ Ding and Sun, “Sadan VIE.”

⁷⁵ Hu, “VIE Jianguan Dingtiao Xinlao Huaduan, Guowuyuan Fazhiban Yijieru.”

⁷⁶ Hu Zhongbin, “Zhengjianhui VIE Yanjiu Baodao Zhailu: Hulianwang Anquan Shouweixie,” [Excerpt of CSRC’s VIE Research Report: Internet-related National Security was Threatened,] *Jingji Guancha Bao*, [The Economic Observer], <http://tech.sina.com.cn/i/2011-09-28/10476122395.shtml>, reposted by Sina September 28, 2011, accessed September 29, 2020.

⁷⁷ Hu, “VIE Jianguan Dingtiao Xinlao Huaduan, Guowuyuan Fazhiban Yijieru.”

⁷⁸ *Ibid.*

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promptly issued an announcement on August 25 that added an additional layer of security vetting to guarantee that ODFD would be exclusive to Chinese-controlled information companies and not open to abuse by non-Chinese companies which intend to bypass the equity caps and restrictions of the Internet sector.⁷⁹

The inter-ministerial disagreement over the VIE strategy was also well reflected in the process of enacting China's new Foreign Investment Law between 2015 and 2020. The draft that had been circulated for public commentary in January 2015 actually disclosed the common method of evaluation of "foreignness" through corporate control rather than share ownership into a formal legal document. According to the draft text, whether a transaction would be considered a "foreign investment" or not was determined by the "actual control" beyond numeric shareholding, but also involved a careful examination of who controlled voting rights and personnel appointment. Additionally, how control would be exerted was not limited to equity ownership, but also included means of contract or trust.⁸⁰

⁷⁹ MofCOM, "Shangwubu Shishi Waiguo Touzizhe Binggou Jingnei Qiye Anquan Shencha Zhidu de Guiding," [Provisions of the Ministry of Commerce on the Implementation of the Security Review System for the Mergers and Acquisitions of Domestic Enterprises by Foreign Investors], <http://www.mofcom.gov.cn/aarticle/b/c/201108/20110807713530.html>, released August 25, 2011, effective from September 1, 2011.

⁸⁰ To be more precise, Article 18 of the Draft Law stipulates that actual control could be evaluated from three criteria. The first can refer to any single entity or person that "directly or indirectly holds more than 50% of the shares, assets, voting rights, or similar equity interests of another entity." The second criterion emphasizes the voting rights and power of personnel appointment despite minority shareholding. In this scenario, "actual control" applies when an entity, despite holding less than 50% of the shares, assets, voting rights, or similar equity interests of another entity, could "directly or indirectly nominate over half of the board or a similar corporate governance body," have the power to guarantee that the persons being nominated would obtain over half of the board or similar corporate governance body of another entity, or have voting power that could wield "substantial influence" in decision-making bodies such as shareholder meetings, shareholder AGMs, or the board of directors. In the third scenario, the VIE model implicitly mentioned the expression "through contract." The original expression is "to have the ability to exert decisive influence (*juedingxing yingxiang*) on the operational, financial, personnel, or technological matters of that entity through contracts, trusts, or other means." MofCOM, "Shangwubu jiu 'Zhonghua Remin Gongheguo Waiguo Touzifa (Cao'an Zhengqiu Yijiangao) Gongkai Zhengqiu Yijian'," [MofCOM seeks public opinions on 'People's Republic of China's Foreign Investment Law (Draft for Comments)'], <http://tfs.mofcom.gov.cn/article/as/201501/20150100871010.shtml>, released January 19, 2015, accessed October 1, 2020.

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But eventually, the actual control vetting approach on foreignness was not adopted in the final version due to some irreconcilable internal conflicts.⁸¹ According to a legal expert, all the ministries wanted to safeguard or expand their power over inward foreign investment and thus squeezed their departmental interests into the lengthy first draft. In fact, the lawmaking process was more of a makeshift and perfunctory response to the mounting calls for foreign firms and governments to improve the investment environment for foreign [read as non Chinese-controlled] companies in the midst of the escalating trade disputes between China and the U.S. since 2017.⁸² By the end of 2018, the central and local governments had shelved their disagreements and deleted the controversial parts, which resulted in a deeply watered-down version of the Foreign Investment Law.⁸³ Effective from January 2020, the much-awaited law and its implementation measures still eschewed the legality question of the VIE model with a catchall clause. It also did not bother to define “actual control” or explain the scope of direct or indirect investment, which meant a continuation of the multiple-ministerial regulation of the VIE model in the information services sector.⁸⁴

⁸¹ Disagreements existed even around the name of the law, as “foreign merchants” (*waishang*) include individuals and enterprises registered in Hong Kong, Macau, and Taiwan, which are excluded by the term “foreign countries” (*waiguo*). He Bin, “Waishang Touzifa Huzhiyuchu, Zhuanmen Jiakai Yici Shenxi Shiyou Duo zhongyao?,” [Foreign Investment Law to be Unveiled, How Important was the Special Meeting Added for its Deliberation?], *Zhongguo Xinwenwang* [China News], <https://cn.chinadaily.com.cn/a/201903/04/WS5c7cbda6a31010568bdcd42f.html>, published March 4, 2019, accessed October 3, 2020.

⁸² Regarding the process of submission to the Standing Committee of the National Peoples’ Congress, China’s national parliament’s two rounds of review and discussion to the passing of the law barely took less than three months. Wang Yuanli, “Juzu Shuju Gaosuni, Weishenme ‘Waishang Touzifa’ Chutai Ke buronghuan,” [Several groups of Data Tell you, Why the Release of ‘Foreign Investment Law’ Cannot Wait], *Diyi Caijing*, [China Business Network], <https://www.yicai.com/news/100139729.html>, published March 15, 2019, accessed September 30, 2020. Such a speedy passing of a Foreign Investment Law was interpreted as Beijing’s conciliation to address US concerns. Huang Yukon, “China’s Foreign Investment Law and US-China Trade Friction,” <https://carnegieendowment.org/2019/03/19/china-s-foreign-investment-law-and-us-china-trade-friction-pub-78647>, published March 19, 2019, accessed September 30, 2020.

⁸³ He Bin, “Waishang Touzifa Huzhiyuchu, Zhuanmen Jiakai Yici Shenxi Shiyou Duo zhongyao?”

⁸⁴ Article 2 Clause 2 of the “Foreign Investment Law” stipulates that “Foreign investors invest in China by means of other methods stipulated by laws, administrative regulations or provisions of the State Council.”

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In addition to inter-ministerial infighting, a more important factor explaining why the VIE model was carried out in the absence of written law or State Council-issued policy was the open, official, and parchment commitments Beijing made for its WTO membership and the principle of equal treatment between national and local goods or services.⁸⁵ Openly acknowledging such discriminatory treatment between foreign-controlled and Chinese-controlled firms made it unwise for Beijing to publicly acknowledge the existence of capital filtration that had been carried out based on corporate control rather than the geographical origin of the investors – a question related to FDI restrictions that will be explored in more detail in the next chapter. But before that, let us zoom into a case study of Alibaba, the largest China-based Internet company in terms of the IPO proceedings. The case study will allow us to see how capital filtration has worked at a microscopic level as well as how offshore-acquired finance works in conjunction with the minority shareholding structure of Chinese control.

5.6 Case Study: Alibaba, a Globally Funded Chinese-Controlled Empire

Alibaba represents one of the largest and most successful Internet companies in China. As Table 5.1 shows, about 61% of the total proceedings from Chinese Internet companies in American stock markets between 2000 and 2020 came from Alibaba alone. In 2013, the year before Alibaba's NYSE IPO, Alibaba alone occupied 84% of China's e-commerce market share, and transactions worth US \$248 billion took place on e-commerce platforms operated by the company.⁸⁶ This section investigates how this behemoth has become globally funded while still being under

⁸⁵ WTO, "Principles of the Trading System," https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm.

⁸⁶ Cui Xi, "Ali Shujv Yaodian: 2013nian Lingshou Jiaoyi'e 2480yi Meiyuan," (Key Points of Ali's Data: Retail Volume of Trade Reaching US\$248 Billion). *Xinlang Keji*, <https://tech.sina.com.cn/i/2014-05-07/05349363201.shtml>, published May 7, 2014, accessed February 16, 2022.

Chinese control, and how the risks and impacts of foreign financial investors that lack corporate control over their invested assets affect them.

Highlighting the globally funded nature of the company, the first part of this section will start with a survey of the company's ODFF-raising history, which involved multiple rounds of investment injected from global investors via its Cayman Islands-domiciled shell company until the arrival of its IPO on the New York Securities Exchange in 2014. Then, by investigating its unique corporate decision-making mechanism, known as the Lakeside Partnership (*Hupan Hehuoren*), I will show how Alibaba's founding members and managers, the vast majority of whom are Chinese nationals, control the entire company despite their minority shareholding relative to foreign investors. Lastly, the Alipay incident of 2011 will be discussed to corroborate the finding that the VIE strategy benefited Chinese entrepreneurs by granting them a disproportionately larger power in corporate control and asset disposition to a level that harmed the interests of foreign shareholders.

5.6.1: Channelling in ODFF: Alibaba's Eight Rounds of Global Fund Acquisition

As Table 5.2 shows below, Alibaba benefited from nine rounds of ODFF boosting. Ma Yun and eighteen others at his residential apartment at Lakeside (*Hupan*) Garden in Hangzhou founded this company in February 1999 with an initial aggregate investment of RMB 500 thousand (around US \$60 thousand) that came from their personal savings. Ma immediately embarked on a fundraising trip to the U.S., meeting venture capital and private equity investors, but as he later revealed, "nobody was interested in Alibaba, and I was denied one by one."⁸⁷ However, an opportunity came in May 1999, when Ma was introduced to Joseph Tsai, a Taiwanese-Canadian

⁸⁷ Su Longfei, "Alibaba Rongzi Shi," [Fundraising History of Alibaba]. *Xin Caifu* [New Wealth], Quoted in "Alibaba Rongzishi, Cong Tianshilun, VC, PE dao 1000yi Meiyuan Shizhi de IPO (Fundraising History of Alibaba, from the Round of Angle Investment to VC, PE and the IPO That Worth 100 US\$ Billion)" <http://www.valuetize.com/global/?p=1565>, published June 17, 2014, accessed September 14, 2020.

employee of the Swedish investment company Investor AB who was impressed by Ma’s business plan and ambition to create an online marketplace for international trade. Tsai quit his position at Investor AB where he earned an annual salary of US \$700 thousand per year, and joined Alibaba as the only co-founder with a western education background and expertise in international banking and investment, despite being paid barely RMB 6 thousand (around US \$725) a year.⁸⁸ By serving as Alibaba’s chief financial officer (CFO) and chief operating officer (COO), Tsai quickly tapped into his professional networks and convinced four institutional investors, including world-renowned investment bank Goldman Sachs and his former employer Investor AB, to invest US \$5 million into Alibaba through its OFC-registered SPV.⁸⁹ With this initial round of foreign investment, Ma and his associates moved the company from their residential apartment to a commercial building. A year later, during a trip to China to seek potential investment opportunities, Masayoshi Son, founder and CEO of the Japanese conglomerate Softbank, which owned one of the world’s largest Internet- and technology-focused venture capital funds, was persuaded by Ma to support his endeavours. As a result, Softbank convinced five other institutional investors to put US\$ 25 million into Alibaba, with Softbank giving the majority share of 20 million.⁹⁰

Table 5.2 Nine Rounds of Alibaba’s Equity-based Fundraising from Financial Markets outside China

Round of ODFF acquisition	Time	Fund Raised (US\$) million	Major Global Investors
1 st	Oct. 1999	5	Goldman Sachs, Fidelity Capital, Technology Development Fund of Singapore, Investor AB
2 nd	2000	25*	Softbank, Fidelity Capital, Transpac Capital

⁸⁸ Flannery Russell, Inside Alibaba: Vice Chairman Joe Tsai Opens Up About Working With Jack Ma And Jonathan Lu, *Forbes*, <https://www.forbes.com/sites/russellflannery/2014/01/08/inside-alibaba-vice-chairman-joe-tsai-opens-up-about-working-with-jack-ma-and-jonathan-lu/?sh=33e5ad49511b>, published January 8, 2014, accessed September 15, 2020. Zhang Chao, “Alibaba IPO Wangshi,” [Alibaba IPO Story] *Touzhong Wang*, <https://www.chinaventure.com.cn/news/80-20191119-350285.html>, published November 19, 2019, accessed 19 September 19, 2020.

⁸⁹ Ibid.

⁹⁰ Ibid.

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3 rd	Feb. 2004	82**	Soft Bank, Fidelity Capital, Granite Global Ventures, Venture TDF China
4 th	Aug. 2005	1000***	Yahoo
5 th	Nov. 2007	1700****	IPO on HKSE
6 th	Sept. 2011	2000	Silver Lake, DST Capital, Temasek, YF Capital
7 th	Aug. 2012	4300	Silver Lake, DST Capital, Temasek, YF Capital, Boyu Capital, CIC, CITIC, CDB
8 th	Sept. 2014	21,767	IPO on NYSE
9 th	Nov. 2019	13,000	Secondary IPO on HKSE

* of which US\$ 20 million came from Softbank.

** of which US\$ 60 million came from Soft Bank.

*** US\$ 1 billion cash plus all of Yahoo's assets inside China

**** A total of US\$ 274 million in proceedings with a 24-month lock-up period, came from eight cornerstone investors, including Yahoo, AIG Global Investment Corporation, Foxconn (Far East), China Industrial Bank Corporation (Asia), Cisco Systems International, Baldonna Investments, Finawood Investments, and Honeybush. The listing was withdrawn in June 2012.

Source: Alibaba's company releases in 2004, 2005, 2007, 2011; Lin, *Feiteng 15 Nian*, p.337.

Feeling increasingly optimistic about China's e-commerce market, Softbank mustered a group of Internet-focused venture capital firms in 2004 to pour another US\$ 82 million into Alibaba in support of its e-commerce business expansion. This round of finance came at the moment when eBay's joint venture inside China eachnet.com (*yiqu wang*) controlled 80% of China's burgeoning online consumer-to-consumer (C2C) market. As a counteroffensive against eBay, Alibaba used the funds to establish its own C2C platform called Taobao.com. Of the US\$ 82 million in acquisitions, US\$ 60 million from Softbank was used to develop Taobao.com.⁹¹

The next round of financial boosting, which came barely a year later, was even more impressive. In August 2005, Yahoo sold all of its China-related businesses and its brand and intellectual property rights to Alibaba. This sale was coupled with a US \$1 billion cash investment, the largest that Alibaba had ever received, in exchange for 40% of Alibaba's shares. After that

⁹¹ Jin Zhihui, "Alibaba He Yahu de 'Wu'nian Zhiyang'," [Alibaba and Yahoo's Five-year Itch,] *Huanqiu Qiyejia*, <https://www.reuters.com/article/idCNCHINA-3414220101129>, reposted in *Reuters* November 28, 2010, accessed November 22, 2020.

round of financial acquisition, Softbank owned 29.3% of the shares while Ma and the other company founders owned the remaining 30%, although corporate control was exercised by Ma and his Chinese fellows. Of the four members of the board of directors, Yahoo and Softbank each had only one seat, taken by Yahoo's Taiwanese-American co-founder Jerry Yang and Masayoshi Son, while Alibaba's founders and managers, despite their minority shareholding, had two.⁹² Furthermore, Softbank had relinquished its voting rights while Yahoo, although accounting for 40% in shareholdings, was only equipped with 35% of the voting rights.⁹³ The Chinese founders and managers controlled the remaining 65%.

Selling 40% of the company's shares to Yahoo presented a challenge to Ma Yun and his Chinese associates. To safeguard his authority, and more broadly, the Chinese founders and management team's control over the company, Ma held a private meeting with Jerry Yang at Pebble Beach Golf Links to confirm that Yang and Yahoo "have no intention of meddling in Alibaba's daily operations."⁹⁴ As a result, in addition to the voting mechanism described above, special clauses were added into the agreement between Alibaba and Yahoo to consolidate Chinese control; under no circumstances could Ma Yun be stripped of his CEO position by the board of directors until October 2010.⁹⁵ This clause actually emboldened Ma to harm Yahoo and Softbank's interests by transferring Alipay to a domestic company – a case that we will look at in the later sections.

On the other hand, this deal marked Yahoo's strategic shift in abandoning American control over assets in China. For this American Internet giant, transferring decision-making to a

⁹² Wang Shanshan, Yuzhe Zhang, Huawei Ling, Qiong Guo, Ziwu Wang, Fei Zheng, and Yanyan Fu, "Zhifubao Kaoyan," [The test of Alipay], *Caixin Xinshiji*, <https://magazine.caixin.com/2011-06-18/100270833.html>, published June 18, 2011, accessed November 22, 2020.

⁹³ Ibid.

⁹⁴ Su, "Alibaba Rongzi Shi."

⁹⁵ Wang Shanshan, "Zhifubao Zhuanyi Zhenxiang," [The Truth Behind Alipay's Transfer], *Caixin Xinshiji*, <https://magazine.caixin.com/2011-06-04/100266286.html>, published June 4 2011, accessed September 14, 2020.

Chinese team was a “painful decision.”⁹⁶ Yahoo had faced multiple challenges since it launched its Chinese-language services in 1999. For instance, as a foreign-based and -controlled company, Yahoo had not yet obtained its ICP license from the MII, which was a prerequisite to operate local websites inside China. As a result, Yahoo had to cater to its Chinese customers in a distant and relatively inefficient manner because the company’s servers were located outside China. Because of the bandwidth limitations, accessing Yahoo’s U.S.-based servers was time-consuming and unstable for users in Mainland China. Moreover, much of the news content from Yahoo, directly translated from English to Chinese, was censored in China.⁹⁷ Last but not least, Chinese media outlets and Internet companies were unwilling to cooperate with a foreign Internet giant because of the political risks.⁹⁸ All these setbacks led to Yahoo’s decision to hand its Chinese assets over to Alibaba.

Of the US\$ 1 billion that Yahoo invested in Alibaba, only 250 million was used to fuel Alibaba’s business expansion. The rest was divided into rewards for the foreign financial investors that had funded Alibaba in previous rounds. Financial investors like Goldman Sachs, Stockholm-based Investor AB, and California-based Fidelity Capital sold their shares in Alibaba and earned a total of US\$ 570 million. Compared with the initial investment of US \$32 million made into Alibaba, the return rate was an unimaginable 1,780%. Softbank also sold part of its holdings and gained US\$ 180 million while still holding 29% of the shares.⁹⁹

In November 2007, Alibaba listed the Business-to-Business (B2B) chunk of its e-commerce business on the HKSE and managed to raise US\$ 1.7 billion. It was also when early

⁹⁶ Zhang Fan, “Yahu Zhongguo Sanbuqu (Yahoo’s Trilogy in China),” *Caijing*, <https://magazine.caixin.com/2005-08-22/100080999.html>, August 22, 2005, reposted by *Caixin*, accessed September 17, 2020.

⁹⁷ *Ibid.*

⁹⁸ *Ibid.*

⁹⁹ Su, “Alibaba Rongzi Shi.”

venture capital and private equity investors exited by selling their shares to public investors, earning them ten times their initial investment.¹⁰⁰ But Yahoo's cordial relationship with Alibaba, a bond previously sustained through the personal friendship between Ma Yun and Jerry Yang, soured after the latter stepped down as Yahoo's CEO in 2009. Yang's successor Carol Bartz openly chastised Ma Yun for failing to properly manage Yahoo China and "wanted Yahoo's brand in China back."¹⁰¹

To ward off Bartz's threat to increase Yahoo's corporate influence on Alibaba, Ma Yun invited other financial investors to buy Alibaba's shares and dilute Yahoo's holdings. In the fall of 2011, financial investors such as California-based Silver Lake, Moscow-headquartered DST Global, Singaporean government-controlled Temasek, and Shanghai-based and Ma Yun-co-founded YF Capital. This start-up dispensed a total of US\$ 2 billion to purchase 5.7% of the shares held by Alibaba's management team and employees while also renouncing their voting rights.¹⁰² On May 20, 2012, Alibaba and Yahoo reached an agreement that allowed Alibaba to buy back up to half of Yahoo's stake in Alibaba, or approximately 20% of Alibaba's total shares. The deal was finalized on September 18, 2012 at a price of approximately US\$ 7.1 billion that included US\$ 6.3 billion in cash and up to US\$ 800 million in Alibaba's newly issued preferred stock.¹⁰³ Additionally, Alibaba was given the right to a further buyback of half of Yahoo's remaining shares once Alibaba's IPO on the NYSE was completed.¹⁰⁴

¹⁰⁰ Su, "Alibaba Rongzi Shi."

¹⁰¹ Fletcher Owen, "Yahoo, Alibaba relationship frays under Bartz," *Computer World*, <https://www.computerworld.com/article/2525320/yahoo--alibaba-relationship-frays-under-bartz.html>, published May 19, 2009, accessed September 19, 2020.

¹⁰² Liao Lingjun and Mo Ding, "Ali Hunxue," [Mix-Blooded Alibaba], *Huanqiu Qiyejia*, quoted in Reuters, <https://www.reuters.com/article/huanqiu-ali-mix-blood-idCNCNE89F05620121016>, published October 15, 2012, accessed November 22, 2020.

¹⁰³ Alibaba, "Yahoo! and Alibaba Reach Agreement on Comprehensive Plan for Alibaba Stake," https://www.alibabagroup.com/cn/news/press_pdf/p120520.pdf, published May 20, 2012, accessed November 20, 2020.

¹⁰⁴ Alibaba, "Alibaba Jituan Wancheng 76 Yi Meiyuan Gufen Huigou Jihua, Yu Yahu Guanxi Jiekai Xinpianzhang,"

To collect the money that would be used to buy back Yahoo's ownership, Alibaba sold ordinary shares worth US\$ 2.6 billion (7.2% of the total) in two batches in August 2012,¹⁰⁵ and then issued transferable shares worth US\$ 1.688 billion to various financial investors. The names of the investors have not been disclosed, but they included 12 international hedge funds, private equity firms, mutual funds, and sovereign wealth funds, among which old investors such as Silver Lake, DST and Temasek increased their shareholdings.¹⁰⁶

Compared with the previous rounds in which investors were foreign-owned and -based financial institutions, the new shareholding buyers came from Chinese states and a larger cohort of international investment banks.¹⁰⁷ According to an anonymous fund manager, the consortium of those from Chinese states acquired 5% of the equity shares from Alibaba, among which the China Investment Corporation (CIC), a central state-owned sovereign wealth fund, purchased the largest number of ordinary shares because "Alibaba badly needed cash to kick Yahoo away, and the CIC was an optimal choice as it had faith in Alibaba's financial business and did not seek to meddle in its operations; therefore, the two reached an agreement on further share-buying during the IPO."¹⁰⁸ As for the China Developmental Bank (CDB), a central state-owned policy bank that

[Alibaba Completed US\$7.6 Billion Share Buy-Back Plan, Opening a New Chapter with Yahoo,] https://www.alibabagroup.com/cn/news/press_pdf/p120918.pdf, published September 18, 2012, accessed September 19, 2021.

¹⁰⁵ Su, "Alibaba Rongzi Shi."

¹⁰⁶ Ibid.

¹⁰⁷ Alibaba is one of many Internet companies founded, owned, or controlled by Chinese state agencies or companies with the investments and good fortunes made by relatives of Chinese top-leadership through an overseas IPO. As per the company's 2012 round of fundraising, Boyu Capital, a private equity firm that invested over US\$ 100 million, was co-founded and co-owned by Jiang Zhicheng, grandson of former CCP Secretary General and Chinese president Jiang Zemin. See, for instance, Mitchell Tom, Kinder Tabby, and Sevestopulo Demetri, "Firm founded by Son of China finance tsar invests heavily in tech," *Financial Times*, <https://www.ft.com/content/62554721-3b52-4cb9-8d1d-ccdf40b4e463>; Forsythe Michael, "Alibaba's I.P.O Could Be a Bonanza for the Scions of Chinese Leaders," *New York Times*, <https://dealbook.nytimes.com/2014/07/20/alibabas-i-p-o-could-be-a-bonanza-for-the-scions-of-chinese-leaders/>; Wu Kane, "Exclusive: Ant Investor Boyu Capital targets \$ 6 billion for new private equity fund -sources", *Reuters*, <https://www.reuters.com/article/us-boyu-capital-fundraising-exclusive/exclusive-ant-investor-boyu-capital-targets-6-billion-for-new-private-equity-fund-sources-idUSKBN2A00KK>

¹⁰⁸ Qin Wei, and Jiang Jiadai, "Alibaba Guquan Biangengshi: Zhongtou Guokaihang Deng Guojiadui Shenmi Rugu," [History of Alibaba] Stock Holding Change: National Team of CIC and CDB Mysteriously Bought

often funds massive Chinese infrastructural projects, Alibaba had relied on its help two months earlier when privatizing and delisting its B2B arm from the HKSE as part of a recapitalization plan to make the NYSE IPO more appealing. Out of the US\$ 2.5 billion that Alibaba spent to purchase and delist 27% of its publicly floated shares,¹⁰⁹ only 20% came from Alibaba's own coffers. The remaining 80% came from banking loans, among which the CDB provided US\$ 1 billion and the other \$1 billion came from eight international banks that all wanted to become Alibaba's underwriters. Eventually, only six international investment banks managed to be bookrunners for its IPO, sharing US\$ 300.4 million as part of a commission of 1.2% of the total deal.¹¹⁰

After the last round of pre-NYSE IPO financing in 2012, Alibaba's ownership structure changed, with Yahoo's shareholdings dropping to 23% and Softbank still holding 31.9%, thus together giving non-Chinese investors the majority of shares in Alibaba.¹¹¹ As per the purchasing agreements signed with Alibaba's leadership, the company's new financial investors all willingly abandoned their voting rights and seats in the board of directors in exchange for high returns from Alibaba's IPO.

In November 2019, Alibaba's HKSE listing gave it the biggest fundraising of the year. The transaction was made against the backdrop of escalating trade and tech hostilities between China and the US, which led some observers to argue that the secondary listing was "politically motivated,"¹¹² driven by Beijing's dictates to be "a good corporate citizen and shrewd operator"

Shares,] *Ershiyi Shiji Jingji Baodao*, <http://finance.sina.com.cn/chanjing/gsnews/20130725/022216232701.shtml>, reposted by *Sina*. July 25, 2013, accessed February 20, 2022.

¹⁰⁹ Alibaba, "Alibaba Jituan Wancheng 76 Yi Meiyuan Gufen Huigou Jihua, Yu Yahu Guanxi Jiekai Xinpianzhang."

¹¹⁰ Barrero Elzio, "Alibaba IPO Underwriters Earn USD 300 Million in Fees, 1.2 Percent of the Deal," <https://www.reuters.com/article/us-alibabaipo-fees-idUSKCN0HH1EY20140922>, published September 22, 2014, accessed February 20, 2022.

¹¹¹ Liao and Ding, "Ali Hunxue."

¹¹² Nuttall Chris, "Alibaba's trade War IPO," *Financial Times*, <https://www.ft.com/content/975df4c4-8167-11e9-b592-5fe435b57a3b>, published May 28, 2019, accessed September 23, 2020.

and to “bolster Hong Kong” amid months of pro-democracy protests and turmoil.¹¹³ The other proposed explanation for why the secondary listing only became feasible in 2019 was because the HKSE had revised its listing rules and had allowed listing companies with weighted voting rights since April 30, 2018.¹¹⁴ This new rule, according to a financial journalist, “let individuals who were founders or key management of companies to hold shares with more voting rights or weight than other regular shareholders,”¹¹⁵ which was actually one of the issues that hampered Alibaba from listing on the HKSE in the first place in 2014, as it was incompatible with Alibaba’s core corporate decision-making mechanism.

Despite multiple rounds of foreign investment injection, Alibaba was always firmly under the complete control of Ma Yun and his Chinese associates.

5.6.2 The Board Over the Board: The Lakeside Partner (Hehuoren) Panel

So what was the decision-making mechanism that obstructed Alibaba from listing on the HKSE in the first place? How exactly would the Chinese founders and managers of Alibaba guarantee that, despite their minority shareholding, corporate control would always rest in their hands? Like American Internet giants Google and Facebook,¹¹⁶ most China-based and Chinese-controlled companies use a preferential stock structure with unequal and weighted voting rights in the Annual General Meeting (AGM) to consolidate decision-making authority within a small

¹¹³ He Laura, “Alibaba’s homecoming is about pleasing and buying trade war insurance,” *Cable News Network*, <https://www.cnn.com/2019/11/15/tech/alibaba-hong-kong-china-trade-war/index.html>, published and accessed November 15, 2019.

¹¹⁴ Hong Kong Exchanges, “Hong Kong’s Listing Regime Enters New Era, Featuring Emerging and Innovative Firms,” https://www.hkex.com.hk/news/regulatory-announcements/2018/180424news?sc_lang=en, published April 24, 2018, accessed September 25, 2020.

¹¹⁵ Yiu Enoch, “Hong Kong exchange, spurred by Alibaba, Xiaomi listings, proposes expansion of IPO reforms to attract more tech giants,” *South China Morning Post*, <https://www.scmp.com/business/banking-finance/article/3048471/hong-kong-exchange-spurred-alibaba-xiaomi-listings>, published January 31, 2020, accessed September 22, 2020.

¹¹⁶ Govindarajan Vijay, Shivaram Rajgopal, Anup Srivastava, and Luminta Enache, “Should Dual-Class Shares Be Banned?,” *Harvard Business Review*, <https://hbr.org/2018/12/should-dual-class-shares-be-banned>, published December 3, 2018, accessed February 15, 2022.

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China-based leadership group. However, the one used by Alibaba was even less transparent and institutionalized, which gave its effective controllers more discretionary power in making key decisions behind the backs of board members. It is perhaps common sense that a board, referring to a panel of elected individuals representing shareholders in corporate management and oversight, is the highest decision-making body in a firm. However, Alibaba has installed a uniquely designed top-down approach to intervene in the composition of board members known as “lakeside partnership” (*Hupan Hehuoren*), thus making the board of directors a secondary puppet organization inferior to the company’s founders and managers.

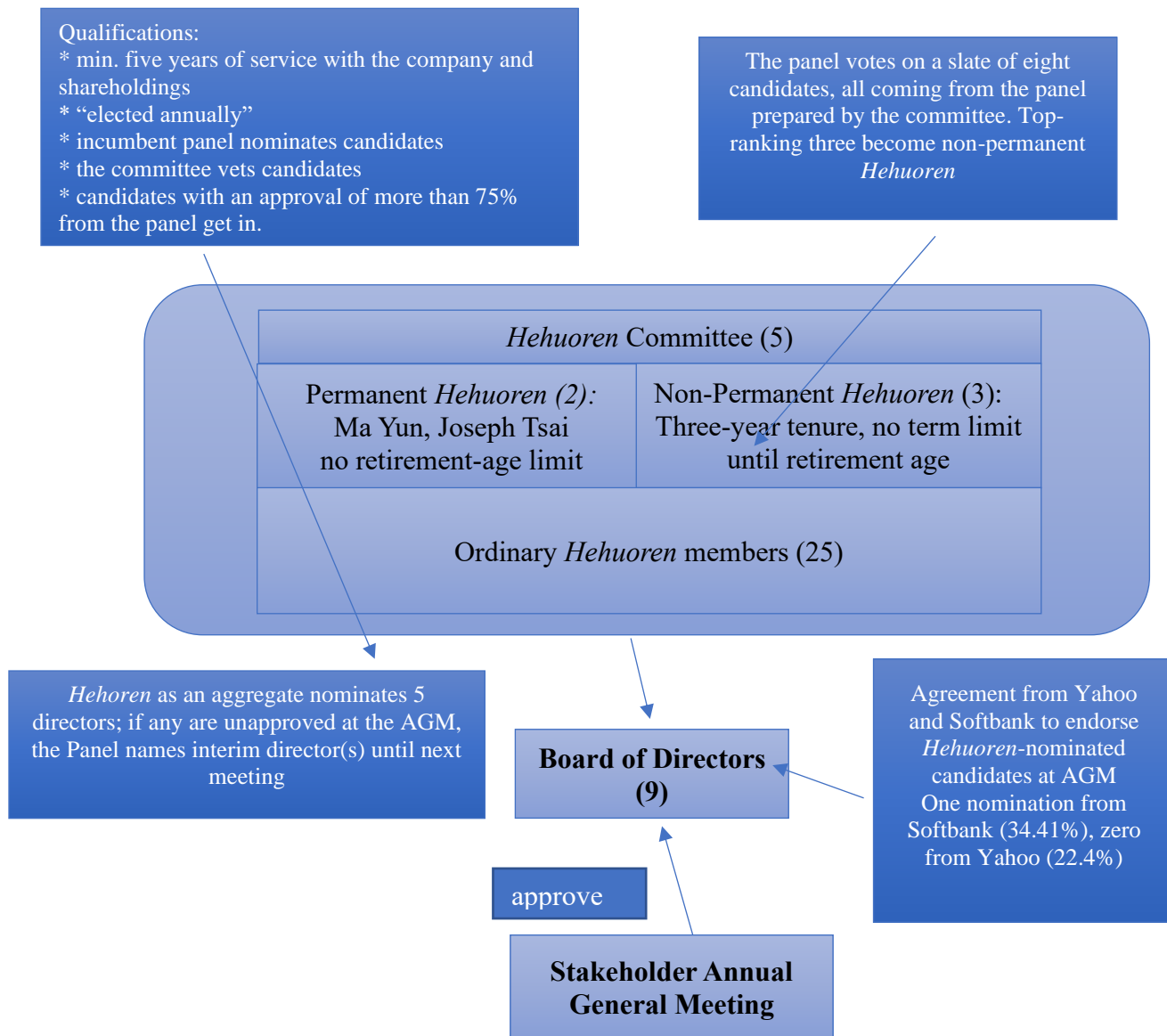
Alibaba’s internal decision-making and power structure have long been mysterious. However, to fulfil the SEC’s listing requirement, Ma Yun disclosed details about the *Hehuoren* institution on September 10, 2013 via an internal e-mail to Alibaba’s employees.¹¹⁷ According to the email, the lakeside partnership was formalized in July 2010 and named after Ma Yun’s residence, which was adjacent to Hangzhou’s West Lake where the company was founded. As Diagram 5.3 below shows, the major influences behind the top decisions by Alibaba’s board of directors were the selectorate *Hehuoren* panel, and particularly Ma Yun and Joseph Tsai. The *Hehuoren* panel’s membership was not fixed and changed from time to time due to the election of new partners and the retirement or departure of incumbent partners. The panel admitted new members each year, and the nomination of new members could only be carried out by the existing partners who were able to propose new ones to the committee. After reviewing the nominations, the *Hehuoren* committee would decide whether the slate would proceed to the entire panel for

¹¹⁷ Ma Yun, “Email Message to Alibaba’s Employees. Quoted in *Sina*. “Alibaba Pilu Hehuoren Zhidu: Zhixing Sannian, Yiyou 28 Ren,” [Alibaba Disclosed its Partnership Institution: Three Years in Practice, Now Counts 28 Members],”<https://tech.sina.com.cn/i/2013-09-10/12308725122.shtml>, published September 10, 2013, accessed September 24, 2020. The roster of *Hehuoren* was disclosed in the June 16 version of the prospectus. Liu Xiaojing and Xinci Wang, “Alibaba IPO Qian Wugai Zhaogushu” [Alibaba revised the Prospectus Five Times Before IPO,] *Caixin*, <https://companies.caixin.com/2014-09-11/100727355.html> published September 11, 2014, accessed September 23, 2020.

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voting. Then, all incumbent partners would vote on a one-partner-one-vote basis, with candidates that received an approval of more than 75% becoming new partners. In terms of eligibility, candidates needed to have at least five years of continued service with Alibaba or affiliated companies, and must own equity interests in the company. Additionally, candidates were required to demonstrate a “high standard of personal character and integrity, maintain a ‘track record of contribution to the corporate business’, and serve as a ‘culture carrier’ committed to Alibaba’s mission, vision, and values.”

Diagram 5.3 Power Structure of the Alibaba *Hehuoren* Panel in 2014



Source: various documents disclosed by Alibaba in mid-2014, compiled by author

The core part of the *Hehuoren* selectorate is a self-nominated committee responsible for administering *Hehuoren* elections. The committee members serve a three-year term that can be renewed indefinitely.¹¹⁸ Prior to the committee election that occurs every three years, the incumbent committee nominates a number of partners equal to the number of partnership committee members to serve the next tenure, as well as three additional nominees. The slate is then passed to each member of the *Hehuoren* panel, and they are required to eliminate three and vote out a number equal to the number of partnership committee members. In other words, the three nominees who receive the least votes from the *Hehuoren* members will not serve in the next mandate. All ordinary *Hehuoren* members are required to retire at the age of sixty or upon the termination of their qualifying employment. The *Hehuoren* committee can designate retired members as honorary partners, and they may be entitled to allocations from the deferred portion of the annual cash bonus pool as retirement pension payments.

However, exceptions are granted to permanent *Hehuoren* who are the most powerful figures in Alibaba and are able to serve until they voluntarily retire, die or become incapacitated. According to the *Hehuoren* Charter, “either two or three partners at a time may be designated as continuity partners, with Ma Yun and Joseph Tsai serving as the initial continuity partners [read as permanent *Hehuoren*].” To become a permanent *Hehuoren*, the candidate must be nominated by a retiring or incumbent permanent *Hehuoren*, put differently, only Ma and/or Tsai. A *Hehuoren* member, whether they are permanent or ordinary, may also be removed by a simple majority vote from all *Hehuoren* present at any duly-called meeting regarding the violations of certain standards set forth in the partnership agreement. However, the *Hehuoren* Charter does not mention how the

¹¹⁸ SEC, Form-1 (Alibaba IPO Prospectus), p.230. The committee’s dominance in the entire *Hehuoren* group also comes from its power to allocate the relevant portion of the annual cash bonus pool for all *Hehuoren* members.

meeting can be convened and who can do so. Furthermore, any amendment to the *Hehuoren* agreement requires an approval of 75% by attending partners and must be done so at a meeting where at least 75% of all partners are in attendance.

There are two ways in which *Hehuoren* as a collective can exert effective control over Alibaba. The first comes from its unshakable power to shape the board composition. For instance, the *Hehuoren* panel has the exclusive right to nominate a simple majority of the members on the board of directors. Although the election of each director-nominee for *Hehuoren* is subject to a majority vote from shareholders at an AGM, *Hehuoren* has the right to appoint a different person to fill the vacancy until the next AGM in the case where a director-nominee is not elected or quits the position after election. If *Hehuoren*'s nominated or appointed board directors do not form a majority, *Hehuoren* has the discretionary power to appoint additional directors to the board to ensure that their appointees always take majority.

Hehuoren's nomination power makes them almost impossible for outside members to challenge much less overthrow, because any revisions to such clauses requires 95% of the shareholders to vote in favour of them at an AGM. In fact, Ma Yun could veto such an initiative entirely by himself, as he held 8.8% of Alibaba's total issued shares at the time of the NYSE IPO. Thus, Ma himself could turn down any proposals against *Hehuoren*'s interests. In other words, as long as *Hehuoren*'s aggregate shareholding was above 5%, their dominance over the board's composition was unshakable. In the IPO Prospectus, Alibaba made this point crystal clear: "the nomination rights of the Alibaba Partnership [read as the *Hehuoren* institutions] and the voting agreement will limit your ability to influence corporate matters, and the interests of the Alibaba Partnership may not coincide with your interests."¹¹⁹

¹¹⁹ Ibid.

As shown in Table 5.3 below, Alibaba's board had nine members upon the completion of the company's IPO in 2014. As per the nomination clause, *Hehuoren* could nominate a majority of five, although it chose to do just four.¹²⁰ However, after the IPO, *Hehuoren* appointed another two board members and increased the total number of directors to eleven. Through a voting agreement, Softbank, which had only one board member, agreed to vote in favour of the *Hehuoren*-proposed nominees at each AGM as long as it held at least 15% of Alibaba's outstanding ordinary shares. In addition, if Softbank gained more than 30% of the outstanding ordinary shares, the voting weight which was correspondent to the portion beyond 30% would be granted to a trust company that was owned and controlled by Ma Yun and Joseph Tsai, both of whom were Alibaba's permanent *Hehuoren*. However, if Softbank's holdings dropped below 15%, it would lose its only seat in the board.¹²¹ Yahoo had no seat on Alibaba's board.¹²²

Table 5.3 Composition of Alibaba's Board (2012-2020)

	Directors of the Board	Expiration of three-year term
Group I	Joe Tsai*, Lu Zhaoxi, * Michael Evans*, (+Börje Ekholm)	AGM of 2021,2018,2015
Group II	Zhang Yong*, Chee Hwa Tung, Jerry Yang, (+Wan Ling Martello)	AGM of 2022,2019
Group III	Ma Yun*, Masayoshi Son,^ and Walter Kwauk	AGM of 2020,2017

**Hehuoren* nominee, ^ Softbank nominee;

Ekholm was added on board in June 2015, Martello in Sept. 2015; Ma Yun was replaced by Maggie Wei Wu^ in September 2020; Lu Zhaoxi replaced by Jing Xiandong^ in September 2016, Masayoshi Son replaced by Kabir Misra^ in September 2020.

Source: SEC, Form-1 (Alibaba IPO Prospectus); Alibaba Group, Corporate Governance, https://www.alibabagroup.com/en/ir/governance_6, accessed on 15 September 2020

¹²⁰ Michael Evans served as the independent director nominated by the nominating and corporate governance committee upon the IPO. Afterwards, he became a *Hehuoren* nominee. SEC, Form-1 (Alibaba IPO Prospectus), Evans was the chief engineer behind China Telecom's partial overseas listing in 1997 in the capacity of a banker and a partner associated with Goldman Sachs. See Chapter Four for more information.

¹²¹ Pengpai, "Shuide Ali: 28 Ge Hehuoren Ruhe Zhangwo Qainyi Diguo," [Who Does Alibaba Belong to: How the 'Partnership' Controls the Empire That Worth Hundreds of Billions,] http://m.thepaper.cn/kuaibao_detail.jsp?contid=1245983&from=kuaibao, published May 8, 2014, accessed September 23, 2020.

¹²² Jerry Yang was the Yahoo nominee on Alibaba's board from October 2005 to January 2012. He left Yahoo in 2012 and was invited back on Alibaba's board in 2014 as an independent director.

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Alibaba also adopted an anti-takeover design that could ward off any possible reshuffling of board membership that could challenge *Hehuoren*'s domination over its composition.¹²³ As Table 5.3 above shows, the board of directors is divided into three groups designated as Group I, Group II, and Group III with the number of directors in each group being roughly equal. Directors assigned to Group I initially serve until the first AGM of shareholders following the completion of the 2014 IPO. In a similar vein, directors assigned to Group II would serve until the second post-IPO AGM of shareholders, and directors assigned to Group III would initially serve until the third AGM.

The other way in which *Hehuoren* controlled the company was that all of its members simultaneously held important managerial positions in the companies operating inside China. In fact, Alibaba acknowledged that the *Hehuoren* panel was “largely comprised of members of our management team.”¹²⁴ The managerial portfolios of *Hehuoren* members manifest such overlapping. According to Alibaba's IPO Prospectus, the core assets of the 2014 IPO included three online retail market sites (Taobao.com, Tmall.com, and Juhuasuan.com), three wholesale online sites (AliExpress, Alibaba.com. and 1688.com), Zhejiang Ant Small and Micro Financial Services Company, the cloud computing service Aliyun, and the shipping and delivery operator China Smart Logistics. As Table 5.4 below shows, *Hehuoren* members all held key positions in either the Alibaba Corporation or the affiliated companies that managed listed assets.

Table 5.4 30 *Hehuoren* Members, Their Positions and Shareholdings in Alibaba in 2014

Name	Position in the <i>Hehuoren</i> Committee	Managerial Positions held in Alibaba Corporation	Share-holding
Ma Yun	Permanent	Executive Chairman	8.8%
Joseph Tsai*	Permanent	Executive Vice Chairman	3.6%

¹²³ For more information on how classified boards as a defensive tool against take over, see Faley Olubunmi, 2007, “Classified boards, firm value, and managerial entrenchment,” *Journal of Financial Economics* 83: 501–29.

¹²⁴ SEC, Form-1 (Alibaba IPO Prospectus), p.47.

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Lu Zhaoxi	Non-permanent	Chief Executive Officer (CEO)	Undisclosed	Sub-total: 2.2%
Peng Lei	Non-permanent	Chief People Officer (CPO)	Undisclosed	
Zhang Yong		Chief Operating Officer (COO)	Undisclosed	
Wu Wei		Chief Financial Officer (CFO)	Undisclosed	
Wang Jian		Chief Technology Officer (CTO)	Undisclosed	
Jiang Peng		President, Alibaba Cloud Computing, Yun OS and Digital Entertainment; Deputy CTO	Undisclosed	
Shao Xiaofeng		Chief Risk Officer	Undisclosed	
Dai Shan		Chief Customer Officer	Undisclosed	
Timothy A. Steinert *		General Counsel and Corporate Secretary	Undisclosed	
Jin Jianhang		President	Undisclosed	
Zeng Ming	Non-permanent	Chief Strategic Officer (CSO)	Undisclosed	
Cai Jingxian		Principal Engineer		
Cheng Li		Chief Architect, Zhejiang Ant Small and Micro Financial Services Company		
Fan Luyuan		President, China Business, Zhejiang Ant Small and Micro Financial Services Company		
Fang Yongxin		Director, Human Resources		
Hu Xiaoming		Risk Manager, SME Loan Business; Chief Risk Officer, Zhejiang Ant Small and Micro Financial Services Company		
Jiang Fang		Vice President, Corporate Integrity and Human Resources		
Jing Xiandong		CFO, Small and Micro Financial Services Company		
Liu Zhenfei		Vice President, Infrastructure Operations		
Ni Xingjun		Principal Engineer, Zhejiang Ant Small and Micro Financial Services Company		
Peng Yijie		Vice President, International, Zhejiang Ant Small and Micro Financial Services Company		
Tong Wenhong		COO, China Smart Logistics		
Wang Shuai		Senior Vice President, China Corporate Communications and Marketing		
Wu Minzhi		President, Alibaba.com and 1688.com		
Wu Yongming		Senior Vice President, Corporate Development		
Yu Siying		Associate General Counsel, China		
Zhang Jianfeng		President, Taobao Marketplace		
Zhang Yu		Vice President, Corporate Development		

* Joseph Tsai is a Canadian citizen and Hong Kong resident. Timothy A. Steinert is also a Hong Kong resident. Neither specializes in the management of Internet assets. Steinert had a BA in History and a JD in Law, and worked in Hong Kong, while Joseph Tsai, as mentioned above, specializes in financial investment and international banking.

Source: SEC, Form-1 (Alibaba IPO Prospectus); Casey Quentin, "Who Is Joseph Tsai? The Canadian Man of Action behind Alibaba's Embattled Jack Ma," *Financial Post*, <https://financialpost.com/personal-finance/high-net-worth/whos-joseph-tsai-the-canadian-man-of-action-behind-alibabas-embattled-jack-ma>, published and accessed September 1 2021; Steinert Timothy, Personal Profile, LinkedIn, <https://hk.linkedin.com/in/timsteinert>, accessed September 1, 2021.

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To sum up, compared with the preferential stock structure that only granted China-based founders voting privileges in the AGM and the transparency of the weighted voting and voting process in the AGM, Alibaba's *Hehuoren* system had gone further in concentrating corporate control into a handful of company founders and managers. This design has made the Chinese founders more influential in corporate matters and weakened the AGM's power in electing board members. In fact, the majority of corporate decisions were not made during the AGM but were formulated and confirmed at the board level. Therefore, dominating the board meant controlling the entire company. This point is conveyed explicitly to investors in Alibaba's IPO documents -- share ownership does not equate to voting rights, a design that the prospectus confirms "will limit your [investors'] ability to influence corporate matters, including any matters determined at a board level."¹²⁵

5.6.3 When a "False Divorce" Became True: The Alipay Case

What would happen to foreign investors that owned the majority shares but could not operate or control their assets inside China? The Alipay (*Zhifu Bao*) case offers an answer. As an e-commerce giant, Alibaba boasts a PayPal-like online payment tool named Alipay. This software is central to the entire business empire because it provides payment services for all B2B, B2C, and C2C services. All of the business on Taobao, Alibaba's e-commerce platform, goes through Alipay. According to a firm analyzing market shares, Chinese market transactions through third-party payments reached RMB 1.132 trillion in 2010, with Alipay boasting half of the market shares.¹²⁶

¹²⁵ SEC, Form-1 (Alibaba IPO Prospectus), p.39

¹²⁶ Pu Jun, "2010nian Zhongguo Disanfang Zhifu Shichang Jiaoyi'e Po Wanyi," [Chinese Third-Party Payment Market Surpassed 1 trillion Yuan in 2010,] *Caixin*, <https://companies.caixin.com/2011-02-21/100227311.html>, published February 21, 2011, accessed September 25, 2020.

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The Alipay controversy started with a decision made by Ma Yun to unilaterally end the VIE agreement between the Cayman Islands-registered Alibaba Corporation and Alipay E-Commerce Corporation, and spin off Alipay as a separate Chinese-registered and -owned company. Before Ma's action, Yahoo and Softbank together owned more than 70% of Alipay's shares. However, in two separate instances on June 1, 2009 and August 6, 2010, Ma used his dominance over Alibaba's assets inside China and the power granted by the *Hehuoren* system to spend a total of RMB 330 million to transfer the Alipay assets from a China-based WFOE established by Alibaba Corporation on paper to Zhejiang Alibaba Commerce Ltd., a completely domestic company founded in October 2000.¹²⁷ This Zhejiang-registered company was fully owned and controlled by two Chinese citizens, with Ma Yun himself owning 80% of the RMB 710 million in registered capital and Xie Shihuang owning the rest. As stated in earlier sections, the VIE structure was based on contractual arrangements rather than equity ownership, so the parent company (i.e. the Cayman Islands-registered Alibaba Corporation) had no obligation to inform ODFI investors of such decisions. However, the cost was colossal for all shareholders, especially Yahoo and Softbank, who would lose out on any direct benefit from launching Alipay and its future IPO.¹²⁸

But why did Ma make such a controversial move? Ma defended himself by saying that the third-party payment platform's pending parchment regulation with the People's Bank of China (PBoC), China's central bank, was the major reason. As early as 2006, the PBoC had released its

¹²⁷ Wang, Shanshan, Ning Yu, Yongqiang Gu, and Tao Zhang, "Zhifubao 3.3yi Zhuanshou," [The Transfer of Alipay at 330 million Yuan,] *Caixin Xinshiji*, <https://magazine.caixin.com/2011-05-13/100258948.html>, published May 16, 2011, accessed September 25, 2020.

¹²⁸ Alipay was restructured and named Ant Finance. However, in October 2020, the Chinese central authority halted its dual listing on the Shanghai and Hong Kong stock exchanges just days before the scheduled date. For more information, see Yang Jing, and Lingling Wei, "China's President Xi Jinping Personally Scuttled Jack Ma's Ant IPO," *The Wall Street Journal*, <https://www.wsj.com/articles/china-president-xi-jinping-halted-jack-ma-ant-ipo-11605203556>, published and accessed November 12, 2020.

first draft of the third-party payment regulation and sought public comments. Various rounds of revision had taken place since then, and the PBoC had permitted China-based and Chinese-controlled companies like Alibaba to operate such business despite an absence of written rules. Allegedly, Ma was obliged to make Alipay a fully Chinese-owned and -controlled company in anticipation of the need to avoid contravention with the PBoC's pending policy, which would require third-party payment providers to obtain an operating license, something prohibited to non-Chinese controlled investors.

On June 14, 2010, the PBoC officially unveiled the much-awaited announcement that any firm providing third-party payment business must apply for an operating license from the PBoC, and that the applicant must be “a limited liability company or joint-stock company legally established inside the People's Republic of China as the corporate body of a non-financial institution.”¹²⁹ But the document intentionally skewed the question of whether foreign investment was allowed in such business and whether an equity cap applied in that case. Rather, it stated that, “the business scope of foreign-funded payment institutions, the eligibilities of overseas investors, the ratios of the investments of overseas investors, and other such matters shall be determined by the PBoC in other initiatives and be submitted to the State Council for approval.”¹³⁰

One of the major reasons why the written regulation took four years to come out was because the different ministries failed to reach a consensus on what percentage of ownership foreign investors should be allowed to have in third-party payments. One option was 50%, in accordance with the equity cap of the MII/MIIT on telecom VASs.¹³¹ The other option was 20-

¹²⁹ People's Bank of China (PBoC), “Feijinrong Jigou Zhifu Guanli Banfa,” [Administrative Measures for the Payment Services Provided by Non-Financial Institutions,] http://www.gov.cn/flfg/2010-06/21/content_1632796.htm, released June 14, 2010, effective from September 1, 2010. Article 8.

¹³⁰ Ibid. Article 9.

¹³¹ Wang, “Zhifubao Zhuanyi Zhenxiang.”

25%, based on the foreign equity granted to banking and financial institutions that agreed that no single foreign shareholder could surpass 20%, and that their aggregate shares could not surpass 25%.¹³²

Eventually, a fixed numeric benchmark was not written into the policy. The deeper reason, according to one industrial insider's interpretation, was still related to China's WTO commitment and practical protectionist considerations.¹³³ China did not make any commitment to opening its payment sector when gaining their WTO membership in 2001. In 2010, the American credit card company VISA was still in a row with its Chinese equivalent Union Pay, which was yet to be adjudicated by the WTO.¹³⁴ Although technically speaking, third-party payment does not include banking payment, the Chinese government believed that if the PBoC accepted foreign equity in third-party payments and allowed foreign investors to apply for an operating license, it would run counter against and weaken its official stance in the Union Pay issue.¹³⁵

Since the PBoC's parchment regulation did not specifically mention how VIE companies were to be regulated, Alibaba promptly communicated with the PBoC and was told that if the license-applying company contained a foreign *equity* investment, it must obtain approval from the State Council rather than the PBoC alone.¹³⁶ Going through the State Council meant that the vetting and approval of many more interested ministries would be involved. According to Alipay's CFO Jing Xiandong, Alibaba decided to spin off Alipay from the Cayman Islands-registered Alibaba Corporation and transfer the assets to the purely domestically registered and Chinese-controlled

¹³² Ibid.

¹³³ Wang et al., "Zhifubao Kaoyan."

¹³⁴ For more information on this dispute and WTO's settlement, see WTO, "DS413: China-Certain Measures Affecting Electronic Payment Services," https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds413_e.htm, n.d., accessed September 24, 2020.

¹³⁵ Wang et al., "Zhifubao Kaoyan."

¹³⁶ Wang et al. "Zhifubao 3.3yi Zhuanshou."

Zhejiang Alibaba “out of fear for the risks and waiting time.”¹³⁷ In fact, the idea of spinning off Alipay was endorsed by a board meeting on July 24, 2009, with Masayoshi Son and Jerry Yang’s giving the green light “as long as a VIE contractual relationship existed.”¹³⁸ In other words, Yahoo and Softbank gave their consent on the condition that the spinoff was merely a tactic to obtain the operating license and that future profits would be transferred back to Alibaba Corporation in the Cayman Islands.

On August 6, 2010, Ma Yun transferred the remaining 30% of Alibaba’s ownership to Zhejiang Alibaba, thus turning Alipay into a full subsidiary of Zhejiang Alibaba. However, until this moment, the spun-off Zhejiang Alipay, the company that held Alipay’s assets, was still under VIE contracts. The second transfer took place when *Hehuoren*’s nominees (i.e. Ma Yun and Joseph Tsai) still dominated the four seats of board membership. In October 2010, the voting agreement that Alibaba signed with Yahoo in 2005 expired, and Yahoo was now able to add one more member, making it on par with *Hehuoren*. As some observers pointed out, control over Alibaba, the status of Alipay, and the board membership change were not in isolation, but were “the same chess game played by Ma Yun.”¹³⁹

Ma went further. In late January 2011, imminent to the official release of its third-party payment licenses, the PBoC requested all the recipients it had already vetted to submit written declarations on whether any capital outside China had exerted control over the companies through shareholdings, contracts, or other arrangements.¹⁴⁰ According to a source at the PBoC, the move was merely for the purpose of filing documents and to check if any non-Chinese entities were

¹³⁷ Wangyi, “Ma Yun Jiu Zhifubao Shijian Zhaokai Meiti Goutonghui Shilu,” [Records of The Press Conference Organized by Ma Yun Regarding the Alipay Incident,] <https://www.163.com/tech/article/76166VUD000915BF.html>, published June 15, 2011, accessed on 25 September, 2020.

¹³⁸ Ibid.

¹³⁹ Wang et al., “Zhifubao Kaoyan.”

¹⁴⁰ Ibid.

exerting any *real* control over the licensed company. There was no intention or insinuation that the existence of a VIE would nullify the license.¹⁴¹ However, on the day before the submission, Ma Yun unilaterally ended the VIE contract between Alipay and Cayman Islands-registered Alibaba Corporation. Yahoo, one of the major shareholders of Alibaba, was kept in the dark for about two months. Yahoo alleged that Alibaba's notification on ending the VIE contract did not come until March 31, and that it was not approved by either the board or the shareholder meeting. Due to the large slice of valuable assets in Alibaba that Yahoo lost, the company's share price plunged on May 11 by 7.28%, then nosedived by 6.23% in the following day.¹⁴²

The reason why Ma Yun could spin off such valuable assets from the holding company without even being noticed by major foreign investors was because under the VIE design, the fully Chinese-owned and -controlled VIE company that could apply for and hold government-issued licenses and the WFOE that the foreign holding company established as an affiliate inside of China were essentially one company with two names. In other words, the six contracts that bound Zhejiang Alipay and the Cayman Islands-registered Alibaba Corporation together were all signed by the same person, Ma Yun, under two different names. As a result, they could also all be terminated and declared void by Ma himself.

In public, Ma Yun had used the PBoC's policy as a pretext to justify enhancing *Hehuoren's* interests at the expense of foreign investors. On June 14, 2011, Ma defended his actions in a press conference, saying that the decision was "very difficult but the only responsible way" because "a [third-party payment] license applicant with foreign [equity] investment would need the State

¹⁴¹ Shi Jinfeng, "Di'sanfang Zhifu Paizhao Xijie Fupan: Yanghang Fahan Yaoqiu Baobei," [Retrospecting Administrative Approval Details of Third-Party Payment License: People's Bank of China Requested Document Filing,] *Ershiyi Shiji Jingji Baodao*. Reposted by *Sina* <http://finance.sina.com.cn/chuangye/internet/20110622/100810029745.shtml>, published June 22, 2011, accessed September 24, 2020.

¹⁴² Wang et al. "Zhifubao 3.3yi Zhuanshou."

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Council's approval, which takes a long time. A refusal could jeopardize the tens of thousands of e-commerce websites operated by Alibaba."¹⁴³ Therefore, Alipay "must be one of the first applicants to obtain the license in a secure and legal way without any fluke mind (*jiaoxing xinli*"); and to achieve this end, "200% of the efforts must be made to ensure 100% of the final result."¹⁴⁴ Moreover, Ma said that "for the first time, I respect the PBoC's consideration over national security" regarding the regulations on third-party payments.

However, Ma's allegations were spurious. Among the other 26 companies that obtained third-party payment licenses together with Alipay, half of them resorted to ODFI via the VIE model in the same way Alibaba did. Regarding the five applicants that did not receive the license, the reason was simply because of the late submission of application materials.¹⁴⁵ Even for the regulator, Ma Yun's "national security" justification and the alleged risk of Alipay being shut down "was nothing but fearmongering (*weiyang songting*)" because all the applicants had disclosed their foreign shareholding status and VIE structure to the PBoC in early 2011.¹⁴⁶ In fact, several officials from the PBoC disclosed that although the PBoC had demanded that the license applicant and holding company should not have any direct or indirect shareholdings from foreign investors, it did not treat the VIE model as foreign shareholding and control.¹⁴⁷ Moreover, the PBoC's officials even acknowledged that since Alipay was the dominant player in third-party payments, they "frequently consulted with Alibaba throughout the process of drafting the regulation" and that the final version was "substantially influenced" by Alipay's interests and stance.¹⁴⁸

¹⁴³ Wangyi, "Ma Yun Jiu Zhifubao Shijian Zhaokai Meiti Goutonghui Shilu."

¹⁴⁴ Ibid.

¹⁴⁵ Wang et al., "Zhifubao Kaoyan."

¹⁴⁶ Ibid.

¹⁴⁷ Ibid.

¹⁴⁸ Ibid.

In a calm dénouement, no legal action was pursued. Rather, an agreement was reached between Ma Yun and Alibaba's major shareholders Yahoo and Softbank. As compensation, the Cayman Islands-registered Alibaba Group would license technology services and intellectual property to Alipay, and in return, Alipay would pay royalties to Alibaba. Moreover, once Alipay got their IPO, Alibaba would get no less than \$2 billion and no more than \$6 billion in proceeds.¹⁴⁹

A controversy that was caused by contracts was, again, resolved by another contract.

5.7 Concluding Remarks

The VIE model largely inherited the institutional spirit of its CCF and "Red Chip" predecessors in the sense that foreign investors did not have corporate control over their invested assets in Mainland China. More precisely, it used the CCF strategy's rationale of having foreign investors maintain a contractual relationship rather than an equity relationship with the invested entity and the "Red Chip" strategy's embedding of cross-border corporate construction into global financial markets with OFC-incorporated SPVs. Widely used by China's Internet-based companies since the early 21st century, the VIE model made four upgrades and improvements from its two predecessors.

First, the VIE model marked a new *target* for capital filtration in terms of corporate ownership. Unlike its two predecessors, which were tailor-made for China's telecommunications SOEs, the VIE strategy was used by Internet firms founded and managed by China-based private entrepreneurs. More importantly, unlike the CCF and "Red Chip" strategies, which used foreign finance to push the marketization and corporatization reforms of the governance system for China's telecom services and to create centralized state-owned national champions, the VIE

¹⁴⁹ Dignan Larry, "Alibaba, Yahoo, Softbank Settle Alipay Rift," *Computer Network*, <https://www.cnet.com/tech/services-and-software/alibaba-yahoo-softbank-settle-alipay-rift/>, published July 29, 2011, accessed September 25, 2020.

strategy helped privately-held companies to obtain ODFI that Chinese domestic institutions could not provide.

Second, the VIE model represented an *earlier* and *deeper* engagement of foreign financial elites in the growth of invested companies in China. Due to their risky nature, Internet-related businesses is shunned by state-owned capital. However, they appealed to Chinese private entrepreneurs and foreign private equity and venture capital investors. As one seasoned China observer correctly pointed out, “China’s Internet was created by young Chinese entrepreneurs funded by Intel, IDG, Rupert Murdoch, Dow Jones, and a growing list of Silicon Valley venture capitalists who saw the Chinese Internet as the next global quick-money bonanza.”¹⁵⁰ Compared with the “Red Chip” strategy in which Western investment banks weighed in from the stage of corporatization and the ensuing foreign listing preparation, the VIE strategy demonstrated a much earlier and deeper entwinement in terms of the level of corporate involvement from transnational financial elites. Venture capitalists and private equity firms were involved in the VIE model to finance the growth of Chinese Internet companies from scratch. For the successful and promising ones, international investment banks, law firms, and accountancies spearheaded their debuts on foreign securities exchanges through IPOs. After that, public investors worldwide would buy and trade the shares or bonds issued by these China-based companies’ overseas SPVs.

Third, a remarkable feature of the VIE model was how it combined state endorsement with the CCF-inspired and -inherited contractual control and the “Red Chip”-established and -exemplified embedding into global financial networks. From the outset, the VIE structure was born out of Beijing’s matchmaking, in a sense that Chinese Internet firms were allowed to draw funding from international profit-seeking investors drooling over China’s gigantic,

¹⁵⁰ McGregor James, *One Billion Customers: Lessons from the Front Lines of Doing Business in China*, Free Press, 2005, p.248

underexploited, and lucrative information services market, on the condition that foreign investors retreat to the position of passive investors and financial rentiers. In other words, ODFF investors were allowed to share profits but not to meddle in daily corporate management – an outcome desirable for both the Chinese entrepreneurs that founded and ran the company and the authoritarian elites in Beijing.

In terms of shareholding, non-Chinese financial investors held the majority of stocks issued by the VIE-structured companies, making them legally speaking the owners of all China-based assets. However, a *contractual* arrangement borrowed from the CCF design allowed Chinese entrepreneurs and management teams with negligible share ownerships to have disproportionate dominance over corporate decision-making and management. This was achieved through the uncanny resemblance between the WFOE and VIE, which were essentially the same company under two different names staffed and controlled by the same group of Chinese entrepreneurs and managers. In contrast, filtering out foreign corporate control for state-owned telecom giants was achieved either through the CCF design's endorsement of supervisory and superior ministries, or the "Red Chip" strategy's usage of numerical designs on paper that only allowed a maximum of 25% of shares without corporate control rights to be sold to international investors.

At the sub-state level, multiple Chinese governmental agencies shared power over the regulation of VIE-structured Internet companies, thus guaranteeing that ODFF did not incur foreign corporate control. More precisely, the party-state deliberately chose not to use parchment laws enacted by the parliament or the State Council to recognize the usage of the VIE model, but instead acquiesced various ministry-level agencies to use fragmented decrees to vet and treat these companies as Chinese domestic companies. The overall effect was that, on a case-by-case verification, as long as Chinese regulators knew that corporate control was retained by Chinese

[Type here]

nationals, the VIE companies would be given national treatment, thus allowing them to “bypass” stringent and discriminatory regulations applying to non-Chinese controlled industrial investors – a set of measures that will be investigated in the next chapter.

I identified two layers of state control involved in this verification process. The first layer of control referred to a MII/MIIT-conducted case-by-case vetting of ownership and shareholding at the critical moment of the IPO, which would be when the offshore-registered shell was floated on international securities exchanges to raise ODFF. Next, a coalition of ministries with power over inward and outward foreign capital flow, currency exchange, business license issuance, and taxation required VIE-users to report the shareholding structure as a guarantee that the mechanism served only Chinese-based companies and would not be exploited as a “Trojan horse” by foreign industrial investors to slip into the Chinese internet market.

Depriving foreign investors of their control over their assets inside China also benefitted the Chinese company founders and management teams. As Ma Yun once openly claimed, “there is no problem if you want to buy shares, but I must be the person controlling the company; otherwise, I do not need your investment. You can be the shareholder, but do not meddle with anything in the company (*shenme dou buyaoguan*).”¹⁵¹ In reality, as the Alibaba case reveals, the board of directors was reduced to a puppet through the *Hehuoren* design, thus allowing Ma Yun and his management team, who owned less than 20% of the aggregate stock, to leverage and tightly control the entire corporation.

However, owning a company without the ability to exert control makes large shareholding ODFF investors vulnerable. Such vulnerability was further aggravated by Beijing’s tacit, delicate, and acquiescing attitude towards the VIE model, which could be used by Chinese entrepreneurs

¹⁵¹ Wang, “Zhifubao Zhuanyi Zhenxiang.”

like Ma Yun as a pretext to expropriate foreign-owned assets to the detriment of non-Chinese investors' interests as seen in the Alipay case.¹⁵² In this regard, the VIE model as a set of contractual arguments between an ostensibly foreign-invested company and a local Chinese operator – both controlled by the same people in practice – was more precisely a mechanism that served to prevent foreign investors from properly exercising their property rights.

The preferential stock structure that centralizes corporate control into company founders and the management team are used elsewhere, particularly by US-based Internet companies such as Facebook. A notable difference however is that, within a sovereign nation-state such as the US, the local judicial system provides a last resort against asset appropriation or unlawful activities that harm investors. However, in the cross-border investment context, where an authoritarian party-state that manipulates written laws is involved, “the contracts are only binding and enforceable if Chinese courts are willing to uphold them. Since the entire VIE structure is built on the premise of circumventing the Chinese government’s [parchment] regulations, relying on Chinese courts to uphold VIE contracts is highly risky.”¹⁵³ Worse still, as the unravelling of the CCF joint-venture has shown in Chapter 3, the Chinese state apparatus has a notoriously biased record for securing the property rights of foreigners in disputes with Chinese entities.

Last but not least, the VIE model represented a proliferation of capital filtration in terms of the sheer number of China-based users. CCF and “Red Chip” strategies were only used by oligopolistic national telecom champions. However, the VIE model was used by almost all of

¹⁵² Ironically, Alibaba made this point crystal clear in its IPO Prospectus that “If the PRC government deems that the contractual arrangements in relation to our variable interest entities do not comply with PRC governmental restrictions on foreign investment, or if these regulations or the interpretation of existing regulations changes in the future, we could be subject to penalties or be forced to relinquish our interests in those operations.” But such clause did not dissuade investors from taking a risk. SEC, Form-1 (Alibaba’s IPO Prospectus), p.40.

¹⁵³ Rosier Kevin, “The Risks of China’s Internet Companies on U.S. Stock Exchanges,” <https://www.uscc.gov/research/risks-chinas-internet-companies-us-stock-exchanges-addendum-added-september-12-2014>, published September 12, 2014, accessed February 15, 2022. p.5

China's nearly two hundred Internet-based companies which provide a kaleidoscope of businesses in services like web search, e-commerce, social networking, instant messaging, ride hailing, third-party payments, and cloud storage. Thanks to the VIE model, China underwent an impressive information revolution in the span of about two decades. By the end of 2020, China boasted 989 million netizens,¹⁵⁴ among which 99.7% were smartphone users.¹⁵⁵ It is thus safe to say that ODFF channelled via the VIE model created China's booming Internet industry.

The great progress from China's information companies has largely eclipsed some world-renowned companies. Chinese netizens search with Baidu rather than Google; shop with Taobao, JD, or Pinduoduo instead of eBay or Amazon; share texts, images and videos through Xiaohongshu, QQ, WeChat, or Weibo instead of Instagram, WhatsApp, Facebook, or Twitter; and watch films or TV series on iQIYI or Youku rather than YouTube or Netflix. These international giants and their business models offer templates for their Chinese counterparts to copy, but strangely, none of them has gained a strong foothold in the Chinese market, with some even being kicked out completely or failing to enter in the first place.¹⁵⁶ So what measures were taken by the Chinese state to engage with industrial investors aiming to enter the Chinese market without relinquishing corporate control? How effective were these measures? Can they outcompete local China-based rivals? Let us explore these questions in the next chapter.

¹⁵⁴ Cyberspace Administration of China, "Di47ci 'Zhongguo Hulian Wangluo Fazhan Zhuangkuang Tongji Baogao'," [The 47th Report on Internet Development in China,] http://www.cac.gov.cn/2021-02/03/c_1613923423079314.htm, published and accessed February 3, 2022.

¹⁵⁵ Ibid.

¹⁵⁶ Just to name a few, eBay pulled out in 2006. Google's search engine pulled out in 2010, and Amazon's e-commerce arm pulled out in 2019. Facebook, Instagram, Twitter, YouTube, and Netflix are all unavailable in China unless using VPN.

Chapter 6: The Foreign Direct Investment Restriction Facet of Capital Filtration

The previous chapters have demonstrated that Beijing's support of offshore domesticated foreign finance (ODFF) represents a permissive facet of its regulatory prowess, but there is also a coercive facet built against foreign industrial capital seeking independent corporate control and operation in the Chinese market. So how was capital filtration applied to multinational information companies attempting to enter China through foreign direct investment (FDI)? What "weapons" did Beijing use to weaken their corporate influence and business expansion in China? How did foreign investors adjust their market entrance or operational strategies when facing repressive and nationalist regulations from Beijing? Were such counteractions successful? This chapter aims to answer these questions.

I divide the content below into two parts. The first part introduces Chinese regulatory "toolkits" against foreign information companies with China's accession to the World Trade Organization (WTO) in December 2001 serving as a watermark, as foreign equity was officially forbidden in China before that period. I first sketch out the historical evolution of Beijing's regulatory framework against FDI from the 1990s, with a particular emphasis on Beijing's calculations and *de jure* concessions granting ownership shares to foreign investors during its WTO negotiations in 1998 and 1999. Next, moving into the post-accession era, I will show how the four major administrative hurdles of joint venture requirements, application-related red tape, national security reviews, and operating license requirements (some discretionarily or haphazardly imposed by ministries with power over the telecom and Internet sectors) have discouraged foreign telecom and Internet companies from entering the Chinese market in the first place and how they strained post-entry business operations and competitiveness.

In the second part, I will use three mini-case studies to illustrate the attempts, processes, and fates of three global information giants, Google, Apple, and Facebook, in China. They serve to provide detailed and company-specific evidence that corroborates my arguments of the FDI restrictive facet of capital filtration.¹ As targets of Beijing's repressive FDI regulations, these cases are selected for two reasons. First, the three companies share similarities based on their corporate prowess² and their global popularity and influence.³ Second, despite the similarities, their trajectories and results differ: Facebook has not yet obtained an entry permit despite multiple tries; Google pulled its core search-related services out of China after a short stint; and Apple is an outlier that has maintained market presence and enjoyed steady growth. Revealing and comparing how these gigantic American information companies engage with Chinese regulators can offer telling and representative examples of how capital filtration works in practice.⁴

¹ Google Inc. was restructured and renamed Alphabet in 2015, and Facebook Inc. was renamed Meta Platforms Inc. in 2021.

² In 2020, Alphabet, Google's parent company, recorded revenues of US\$ 182.5 billion, Facebook US\$ 85.965 billion, and Apple US\$ 274.3 billion. According to the 2020 Fortune Global 500 list ranking multinational companies worldwide based on their revenues, Apple ranked 12th, Alphabet 29th, and Facebook 144th. Sources: Curry David, Apple Statistics, <https://www.businessofapps.com/data/apple-statistics/>, Meta, "Facebook Reports Fourth Quarter and Full Year 2020 Results," <https://investor.fb.com/investor-news/press-release-details/2021/Facebook-Reports-Fourth-Quarter-and-Full-Year-2020-Results/default.aspx>, released and accessed January 27, 2021; *Fortune*, Alphabet Company Profile, <https://fortune.com/company/alphabet/fortune500/>, accessed March 13, 2021.

³ In 2020, Facebook counted 2.8 billion monthly active users worldwide. Source: Meta, "Facebook Reports Fourth Quarter and Full Year 2020 Results." For the fiscal year of 2019, Alphabet's core products and platforms – Android, Chrome, Gmail, Google Drive, Google Maps, Google Play, Google Search, and YouTube – each boasted over 1 billion monthly active users. U.S. Securities and Exchange Commission (SEC), "Form 10-K of Alphabet Inc.," <https://www.sec.gov/Archives/edgar/data/1652044/000165204420000008/goog10-k2019.htm>, accessed March 21, 2021. In January 2021, Apple Inc. recorded 1 billion active iPhones and 1.65 billion Apple devices in active use. This project focuses on Apple's services, such as iCloud, iTunes, iMovies, Apple Store, and Apple Music, which are inseparable from Apple's devices. By the end of September 2020, the company's rate of paid service subscribers reached 585 million and was expected to surpass 600 million by the end of the year. See, Kastrenakes Jacob, "Apple says there are now over 1 billion active iPhones," *The Verge*, <https://www.theverge.com/2021/1/27/22253162/iphone-users-total-number-billion-apple-tim-cook-q1-2021>, published January 27, 2021, accessed March 22, 2021.

Peterson Mike, "Apple's services now have 585M paid subscribers, on-track to hit 600M by end of 2020," <https://appleinsider.com/articles/20/10/29/apples-services-now-have-585m-paid-subscribers-on-track-to-hit-600m-by-end-of-2020>, published October 29, 2020, accessed March 22, 2021.

⁴ Exploring how each of American Internet-based companies succumbs to the Chinese regime's repressive regulation is beyond of this chapter's scope of research, but several examples are proposed here. For instance, regarding Amazon, see Stecklow Steve and Jeffrey Dastin, "Special Report: Amazon partnered with China

6.1 WTO Accession as a Milestone: From Zero Tolerance to Sino-Foreign Joint Venture

The first barrier Beijing erected against foreign industrial investment in the information services sector was the numerical equity cap. Before 1995, Beijing's attitude and actions towards foreign capital in the information services sector was a blanket prohibition on the operation and management of telecom networks by foreigners. In other words, the authorities outlawed any form of FDI in the Chinese market. The earliest recorded forbiddance of foreign capital in the telecom services sector can be traced back to 1983, and it excludes information services from the list of opening sectors in which Sino-foreign joint ventures are permitted.⁵ More detailed implementation guidelines for foreign invested companies came in 1990, stipulating that they were forbidden from the "electronic communications sector".⁶ As a result, the majority of foreign capital inflow came from favorable foreign loans (FLs) channeled through the Chinese state. Until the mid-1990s, soft loans provided by telecom equipment vendors from the Global North and their governments, required administrative approval from the State Development Planning Commission (SDPC) and was thus subject to the state's overall foreign debt level.⁷

propaganda arm," *Reuters*, <https://www.reuters.com/world/china/amazon-partnered-with-china-propaganda-arm-win-beijings-favor-document-shows-2021-12-17/>, published and accessed December 17, 2021. Regarding Microsoft's LinkedIn, see, Mozur Paul, Raymond Zhang and Steve Lohr, "China Punishes Microsoft's LinkedIn Over Lax Censorship," *New York Times*, <https://www.nytimes.com/2021/03/18/technology/china-linkedin-censorship.html>, published and accessed March 19, 2021.

⁵ State Council, "Zhongwai Hezi Qiyefa Shishi Tiaoli," [Regulations for the Implementation of the Law on Joint Ventures Using Chinese and Foreign Investment,] issued and effective from September 20, 1983.

⁶ Ministry of Foreign Trade and Economic Cooperation (MoFTEC), "Waizi Qiyefa Shishi Xize," [Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises in China,] issued and effective from December 12, 1990.

⁷ Shi Cuiming, "Shixing Lianhe Touzi, Jiakuai Tongxin Fazhan" [Carrying out joint handed investments, speeding up telecommunication development], *Tongxin Qiye Guanli* [Management of Telecommunication Companies], 2(1997), pp.5-7. For instance, in the first half of 1993, State Development Planning Commission approved seven Western governments' loan projects worth US\$ 171.8 million for the PT system. "Youdianbu 1993nian 7-8yuefen Qiye Guanli Dashiji," [Major Corporate Management Events in MPT between July and August 1993,] *Tongxin Qiye Guanli*, [Telecom Enterprise Management,] 6, p.25.

The Ministry of Post and Telecommunications (MPT) and its local affiliates safeguarded this stance and were concurrently the monopolistic operators and regulators of China's telecom business – a hangover of the country's socialist legacy. In a policy document issued in 1990, the MPT reiterated its monopolistic status and underscored that foreign business were strictly prohibited from operating or participating in the telecommunications sector.⁸ This document, reissued by the State Council to all central and local government organs, indicated that the top leadership, Premier Li Peng in particular, fully supported the MPT. However, after Deng Xiaoping used his utmost authority to restart the economic reforms that had been stalled following the 1989 Tiananmen crackdown and the mantle of “socialist market economy” was included in the Chinese constitution in 1993, the MPT's privileges in regulating and running China's telecom assets were challenged by other ministries and particularly the reformist vice premier Zhu Rongji. In 1993, Beijing, under the authority of Zhu who took over most of Li Peng's economic portfolios after the latter suffered a stroke, tried to break the MPT's monopoly over China's telecom assets and speed up infrastructural construction. The MPT reluctantly loosened its control and yielded to pressure from a coalition of governmental agencies to allow other agencies to participate in telecom networks.⁹ Even though, its attitude to FDI remained adamant. In 1993, the MPT reiterated the principle that “organizations and persons outside of China (*jingwai*), wholly foreign-owned companies inside China, Sino-foreign equity joint ventures (*hezi qiye*), and contractual cooperated

⁸ State Council, “Guowuyuan Zhuanpi Youdianbu Guanyu Jiaqiang Tongxin Hangye Guanli he Renzhen Zhengdun Tongxin Zhixu de Tongzhi,” [State Council's Repost of MPT's Request on Strengthening Regulation in the Telecom Sector and Rectifying Telecom Order,] http://www.gov.cn/zhengce/content/2012-09/21/content_3595.htm, issued September 3, 1990, accessed March 12, 2021.

⁹ State Council, “Guowuyuan Zhuanpi Youdianbu Guanyu Jinyibu Jiaqiang Dianxin Yewu Shichang Guanli Yijian de Tong,” [State Council's Repost of MPT's Notification on Further Strengthening Regulation over Telecom Services Market,] <http://fgcx.bjcourt.gov.cn:4601/law?fn=chl035s084.txt>, issued August 3, 1993, accessed March 12, 2021.

companies (*hezuo qiye*) cannot invest, operate or participate in the management of telecom services”.¹⁰

As Chapter 3 shows, the CCF model invented by China Unicom in 1995 marked a practical deviation from the official stance against foreign operations and management of telecom assets inside China. As a competitor of the MPT, China Unicom was tasked with providing faster and cheaper telecom services, but due to negligible funding support from its state-affiliated and -owned stakeholders, Unicom was had to use this form of double joint venture that indirectly taps into foreign FDI for initial capital accumulation and the construction of cellular networks with 2nd generation (2G) standards. Although the MPT was capable of delaying Unicom’s market expansion and sabotaging Unicom’s connections with the vast networks under its management, it was unable to stop Unicom’s foreign investment acquisition despite the murkiness of the CCF strategy that gave foreign industrial investors *de facto* power of corporate control to a certain extent. The reason was twofold. First, Unicom’s Chinese shareholders -- a coalition of sixteen ministries, local governments, and SOEs -- had greater institutional prowess and lobbying power than the lone MPT in the central government. Secondly, Unicom had received political support from the State Council to parlay foreign investment to break down the MPT monopoly.

The MPT’s intolerance of FDI became increasingly tenuous after China decided to speed up its WTO negotiations with the U.S. negotiators. The White House had put strong pressure on Beijing to liberalize its telecom services sector. According to Liu Cai, China’s chief telecom negotiator in the WTO talks and head of the MPT’s policy-making sector, a key disagreement was in the percentage of foreign ownership Beijing would allow. The MPT had been slow and

¹⁰ MPT, “Congshi Fangkai Dianxin Yewu Shenpi Guanli Zanzing Banfa,” [Temporary Measures on Loosening Administrative Approval on Telecom Services Operation,] <http://fgcx.bjcourt.gov.cn:4601/law?fn=chl031s073.txt&dbt=chl>, released September 11, 1993, accessed March 12, 2021. Article 6.

unserious in negotiations with its U.S. counterparts before 1998, because it felt China was not ready to join the trade bloc. It was only after March 1998, when Zhu Rongji became premier, that “negotiations went into the substantive stage (*jinru shizhi jieduan*);” and it was even later, in 1999, when the openness of the telecom services sector was “seriously evaluated (*renzhen pinggu*).”¹¹ Under Zhu’s initiative, actions such as separating the MPT’s regulatory functions from its business functions, creating China Telecom, and amalgamating the MPT with the Ministry of Electronic Industry (MEI) into the new Ministry of Information Industry (MII), all enhanced preparations for negotiating Chinese accession into the WTO.

According to the WTO’s regulatory rules, the telecom services sector was divided into two categories: basic telecommunications services (BTS) and value-added telecommunication services (VATS).¹² However, negotiations in both categories with the U.S. reached a stalemate. With the BTS subsector, Wu Jichuan, the MII minister, was only willing to make concessions of up to 25% – a number consistent with China Mobile’s 1997 “Red Chip” IPO, which granted ODFI investors up to 25% of the listed shell company’s ownership. As Liu Cai acknowledged, this number was also proposed for national security reasons. “Shareholders with less than 25% ownership do not participate in management.” So in terms of corporate control, “we are still in charge (*shuo le suan*), the Chinese nationals (*zhongguo ren*) are in charge, state-owned shares (*guoyou gu*) are in charge, and the Communist Party (*gongchandang*) is in charge.”¹³ But the MII’s offer was far below the

¹¹ Zhao Yining, “Zengzhi Dianxin Tanpan: Weile Yige Baifendian de Zhengyi – Zhuanfang Yuan Xinxi Chanye bu Faguisi Sizhang Liu Cai” [Value-added Telecom Services Negotiation: Controversy over One Percent – Interview with former Head of the Legal Department of MII Liu Cai], *Ershiyi Shiji Jingji Baodao*, <http://finance.sina.com.cn/roll/20111121/033510849752.shtml>, reposted in Sina November 21, 2011, accessed March 14 2021.

¹² For more information, see WTO, “Coverage of basic telecommunications and value-added services,” https://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_coverage_e.htm

¹³ Zhao, “Zhuanfang Liu Cai.”

U.S.'s demand of 66.7% – a level that would grant foreign industrial investors absolute corporate control.

Beijing's overall interests and need to clinch a deal with Washington in a timely fashion gave them the upper hand against the MII's ministerial interests. To strike the deal, China's macroeconomic regulator, the State Development Planning Commission (SDPC), and external economic relations manager, the Ministry of Foreign Trade and Economic Cooperation (MoFTEC), deemed the equity bar to be lower, and lobbied the MII to drop the cap to 49%.¹⁴ The proposition was well received by Premier Zhu. Before his trip to the U.S. in April 1999, he consulted with the MII about lowering the equity cap for foreign ownership in BTS to 49%. As Liu recalled twelve years later, "the opinion of a coalition of ministries other than MII (*zonghe bumen*) was 49%, so the MII alone could not resist the pressure (*ding buzhu*)," and "on the condition that the departmental [MII's] opinion was not concurred by the premier, then we must follow the premier's opinion."¹⁵ During his trip to the U.S., Zhu followed the inter-ministerial consensus of 49% on the negotiations table and eventually reached an agreement in the BTS category.¹⁶

With VATS, which included burgeoning Internet-related services, the MII's position was a maximum of 49% for foreign ownership, which was a lot more lenient than BTS. The rationale, according to Liu, was that the entrance of foreign companies "could benefit us more, because they

¹⁴ In 2003, Beijing undertook a major ministerial reshuffle that triggered portfolio mergers and acquisitions and name changes. The Ministry of Foreign Trade and Economic Cooperation (MoFTEC) was renamed the Ministry of Commerce (MofCOM) and took certain functions from the State Economic and Trade Commission (SETC). SETC was alloyed with the State Development Planning Commission (SDPC) and renamed as the National Development and Reform Commission (NDRC). Long Yongtu, China's chief negotiator, was an assistant minister of MofTEC.

¹⁵ Zhao, "Zhuanfang Liu Cai."

¹⁶ Compared with their American counterparts, European telecom companies were more competitive in BTS with their Global System for Mobile Communications (GSM). Pascale Lamy, its chief negotiator, asked for 51% of ownership. But after multiple rounds of tough negotiations, Beijing remained adamant about sticking to 49%. Eventually, Premier Zhu invited Lamy to Beijing and made a "tiny concession in a small detail" before signing the agreement with the EU. Source: Ibid.

would bring in new technologies, business models, and management”¹⁷ – elements that China’s nascent Internet sector badly needed. But the U.S. asked for 51%, leading to a stalemate that remained until November 1999 and led the Americans to threaten leaving the negotiations. To salvage the deal, China’s top decision-making body, the seven-man Politburo Standing Committee, held a meeting to seek solutions which ended at 3 a.m. Several hours later, Premier Zhu personally went to MoFTEC where the negotiations were taking place, and made a compromise of 1% with the Americans, which terminated the negotiation.¹⁸ As a result, foreign investors were allowed to provide telecom services in the form of equity-based Sino-foreign joint ventures, although their equity shareholdings could not exceed 49% in BTS and 50% in VATS.¹⁹

The agreement between Beijing and Washington D.C. marked an official change to foreign investment regulations in the information services sector. Beijing subsequently drafted two regulations for foreign-invested businesses in 2000 and 2001 respectively. The promulgation of *Regulations on Telecommunications* in September 2000 that took effect immediately reflected the first step. Aligning with China’s commitments to the WTO, this policy categorized all telecom

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ More precisely, the equity bar was lowered in three steps applied to three types of telecom services after China’s accession to the WTO. For domestic and international wired services – all categorized under BTS – foreign services suppliers were permitted to set up Sino-foreign joint ventures with a maximum of 25% foreign equity shareholding within three years after accession, but only in Beijing, Shanghai, and Guangzhou. The permitted foreign equity share would increase to 35% within five years after accession, but was limited to 17 Chinese cities (Beijing, Shanghai, Guangzhou, Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xi’an, Taiyuan and Wuhan), and would eventually grow to 49% within six years after accession without any geographic restrictions. In terms of mobile voice and data services – both BTS-related – foreign industrial investors were permitted to establish Sino-foreign joint ventures with a maximum of 25% foreign equity share upon accession, but only in Beijing, Shanghai, and Guangzhou. The permitted foreign equity share would increase to 35% within one year after accession, but was subject to geographical limitation in 17 cities, and would then grow to 49% within three years after accession with no geographic restrictions.

In the area of VATS, foreign services suppliers were permitted to establish joint ventures with a maximum of 30% foreign equity share upon accession, subject to certain geographic restrictions in Beijing, Shanghai, and Guangzhou. The permitted foreign equity share would increase to 49% within one year after accession in 17 Chinese cities, and then 50% within two years after accession without any geographic restriction. Office of the United States Trade Representative, “Background Information on China’s Accession to the World Trade Organization,” https://ustr.gov/archive/Document_Library/Fact_Sheets/2001/Background_Information_on_China's_Accession_to_the_World_Trade_Organization.html, published December 11, 2011, accessed March 22, 2021.

businesses as either BTS or VATS. A year later, coinciding with China's official WTO membership, the State Council unveiled *Provisions on Administration of Foreign-Invested Telecommunications Enterprises* in December 2001, a policy that specified the procedures that foreign corporations must follow to provide telecom services inside China. It also codified a phased-in equity cap of 49% and 50% for foreign-invested telecom companies in BTS and VATS.²⁰

6.2 Equity Concession: More Openness with More Control?

To the surprise of the MII,²¹ neither the BTS nor VATS subsectors witnessed industrial investors swarm onto the Chinese market after China's WTO accession in 2001. According to official statistics from the MII, only 18 foreign industrial investors submitted their application in the first three years, and all were operators in the VATS subsector, among which only two applications were approved by the MII.²² By the end of 2006, still not a single transaction in BTS was initiated,²³ but the total applications for VATS had increased to 29, out of which 14 projects were approved.²⁴

The cautiousness and hesitation of foreign industrial investors to enter China could be explained by three factors. First and foremost, the equity benchmark, ostensibly a compromise

²⁰ State Council, "Waishang Touzi Dianxin Qiye Guanli Guiding," [Provisions on Administration of Foreign-Invested Telecommunications Enterprises,] issued December 11, 2001, effective from January 1, 2002, revised with non-essential changes in 2008 and 2016.

²¹ According to Liu, Minister Wu was "unsure (*nabuzhun*)" of the impact of granting 49% of ownership to foreign BTS investors when he reluctantly succumbed to the pressure exerted by other ministers and Premier Zhu, who wanted to strike a deal with the U.S. quickly. Zhao, "Zhuanfang Liu Cai."

²² *Nanfang Ribao* [Southern Daily], "18jia Waishang Shenqing Touzi Zhongguo Dianxinye, Junwei Zengzhi Yewu," [18 Foreign Investors Applied to Invest in China's Telecom Industry, All Value-Added Services,] <http://tech.sina.com.cn/t/2004-12-16/1206477911.shtml>, reposted in Sina December 16, 2004, accessed March 20, 2021.

²³ Wu Jianwen, "Xinchanbu Shoudao 29fen Waizi Zengzhi Dainxin Yewu Shenqing," [MII received 29 applications from foreign investors interested in value-added telecom services,] *Xinshi Shibao*, [Information Times,] <http://tech.sina.com.cn/t/2006-09-26/12011159917.shtml>, reposted in Sina September 26, 2006, accessed March 23, 2021.

²⁴ *Ibid.*

made by Beijing, practically and simultaneously served as a cap obliging foreign industrial investors to find Chinese partners to form Sino-foreign joint ventures. However, Sino-foreign cooperation in the BTS subsector was an undesirable way to tap into foreign capital from the standpoint of Chinese companies. Thanks to China Mobile's 1997 "Red Chip" overseas listing, China's state-owned telecom oligopolies, which dominated the BTS sector, could absorb foreign investment in a much cheaper and easier way without incurring the challenges posed by their corporate influence inside China. Thus, it would be unwise to accept joint venture propositions from foreign competitors and give them a foothold in the Chinese market.

Second, foreign industrial investors disliked the idea of entering China through Sino-foreign joint ventures because it challenged their independent corporate decision-making, and telecom services were a sector where industrial investors sought to operate their own networks in the host market. The MII was of course, aware of this. Thus, the equity concession simultaneously served as a cap, so that, in the words of China's chief telecom negotiator for the WTO accession, "no single [foreign company] could hold 49% in the joint venture;" while holding minor shares, "no matter 10%, 8% or 5%, would not satisfy their appetite".²⁵

Third, the MII's cleanup of China Unicom's CCF strategy in 1999 and 2000 – a story that Chapter 3 has delved into – provided a fresh and bitter memory of how post-market entrance FDI in the form of Sino-foreign joint ventures were subject to Beijing's repressive appropriation. As one industrial analyst pointed out, "the uncordial relationship with Chinese operators is the largest obstacle for foreign investors entering the Chinese market."²⁶ Thus, multinational telecom companies were discouraged from entering the Chinese market and hoped that a higher-level

²⁵ Zhao, "Zhuanfang Liu Cai."

²⁶ Cui Haiyan, "Jichu Dianxin Kaifanghou Waizi Weihe Bulai Zhongguo," [Why didn't foreign investments enter China after the opening up of the basic telecommunications sector?] *IT Shidai Zhoukan*, [IT Time Weekly,] reposted by Sohu, <https://it.sohu.com/20050222/n224382329.shtml>, published February 22, 2005, accessed March 22, 2021.

Telecom Law enacted by the National Peoples' Congress – China's highest law-making body – would better protect their invested assets.²⁷ For these reasons, BTS-operating telecom multinationals only established liaison offices in China after the WTO accession and hired half a dozen local staff to report on policy changes to their headquarters.²⁸

Since 2001, the MII and its successor Ministry of Industry and Information Technology (MIIT) has “liberalized” the equity cap three times. However, they were either too symbolic, too late, or too little. The first wave of post-WTO accession liberalization referred to the partial relaxation of the equity cap on Hong Kong and Macau-based telecom and Internet investors. Compared to other foreign investors subject to China's WTO commitment, the Closer Economic Partnership Arrangement (CEPA) signed between Beijing, Hong Kong, and Macau in 2003, gave companies from the latter two regions entrance into the Chinese market with two advantages. The first was that Hong Kong and Macau-based companies could enter three months ahead of foreign ones and were not subject to geographical limitations.²⁹ The second was that these investors could organize joint ventures with mainland companies and operate in five VATS subsectors where Beijing had made no commitments to at its WTO accession. As Table 6.1 below shows, in business areas such as Internet data center, content delivery network, domestic virtual private network (VPN), and Internet access, Hong Kong and Macau-based investors could have up to 50% of equity ownership.³⁰

²⁷ Ibid. The two policies were issued by the State Council, while a Telecom Law would need to go through China's parliament, the National People's Congress.

²⁸ Another important non-regulation-induced reason as to why Western investors, particularly American Internet-based companies, did not seek to enter the Chinese market soon after the WTO accession was the bursting of the “Internet Bubble” in the early 21st century. As a result, many U.S.-based Internet companies either went bankrupt or suffered huge losses, which aborted or at least delayed their overseas expansion plans. In this regard, China's WTO accession took place at a lucky moment. Zhao, “Zhuanfang Liu Cai.”

²⁹ See footnote 19 regarding the phased relaxation of the equity requirement. As China's official accession to the WTO was dated to December 11, 2021, allowing Hong Kong and Macau-based investors to enter starting October 1 meant a window of less than three months.

³⁰ Trade and Industry Department of Hong Kong Special Administrative Region, “Closer Economic Partnership

Table 6.1 Openness of VATS in the WTO, Shanghai Free Trade Area (FTA), and CEPA

Subcategories of VATS	WTO Commitment (2001)	CEPA (2003)	Shanghai FTA (2014)	CEPA (2016)
Internet data center services	N.A.	No more than 50%*	0%	No more than 50%
Content delivery network services	N.A.	N.A.	Could be more than 50%	No more than 50%
Domestic VPN services	N.A.	N.A.	No more than 50%	No more than 50%
Internet access services	N.A.	No more than 50%*	Internet access services to end users could be more than 50%	No more than 50%
Online data processing and transaction processing services (e-commerce only)	N.A.	N.A.	No more than 55%	100% (50% for non-E-commerce services)
Multi-party communication services within the Mainland		N.A.	Could be more than 50%	100%
Store-and-forward services	N.A.	No more than 50%*	Could be more than 50%	100%
Call center services	N.A.	No more than 50%*	Could be more than 50%	100%
Information content services	No more than 50%	No more than 50%*	Only App store services could be more than 50%, the rest areas should still not exceed 50%.	100% only for App Store, the rest areas should still not exceed 50%.
Code and regulation conversion services	No more than 50%	No more than 50%	0%	No more than 50%

* Sub-sectors in which Hong Kong- and Macau-based investors were given a three-month early entry into the Chinese market compared with other foreign investors.

Sources: see footnote 19, 30, 38, and MIIT, “Guanyu Gang’ao Fuwu Tigongzhe Zai Neidi Kaizhan Dianxin Yewu Youguan Wenti de Tongzhi,” [Announcement on Hong Kong- and Macao-based Operators to Provide Services in Mainland,] https://www.miit.gov.cn/zwgk/zcwj/wjfb/tg/art/2020/art_ef84988f12c34ee78584707a1cc97d25.html, issued and effective from June 30, 2016.

But these liberalizations could hardly change a sectoral landscape dominated by Mainland-based and owned companies. Firstly, the market of the liberalized VATS subsectors was already dominated by roughly 6,000 Mainland companies, meaning that Hong Kong and Macau investors would face fierce competition.³¹ As a Hong Kong investor acknowledged, companies from the two special administrative regions were not strong in these liberalized subsectors, but rather, specialized in “peripheric but not mainstream (*bianyuan erfei zhuliu*)” VATS subsectors.³² Therefore, their market entry would not pose significant challenges to Chinese telecom companies, let alone reshape the market in the VATS.³³ Moreover, the Short Message Services (SMS) and Asymmetric Digital Subscriber Line (ADSL), two lucrative and promising VATS businesses that Hong Kong, Macau, and foreign operators wanted to provide, were attached to BTS and operated by China’s state-owned oligopolies which disliked foreign entrants.³⁴ Last but not least, such liberalization was granted by the MII, which did not cede any of its administrative approval power. The requirement on joint ventures was still intact, so the proposed transaction still had to navigate the red tape of multiple regulating agencies which would take 180 working days. As an entrepreneur from a Hong Kong operator revealed, such administrative burdens “raised the

³¹ Liu Qi, “Sanjia Xianggang Dianxin Yunyingshang Shenqing Paizhao Touzi Neidi Dianxin,” [Three Hong Kong Telecom Operators Applied for Licenses to Invest in Mainland,] *Jinghua Shibao* [Beijing Times], <http://tech.sina.com.cn/it/t/2003-10-24/0827247822.shtml>, reposted by Sina October 24, 2003, accessed March 22, 2021.

³² Ibid.

³³ Wen Zhaomou, “CEPA Damen Dongkai, Gang’ao Dianxin Yunyingshang Mouhua Neidi Shichang,” [CEPA’s Door Wide Opening: Hong Kong and Macau Telecoms Operators Planning on Mainland Markets,] *Zhongguo Jingying Bao*, [China Business Journal], <http://tech.sina.com.cn/it/t/2003-10-26/1522248500.shtml>, reposted in Sina October 26, 2003, accessed March 23, 2021.

³⁴ Ibid.

concerns of Hong Kong operators on whether they could conduct business effectively on the Mainland.”³⁵

Unlike the Hong Kong and Macau-based companies, this liberalization had little benefit for other non-Greater-China-area industrial investors. CEPA defined Hong Kong and Macau’s services suppliers as those incorporated or established in Hong Kong or Macau that “have engaged in substantive business operations for 3 years or more.”³⁶ So foreign industrial investors intent on entering the Mainland indirectly via Hong Kong or Macau and benefitting from CEPA would need to first operate in the two cities for three years. But for Hong Kong-originated telecom operators, the three-month window granted by the CEPA was enough for them to “gain an upper hand [compared with non-Hong Kong and non-Macau foreign entrants]”, because in the telecom and Internet market, “faster fish eating the slower fish is a basic law.”³⁷

The next wave of equity cap relaxation with the potential to benefit foreign (excluding Macao and Hong Kong) investors was the Shanghai Free Trade Area (FTA) pilot program initiated in 2014. As Table 6.1 above shows, the FTA’s breakthrough was even more limited compared to the decades-old CEPA deal in two ways. First, the MIIT did not give away its administrative approval power, but issued an ambiguous statement indicating that it would establish a “coordinated mechanism with the Shanghai municipal government,” and urged their Shanghai affiliate to “strengthen the guidance and monitoring of foreign invested companies, and regularly report trial programs to MII headquarters and the Shanghai municipal government.”³⁸ Second, while equity

³⁵ Liu, “Sanjia Xianggang Dianxin Yunyingshang Shenqing Paizhao Touzi Neidi Dianxin.”

³⁶ Trade and Industry Department of Hong Kong Special Administrative Region, “Closer Economic Partnership Arrangement, Annex 5, “Definition of ‘Service Supplier’ and Related Requirements,” <https://www.tid.gov.hk/english/cepa/files/annex5.pdf>, p.2.

³⁷ Wen, “CEPA Damen Dongkai, Gang’ao Dianxin Yunyingshang Mouhua Neidi Shichang.”

³⁸ Government of People’s Republic of China, “Zhongguo (Shanghai) Zimao Shiyanqu Jinyibu Duiwai Kaifang Zengzhi Dianxin Yewu,” [China (Shanghai) Trail Free Trade Area Further Opens Value-added Telecom Services Market to Foreign Investors,] http://www.gov.cn/gzdt/2014-01/06/content_2560694.htm, issued January 6, 2014, accessed March 22, 2021.

caps were lowered in some subsectors within VATS compared to the WTO accession treaty, no further progress was made compared to CEPA. In other words, savvy foreign investors would have already established companies in Hong Kong or Macau, operated for a minimum of three years, and entered the Chinese market via the CEPA channel.

In 2015, the MIIT initiated another seemingly audacious move by allowing foreign-invested companies in the e-commerce subsector to have complete ownership.³⁹ However, as the section right below will show, such reform was more of a symbolic measure because operating e-commerce businesses in China required multiple licenses issued by an array of ministries – many of which are unobtainable for companies with even a tinge of foreign equity ownership. However, failing to obtain the relevant licenses would inevitably restrict the operators' business scope and competitiveness. Moreover, this opening for foreign investors came when China's e-commerce market was already saturated by homegrown giants that tapped into ODFD channeled through the VIE model. According to a report issued by a think tank specializing in e-commerce, Alibaba's T-Mall alone grabbed 57.4% of the share in China's business-to-consumer retail market in 2015, with Jingdong having 23.4%. The remaining 20% was shared by dozens of smaller e-commerce operators, among which the only one with foreign equity investment in the form of a Sino-foreign joint venture was Amazon China, which took a miniscule 1.2% of the market share.⁴⁰ Therefore, any foreign investor that attempted to provide e-commerce services in the Chinese market would have to ask themselves two questions: whether their firms could shake the dominance of Alibaba

³⁹ MIIT, "Guanyu Fangkai Zaixian Shuju Chuli yu Jiaoyi Yewu (Jingyinglei Dianzi Shangwu) Waizi Gubi Xianzhi de Tonggao," [Notice on Removing the Restrictions on Foreign Equity Cap in On-line Data Processing and Transaction Processing (Operating E-commerce) Businesses,] https://www.miit.gov.cn/jgsj/txs/zcbz/wstz/art/2020/art_c1c4f526b1ad4cda8e12e7d3536ffdaa.html, issued and effective from June 19, 2015.

⁴⁰ Wangjing She, "2015 Niandu Zhongguo Dianzi Shangwu Shichang Shuju Jiance Baogao," [China's E-Commerce Market Report of 2015], <http://www.100ec.cn/zt/2015ndbg/>, released May 17, 2016, accessed March 23, 2021.

and Jingdong, and how they could do what Amazon, the largest global company, failed to achieve in China.⁴¹

As Table 6.1 shows, in 2016, as an update and further equity liberalization under the framework of CEPA that was first adopted in 2003, MIIT allowed Hong Kong- and Macao-based investors to take no more than 50% equity ownership in five subsectors and completely rescinded equity requirements for six of them which were previously open to less than 50% ownership held by Hong Kong and Macao investors.⁴² Notably, MIIT proceeded with this round of liberalization in a cautious manner, starting with a trial program in 2015 that limited the interested investors from the two cities to service provision in only Guangdong Province before promoting it to a national scale in 2016.⁴³ The MIIT has always been cautious in avoiding any reform measures that would challenge their market admission power.

6.3 Procedural Nuisances in Setting Up a Joint Venture

In addition to the numeric limits on equity ownership, another obstacle for foreign industrial capital entering the Chinese market through FDI was the amount of red tape from ministry-level agencies that had to be cleared before being permitted to set up a Sino-foreign joint venture, which could delay market entrance for years. These indispensable steps were well established in the *Provisions on the Administration of Foreign-funded Telecommunications Enterprises* promulgated

⁴¹ Amazon officially ended its E-commerce business in China in July 2019. The company established a Sino-foreign joint venture with China's Zhuoyue net in 2004, and saw its market share rise to 15.4% in 2008. However, the meteoric rise of China-based and Chinese-controlled VIE users slashed the number to 0.6% in the first half of 2018. For more information, see, *Wangjing She*, "2019 Niandu Zhongguo Lingshou Shichang Shuju Jiance Baogao," [China's Online Retail Market Data Monitoring Report in 2019,] <http://www.100ec.cn/zt/2019wllsbg/>, released June 5, 2020, accessed March 23, 2021.

⁴² MIIT, "Guanyu Gang'ao Fuwu Tigongzhe zai Neidi Kaizhan Dianxin Yewu Youguanwen de Tonggao," [Announcement on Issues Regarding Hongkong and Macao-based Telecom Operators' Service Provisions in the Mainland], https://www.miit.gov.cn/jgsj/txs/zcbz/wstz/art/2020/art_18e6cdb97ffa42feb401edcb61b82c44.html, issued and effective from June 30, 2016.

⁴³ MIIT, "Guanyu Gang'ao Fuwu Tigongzhe zai Guangdongsheng Tigong Youguan Dianxinyewu de Tonggao," [Notification on Hong Kong and Macao-based Operators Offering Telecom Services in Guangdong Province,] https://www.miit.gov.cn/jgsj/txs/zcbz/wstz/art/2020/art_2eb3d3db469f4fa98b283ab43c4eced2.html, issued and effective from August 17, 2015.

in December 2001 when China joined the WTO. The proposed equity joint venture had to fulfil a minimum registered capital requirement of RMB 2 billion,⁴⁴ with RMB 10 million set as the bar for foreign investors providing nationwide BTS and VATS; and RMB 200 million⁴⁵ and RMB 1 million needed for joint ventures to provide telecom services within provincial jurisdictions.⁴⁶ This requirement was found to disadvantage small-scale investors.⁴⁷

The *Provisions* also adopted nebulous language on the qualifications of foreign investors in VATS. It stipulated that all foreign applicants should possess “a good performance record” and “management experiences,” but did not provide any feasible criteria for evaluation.⁴⁸ Regulators could therefore easily and arbitrarily make use of such regulatory ambiguities as a justification for denying market admission into China for newly founded companies.

Foreign investors also had to wait for their application to circulate through numerous time-consuming approval processes between multiple ministries even after fulfilling the previous two requirements. As per current regulations, the Chinese partners of a foreign investor in the proposed joint venture must first submit their application to the MII/MIIT, which would then take 180 days to examine the transactions in BTS and 90 days for VATS. The MII/MIIT could then decide whether or not to transfer the application to China’s chief macroeconomic management agency⁴⁹ for an extended 30-day examination. Only with approval from the MII/MIIT could the transaction

⁴⁴ State Council, “Waishang Touzi Dianxin Qiye Guanli Guiding.” The threshold of RMB 2 billion was lowered to 1 billion in 2008. Exchange rates between the US Dollar and Chinese RMB was 1 to 8.28 between late 1998 and early 2005.

⁴⁵ Ibid. The threshold of RMB 200 million was lowered to 100 million in 2008.

⁴⁶ Ibid. Article 5.

⁴⁷ U.S. Trade Representative, “2018 Report to Congress on China’s WTO Compliance,” <https://ustr.gov/sites/default/files/2018-USTR-Report-to-Congress-on-China%27s-WTO-Compliance.pdf>, issued February 2019, accessed March 25, 2021. pp.154-55.

⁴⁸ State Council, “Waishang Touzi Dianxin Qiye Guanli Guiding,” Article 10.

⁴⁹ State Planning Commission (SPC) and State Development Planning Commission before 2003, and National Development and Reform Commission (NDRC) after.

proceed further and seek permission from China's regulator of external business relations,⁵⁰ albeit with another waiting period of 90 days.

Once the ministries issued their approvals, the proposed deal had to obtain a license from the State Administration for Industry and Commerce (SAIC)⁵¹ before becoming a legal business entity in China. If any ministries vetoed to stop the deal, the proposed joint venture project would not pass. Such lengthy and uncertain procedures, which could last at least a year, substantially deterred foreign investors from setting up business in China and expanding it in a timely manner.

6.4 Stringent National Security Review Mechanism as an Additional Guarantee

To ward off attempts by foreign industrial investors to circumvent the Chinese joint venture requirement and enter China by merging with or acquiring a Chinese firm, Beijing established a stringent national security mechanism as a safeguard. The security vetting process was laid out and put into trial in March 2011,⁵² thereafter officially adopted on September 1, 2011 following the Alipay incident presented in Chapter 5.⁵³ This national security review of inward investment deals referred to an inter-agency conference similar to the Committee on Foreign Investment in the United States (CFIUS).⁵⁴ According to a source inside the Chinese government, this mechanism was under the shared leadership of the Ministry of Commerce (MofCOM) and NDRC. MofCOM's Department of Foreign Investment Administration would vet the proposed transaction

⁵⁰ MoFTEC before 2002, Ministry of Commerce (MofCOM) after.

⁵¹ SAIC was restructured as State Administration for Market Regulation (SAMR) since 2018.

⁵² "Shishi Waiguo Touzizhe Binggou Jingnei Qiye Anquan Shencha Zhidu Youguan Shixiang de Zanxing Guiding," [Provisional Measures on Establishing the Security Review System for Mergers and Acquisitions of Enterprises within China involving Foreign Investors,] <http://www.mofcom.gov.cn/article/b/g/201103/20110307432771.shtml>, issued March 4, 2011.

⁵³ The policy strengthened its national security vetting mechanism by putting the VIE-structured investment under the review. Article 9 mentions "contractual control." MofCOM, "Shishi Waiguo Touzizhe Binggou Jingnei Qiye Anquan Shencha Zhidu de Tongzhi," [Notification on Implementing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors,] <http://www.mofcom.gov.cn/aarticle/b/c/201108/20110807713530.html>, issued August 25, 2011, effective from September 1, 2011.

⁵⁴ For more information, see, U.S. Department of Treasury, "CFIUS Overview," <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-overview>.

and alert the inter-agency conference if the deal fell into any “sensitive sectors”. When filing transaction details into the computer system, bureaucrats at MofCOM or its local affiliates would be alerted by a popped out message that requested national security verification if the deal falls into any of the 60 sectors Beijing deemed sensitive, which included telecom and Internet services.⁵⁵ Subsequently, NDRC would act as an intermediary at the inter-agency level that convenes, chairs, and hosts meetings, and transfers transactional details to other ministries with overlapping interests or jurisdictions. After collecting the assessments conducted by the relevant ministries, NDRC would then notify MoFCOM about its final decision. If the transaction was deemed sensitive, a special vetting procedure would be triggered, but the detailed processes are only “circulated internally”.⁵⁶

However, until mid-2014, three years after the security review mechanism’s promulgation, not one case was reported. The reason was that the high benchmark of the equity cap requirement and the sectoral restrictions applied to foreign investors were already effective in dissuading foreign investors from attempting to invest in “sensitive sectors” in China. And only a handful of transactions could reach the national security review stage.⁵⁷ With some information service subsectors easing equity caps as mentioned in the section above, the national security screening measures were strengthened in 2020. A policy document co-issued by NDRC and MofCOM stipulated that for any foreign-invested companies wishing to operate in Internet-related sectors in China, so long as there is a chance that they eventually would have actual corporate control, the

⁵⁵ Wang Ziwu, “Shangwubu Kuajing Binggou Shencha Sheji 60 Hangye,” [MofCOM’s Crossborder Merger and Acquisition Vetting Involves 60 Industries,] *Caixin*, <https://finance.caixin.com/2011-08-29/100295965.html>, published August 29, 2011. Accessed March 25, 2021.

⁵⁶ Wang Ziwu, “VIE Zai Dizhen,” [VIE Shakes Again,] *Caixin Zhoukan* [Caixin Weekly], <https://magazine.caixin.com/2011-10-08/100311649.html>, published October 10, 2011, accessed September 28, 2020.

⁵⁷ Hu Shuli, “Shuli Guancha: Jinyibu Dakai Waishang Touzi Zhimen,” [Shuli’s Observation: Further Open the Door for Foreign Investors,] *Caixin Zhoukan*, <https://magazine.caixin.com/2014-06-06/100687017.html>, published June 6, 2014, accessed March 26, 2021.

companies must proactively report to the security review working mechanism. Actual control was defined as belonging to “the foreign investor who holds no less than 50% of the enterprise’s equities; the foreign investor who holds less than 50% of the enterprise’s equities but has voting rights with a material effect on resolutions from the board of directors or the shareholder meetings; and the foreign investor with a material effect on the business decisions, personnel, finances, and technologies of the enterprise.”⁵⁸ In other words, the national security vetting mechanism provided an additional layer of protection for the Chinese regime, although it was rarely used because the existing equity cap was already effective at curbing the market entry of foreign industrial investors.

6.5 Post-Entrance Harassment: Licensing Requirements

But setting up a physical presence in China after treading through the aforementioned steps is not sufficient for operating business freely, as Beijing limits the scope of business that joint ventures can provide through licensing requirements. To provide information services, the joint venture must obtain licenses from a wide range of ministry-level agencies with overlapping and undefined regulatory power over these services. As later sections will show, some of the licenses are unobtainable for foreign capital as they are exclusively reserved for wholly Chinese-owned and controlled companies, and sometimes state-owned and controlled ones.

The MII/MIIT is the predominant regulator in issuing operating licenses. The *Regulations of the Telecommunications* and *Provisions on Administration of Foreign-Invested Telecommunications Enterprises (Provisions 333)*, issued by the State Council in 2000 and 2001 respectively, requires all telecom service providers in China to obtain an operating license from the MII or its provincial counterparts, but does not specify exactly which licenses, leaving ample

⁵⁸ NDRC, “Waishang Touzi Anquan Shencha Banfa,” [Measures for the Security Review of Foreign Investment,] https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202012/t20201219_1255025.html, released December 19, 2020, effective from January 18, 2021.

room for the ministry to discretionarily impose on licenses under the vast subcategories of BTS and VATS. The first license that any Internet-related business must obtain is Internet Content Provider (ICP); without it, operating a website in China would be considered illegal and shut down. The wait period for this license is 60 days, but more importantly, the MII/MIIT only grants ICP licenses to Chinese applicants without foreign equity investment.

Such stringent requirements on licensing have motivated many foreign investors to try different workarounds to obtain a license without applying through the MII/MIIT. The solutions were to merge with or acquire a China-based Internet company and share the latter's ICP license, or to rent or buy licenses from Chinese holders. But for service providers reliant on brand recognition among consumers, operating by stealth was unhelpful for their growth in the Chinese market, and as the business grows -- the Google case below will show in detail -- this regulatory backdoor could be noticed by Chinese regulators.

In July 2006, the MII issued a strongly worded notice that made it compulsory for foreign investors to transfer the invested assets to their Chinese joint venture partners. The MII stated they had found some foreign investors had “cooperated with their Chinese partners, evaded (*guibi*) the Provisions [Provisions 333], and illegally operated VATS inside China by authorizing domain names (*yuming shouquan*) and registered trademarks (*shangbiao shouquan*).” As a result, the MII prohibited license holders from “leasing, transferring, or selling their operating licenses in any form, or providing any resources, sites, or facilities to any foreign investors intent on conducting this type of business in China.”⁵⁹ The MII also urged its local counterparts to mobilize existing VATS license holders to conduct “self-examination and self-correction (*zicha zijiu*) under said

⁵⁹ MII, “Guanyu Jiaqiang Waishang Touzi Jingyiing Zengzhi Dianxin Yewu Guanli de Tongzhi,” [Notice on Strengthening the Administration of the Provision of Value-Added Telecommunications Services Involving Foreign Investors,] <http://www.mofcom.gov.cn/aarticle/b/g/200608/20060802960777.html>, issued July 13, 2006, reposted by MofCOM, accessed March 27, 2021.

requirements”, and noted that emphasis should be placed on the “spotlighted companies (*redian gongsi*)” to which the consumers’ attention is attached. For license holders that failed to take corrective actions, the MII threatened to revoke their licenses.⁶⁰

As a result, foreign investors were obliged to transfer assets to Chinese partners. According to an expert on China’s information industry, such government-enforced localization “increased [foreign investors’] concerns on further investment in China”, as “with this policy coming into force, the only remaining bond between the joint venture inside China and its overseas parent company was technological services.”⁶¹ Without control over assets related to the invested company’s core intellectual property rights, such as trademarks and domain names, the influence of headquarters based outside China on management and operations inside China would be weakened.⁶² Multinational companies wishing to do business in China had no choice but to follow the MII’s regulations and thus transfer assets and corporate control to their Chinese partners. As a seasoned Internet commentator pointed out, operating at arm’s length was “definitely doomed to fail (*kending meiyou qiantu*)” for American headquarters seeking to exert corporate control in China.⁶³

The ICP license is simply one of several bumps that the MII/MIIT erected to limit the scope of business that foreign investors could perform in collaboration with their Chinese partners. The

⁶⁰ This notice targeted foreign industrial investors, but not foreign financial investors that invested in China-based, Chinese-owned, and VIE-structured VATS providers – a mode of capital filtration presented in Chapter 5. It reiterated that the overseas IPO of telecom companies in China needed to be first examined and approved by the MII in accordance with state policies. In practice, VIE users just perfunctorily “transferred” licenses from the WFOE to VIE. Li Xiaoyan, “Zhongguo Zengzhi Dianxi Yewu Yancha Waizi, Google MSN Chuxian,” [China’s Value-added Telecom Services Regulation Strictly Vets Foreign Investors, Google and MSN Touched,] *Ershiyi Shiji Jingji Baodao*, <http://tech.sina.com.cn/i/2006-07-29/08501061404.shtml> reposted by Sina July 29, 2006, accessed March 26, 2021.

⁶¹ Ibid.

⁶² Hu Caihe, “Xinlang Moshi Bolan Zaiqi,” [Sina Mode’s Controversy Resurfaced,] *Internet Weekly*, <http://tech.sina.com.cn/i/2006-09-02/11011116656.shtml>, Reposted by Sina September 2, 2006, accessed March 26, 2021.

⁶³ Zhang Fan, “Yahu Zhongguo Sanbuqu (Yahoo’s Trilogy in China),” *Caijing*, <https://magazine.caixin.com/2005-08-22/100080999.html>, August 22, 2005, reposted by *Caixin*, accessed September 17, 2020

MII/MIIT has further categorized the BTS (Category A) and VATS (Category B) into subcategories with the help of a catalogue system. First introduced by the State Council in September 2000 as an attachment to the *Regulations on Telecommunications*, this catalogue was only updated twice by the MII/MIIT (in 2003 and 2015) during the two decades since China's ascension to the WTO, even despite the revolutionary technological progresses made in the field and the new services that had mushroomed since. The 2003 version divided BTS and VATS into Categories A-1 and A-2 and Categories B-1 and B-2. Moreover, it moved Internet connection services (*wangluo jieru yewu*) – a subcategory originally taxonomized as VATS to allow foreign investors to own 50% of the equity in a Sino-foreign joint venture – to BTS, which was exclusive to state-owned telecom oligopolies. According to a telecom engineer from a MII think tank, many foreign companies felt that this move limited their business scope.⁶⁴

The MII/MIIT also shoehorned new types of services into Beijing's outdated WTO telecom commitments in order to increase its discretionary power over granting foreign operations in new services formed from technological developments. For instance, by reshuffling and renaming subcategories under the VATS, the 2003 Catalogue became inconsistent with the items Beijing promised to allow 50% of foreign ownership in certain VAS sectors. In practice, it became ambiguous and confusing as to which areas were open to foreign investors.⁶⁵ But the basic line of reasoning, according to a chief researcher from a think tank affiliated with Tencent, one of China's

⁶⁴ Chen Zhigang, "Oumei Shi Yunyingshang Jiti Youshui, Seyou Dianxin Waizi 49% Dixian," [Ten European and American Operators Lobbied Collectively, Seducing the 49% Bottom Line of Foreign Investment], *Ershiyi Shiji Jingji Baodao*, <http://tech.sina.com.cn/t/2004-09-18/1429427567.shtml>, reposted by Sina September 18, 2004, accessed March 26, 2021.

⁶⁵ To be more precise, the 2000 Catalogue listed 9 VATS services that would be open to foreign investment: 1) email, 2) voicemail, 3) online information and data base retrieval, 4) electronic data interchange (EDI), 5) online information and/or data processing (including transaction processing), 6) enhanced/value-added facsimile services (*zengzhi chuanzhen*), 7) Internet access services, 8) Internet content services, 9) teleconferencing. The 2003 version put 1, 2, and 6 into "store and forward services" (*cunchu zhuanfalei yewu*), renamed 3 "information services" (*xinxi fuwu yewu*), and merged 4 and 5 as "online data processing and transaction processing services" (*zaixian shujv chuli yu jiaohuan yewu*).

largest Internet conglomerates, was that “unpromised areas, including businesses not technologically available at the moment of the WTO accession – like cloud computing – were prohibited from foreign [industrial] investors.”⁶⁶

As a result, very few licenses were issued by the MII/MIIT to foreign-invested telecom and Internet companies. According to statistics released by the MIIT in 2014, 13 years after China’s WTO membership, licenses to operate BTS had only been issued to domestic companies, among which A-1 category licenses were exclusively issued to the central-state owned oligopolies while A-2 licenses were solely given to companies with state or private ownership that operated very small aperture terminal (VSAT) services (*guonei shenxiao koujing zhongduan diquzhan yewu*) of domestic origin.⁶⁷ By the end of October 2014, only a negligible 1.4% of the total 2,389 licenses issued by the MII were given to Sino-foreign joint ventures.⁶⁸

The ICP license is necessary for almost any foreign invested joint venture seeking to open its own website inside China, but it is not sufficient by itself. To distribute or disseminate any goods or services, an array of additional licenses or permits must be obtained, some of which are exclusive to fully Chinese-owned and controlled applicants. For instance, if a foreign investor wants to operate cloud computing – technically known as Internet Resource Collaboration (IRC) – it must obtain an Internet Data Center (IDC) license from the MII/MIIT. Because an IDC license

⁶⁶ Cai Xiongshan, “Zhongguo Dianxin yu Hulianwang Chanye Duiwai Kaifang de Lailong yu Qumai,” [The Ins and Outs of the Opening Up of China’s Telecommunications and Internet Industry,] <https://cloud.tencent.com/developer/article/1052807>, published March 6, 2018, accessed March 28, 2021.

⁶⁷ CTI Forum, “Huopi Congshi Jichu Dianxin Qiye he Zengzhi Dianxin Qiye Mingdan Gongbu,” [Firms Allowed to Operate Basic and Value-added Telecommunications Businesses Unveiled,] <http://www.ctiforum.com/news/guonei/435317.html>, published December 3, 2014, accessed March 27, 2021. According to the list, the MIIT issued the fourth A-level license to China Broadcasting Network Corporation, allowing this company and its subsidiaries to operate in A1-4-2 (domestic Internet data transmission services) and A 2-6 (domestic communication facility services). VSAT services allowed stations on earth to receive and transmit data, voice, and video signals over a satellite network. For more introductory information, see https://en.wikipedia.org/wiki/Very-small-aperture_terminal.

⁶⁸ The author’s calculation based on CTI Forum, “Huopi Congshi Jichu Dianxin Qiye he Zengzhi Dianxin Qiye Mingdan Gongbu.”

does not belong to any subsector that Beijing promised for foreign investment in its WTO accession, the MII could deny applicants with foreign equity ownership. According to official data released by the MIIT, a total of 3,210 IDC licenses had been issued by the ministry by the end of December 2019,⁶⁹ among which a miniscule 15 – or 0.47% of total – were given to applicants with “foreign capital”, including VIE-structured, China-based, and Chinese-controlled investors and Hong Kong-based ones.⁷⁰ According to an analysis by King & Wood Mallesons, one of China’s largest foreign-related law firms, the IDC license was far from enough. Multiple technologies and businesses associated with cloud services require additional licenses like the aforementioned ICP, an Internet Access Services license, a domestic Internet Protocol Virtual Private Network (IP-VPN) license, and a Content Delivery Network (CDN) license – none of which are in areas promised for liberalization in the 2001 WTO accession. Thus, foreign investors are forbidden from acquiring them.⁷¹ Furthermore, the MII has full liberty over how to update and revise the catalogue.

To make things worse, foreign-invested companies must obtain licenses from other ministries to provide Internet-related services. Table 6.2 shows the licenses for such service aspects that are unavailable to companies with foreign equity investment. For instance, a Sino-foreign joint venture

⁶⁹ China Academy of Information and Communications Technology (CAICT), “2019nian 12yue Guonei Zengzhi Dianxin Fuwu Xuke Qingkuang Fenxi Baogao,” [Report on Licenses of Value-added Telecom Services,] https://www.sohu.com/a/367371987_100000136, reposted by Sohu January 16, 2020, accessed March 20, 2021.

⁷⁰ Chen Yao, Xiaoniao Jiang, Guannan Liu, “Waishang Touzi Jingnei Hulianwang Shuju Zhongxin (IDC) Zhi Paizhao Fengxian ji Yingdui Fang’an Qianxi,” [Brief Analysis on Risks and Strategies for Foreign Investment in Mainland Internet Data Center (IDC) Licenses,] <http://www.zhonglun.com/Content/2020/02-27/1539303103.html>, published February 27, 2020, accessed March 31, 2021.

⁷¹ King & Wood Mallesons, “Cong Hainan Zimaogang Zhengce Kan Yunfuwu Luodi – Jianshu Waishang Zaihua Touzi Yunfuwu de Zengzhi Dianxin Jianguan Wenti,” [From Hainan Free Trade Port’s Policies to the Implementation of Cloud Services – Brief Analysis on Value-added Telecom Regulations over Foreign Investment in China’s Cloud Services,] <https://www.chinalawinsight.com/2020/11/articles/uncategorized/%E4%BB%8E%E6%B5%B7%E5%8D%97%E8%87%AA%E8%B4%B8%E6%B8%AF%E6%94%BF%E7%AD%96%E7%9C%8B%E4%BA%91%E6%9C%8D%E5%8A%A1%E8%90%BD%E5%9C%B0-%E7%AE%80%E8%BF%B0%E5%A4%96%E5%95%86%E5%9C%A8%E5%8D%8E/>, published November 26, 2020, accessed March 31, 2021.

with an ICP license is not allowed to provide news information services to the social public through websites, apps, forums, blogs, public accounts, instant messaging tools, or online livestreams. The reason is that Internet content is under the jurisdiction of China’s propaganda regulators – like the State Internet Information Office – which do not permit “Chinese-foreign equity joint ventures, Chinese-foreign cooperative joint ventures, or foreign-funded enterprises from engaging in such businesses.⁷² Foreign-invested joint ventures are also forbidden from providing audio or visual services, as an additional permit is required from another ministry-level agency, the State Administration of Radio, Film and Television (SARFT), which oversees content censorship in China. According to the provisions regulating this sector, the applicant must be “an exclusive state-owned entity or a state-controlled entity.”⁷³ Lastly, the Ministry of Culture requires all Internet businesses related to culture (with the exception of online music) to apply for a license from its system.⁷⁴

Table 6.2 Internet-related Licenses Prohibited to Applicants with Foreign Equity Ownership

License Name	Issuing and supervising ministry-level agencies	Business activities concerned
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⁷² Cyberspace Administration of China (CAC), “Hulianwang Xinwen Xinxi Guanli Guiding,” [Provisions on the Administration of Internet News Information Services,] http://www.cac.gov.cn/2017-05/02/c_1120902760.htm, issued May 2, 2017, effective from June 1, 2017.

⁷³ State Administration of Radio, Film, and Television (SARFT), and MIIT, “Hulianwang Shiting Jiemu Fuwu Guanli Guiding,” [Administrative Provisions on Internet Audio-Visual Program Services,] http://www.gov.cn/flfg/2007-12/29/content_847230.htm, issued December 20, 2007, effective from January 1, 2008.

⁷⁴ An example is online gaming despite its seemingly non-politicalness. An online gaming business must obtain an ICP license from the MII/MIIT to legally open a gaming webpage and an “Internet cultural business” license from the Ministry of Culture (MoC) or its local affiliates because gaming is culture-related. Also, as online games refer to “original digital products”, a “web publication service license” and a game publication number must be obtained from SARFT. Processing time ranges between 1 to 2 months. For relevant legal stipulations, see, State Council, “Hulianwang Xinxi Guanli Banfa,” [Regulation on Internet Information Services,] http://www.gov.cn/gongbao/content/2000/content_60531.htm, issued and effective from September 25, 2000. MoC, “Hulianwang Wenhua Zaxing Guiding,” [Interim Provisions on the Administration of Internet Culture,] http://www.gov.cn/flfg/2011-03/21/content_1828568.htm, issued May 10, 2003, revised July 1, 2004 and February 17, 2011.

Internet News Services	Cyberspace Administration of China (CAC)	Reporting and commenting on politics, economics, military matters, foreign affairs, and other social public affairs, as well as sudden social incidents.
Publication of Audio-Visual Programs Through Information Network**	SARFT	Making, redacting and integrating audio-visual programs; providing them to the general public via Internet; and providing services for people to upload and distribute audio-visual programs (foreign and domestic movies, television shows, Internet dramas, micro-movies etc.)
Internet Culture Services	Ministry of Culture/Ministry of Culture and Tourism	Cultural products produced, disseminated and circulated through the Internet, including: <ul style="list-style-type: none"> - Cultural products specially produced for the Internet, such as music, games, programs, performances, works of art, cartoons, etc. - Cultural products produced from the Internet by certain technical means and reproduced on for dissemination.
Internet Publication Services	GAPPRFT/SARFT, MIIT	Editing, production, or processing of digital works including: <ul style="list-style-type: none"> - Original digital works such as text, pictures, maps, games, cartoons, and audiovisual reading materials in the field of literature, art, science, etc. which are of knowledge and ideology - Published works such as books, newspapers, periodicals, and electronic publications - Online databases that select, comply, or collect the abovementioned published works - Other works as determined by GAPPRFT/SARFT

** This license requires the applicant to be state-owned or state-controlled

Sources: Information Office of the State Council and MIIT, “Hulianwang Xinwen Xinxi Fuwu Guanli Guiding” [Provisions for the Administration of Internet News Information Services], Article 2; SARFT and MIIT, “Hulianwang Shiting Jiemu Fuwu Guanli Guiding,” [Administrative Provisions on Internet Audio-Visual Program Services,] Article 2; Ministry of Culture, “Hulianwang Wenhua Guanli Zanxing Guiding,” [Interim provisions on the Administration of Internet Culture], Article 2. SARFT and MIIT “Hulianwang Chuban Fuwu Gunali Guiding,” [Provisions on the Administration of Online Publishing Services,] Article 2.

But how do these regulators tell non-Chinese-controlled businesses apart from VIE-structured ones when processing license applications? The secret lies in how they vet applicants’ shareholdings and control over corporate affairs, an approach unanimously carried by all ministerial regulators. For them, majority shareholding does not equal decision-making and

corporate control, and this guiding principle can be found in several policy documents issued at the ministry level. The earliest stipulations can be traced to a MII document released in 2001 on the eve of China's accession to the WTO. As per the MII/MIIT's license application guide,⁷⁵ when evaluating an application, regulators must "strip down" the stockholding structure by tracing the identity of shareholders at each level and tracking the percentage of stocks they hold. When filing information online through the application system, applicants will be directed to the shareholder-tracing page and asked to draw the shareholding "tree" to an ending "branch" that must not contain any non-Chinese investors, otherwise the deal will be rejected. Moreover, information like shareholders' names, their ownership percentage, and the time and means of funding injection must also be provided. If the shareholders are entities rather than persons, the ownership tracing must end at natural persons (*ziran ren*), government-affiliated public institutions (*shiye danwei*), or wholly state-owned companies with a description of the *de facto* controllers (*shiji kongzhi ren*). After drawing the shareholding "tree", applicants must provide written promises (*shumian chengnuo*) that none of the shareholders have foreign equity ownership. At the same time, an ownership verification report (*yanzi baogao*) and a legal opinion letter to prove "authenticity (*zhenshi xing*), accuracy (*zhunque xing*), and completeness (*wanzheng xing*)" must be attached to the application by the accounting and legal firms hired by the license applicant(s).⁷⁶ In other words, multiple parties must sign off to guarantee that the applicant is not foreign-controlled.

With these draconian measures in mind, let us now explore how the FDI-restriction facet of capital filtration affects giant American Internet multinationals in practice.

⁷⁵ Communication Administration of MIIT, "Dianxin Yewu Jingying Xuke Shenpi Fuwu Zhinan (Wanzhengban)," [Approval Guideline for Operating Licenses of Telecom Businesses,] https://jyhwhzq.miit.gov.cn/cms_files/filemanager/1499758024/attach/20216/2d5a547676034a62afaa95a59a992de7.pdf, issued and effective from January 15, 2021.

⁷⁶ CAC, "Hulianwang Xinwen Xinxi Fuwu Xuke Zhixiang Fuwu Zhinan," [Application Guidelines for Licenses of Internet News Information Services,] http://www.cac.gov.cn/2019-07/23/c_1565410775838394.htm, published July 23, 2019, accessed March 30, 2021.

6.6 Facebook: An Unopenable Book in China?

Facebook's earliest efforts to extend its business into China can be traced to 2007 when the company registered the domain name facebook.cn and launched a Chinese-language version of its site targeting Mainland Chinese users under the name *feishu* – derived from the Chinese words for “flying” and “book”. However, to the company's disappointment, its flagship social network website facebook.com was banned in Mainland China in early July 2009 following a riot in Xinjiang.⁷⁷ State-run media justified Beijing's move by claiming the website was being used by Xinjiang independence activists to “facilitate their communication worldwide.”⁷⁸ However, this state-imposed service outage did not discourage Facebook's ambitions to enter the Chinese market. Facebook co-founder and CEO Mark Zuckerberg tried a new strategy to enter China by cooperating with Chinese business partners. Starting in 2010, Zuckerberg visited several Chinese telecom and Internet giants such as China Mobile, Alibaba, Baidu, and Sina,⁷⁹ Rumors spread out that Facebook had signed a partnership agreement with Internet search giant Baidu in Spring 2011.⁸⁰ However, as an Internet analyst acknowledges, the administrative approval will take a very long time, and Facebook's entry into the Chinese market in the short term is “unlikely.”⁸¹

For Facebook, finding a local partner and allowing it to own a majority stake in its Chinese operations was a suboptimal but necessary choice. As an industrial commentator pointed out, “no

⁷⁷ *TechCrunch*, “China Blocks Access to Twitter, Facebook After Riots,” <https://techcrunch.com/2009/07/07/china-blocks-access-to-twitter-facebook-after-riots/>, published July 7, 2009, accessed April 5, 2021.

⁷⁸ *People's Daily*, “80 pct of netizens agree China should punish Facebook,” <http://en.people.cn/90001/90776/90882/6697993.html>, published July 10, 2009, accessed April 5, 2021.

⁷⁹ Yang Miao, “Facebook Chuangshiren Xuanfeng Fanghua,” [Facebook Founder's Blitz Visit in China,] *Xinjing Bao*, [Beijing News,] <http://tech.sina.com.cn/i/2010-12-22/01505011063.shtml>, published December 22, 2010, accessed April 5, 2021.

⁸⁰ Zhang Liming, “Facebook Jiakuai Ruhua Bufa, Baidu Bupinglun Hezuo Chuanwen,” [Facebook Speeds up its Steps to Enter China, Baidu Refused to Comment on Cooperation Rumors,] *Beijing Chenbao*, [Beijing Morning Post,] <http://tech.sina.com.cn/i/2011-04-12/02075392425.shtml>, reposted by Sina April 12, 2011, accessed April 6, 2021.

⁸¹ *TechWeb*, “Zhuguan Bumen Cheng Facebook Ruhua Rengzai Shenpi, Duanqi Luoshi Wuwang,” [Supervisory Ministries Say Facebook's Application is Still under Examination, China-Entry is Unlikely in Short Term,] <http://www.techweb.com.cn/article/2011-04-11/1014940.shtml>, published April 11, 2011, accessed April 6, 2021.

matter which company Facebook cooperated with, the joint venture had to operate independently with servers inside China.⁸² Therefore, Facebook's competitive advantage as an open platform that boosted its success and popularity elsewhere became its hurdle in the Chinese market. However, the Chinese partner could offer two benefits: take the job of information censorship off this Silicon Valley firm, and handle day-to-day engagement with Chinese governmental organizations on behalf of Facebook.⁸³

While Facebook tried to please Chinese regulators and obtain market admission, Chinese Facebook imitators, like Renren.com and Tencent's Q-Zone, quickly amassed users. By the end of 2010, China counted 457 million netizens nationwide.⁸⁴ Thanks to the ODFD channeled by VIE-structured funding vehicles, the two platforms counted 480 million and 170 million active Chinese accounts respectively.⁸⁵ But Facebook's plans for China encountered further blows when Instagram, its photo and video-sharing app, was banned in Mainland China following the circulation of pictures of Hong Kong pro-democracy protestors in September 2014.⁸⁶

Perhaps having figured out that a Chinese market entry needed the permission and support of higher-level politicians, Facebook gradually shifted its engagement strategy. In December 2014, Zuckerberg hosted Lu Wei, deputy head of the CCP's Propaganda Department and director of the ministry-level Cyberspace Administration of China (CAC), at Facebook's headquarters in

⁸² *Zhonghua Gongshang Shibao* [China Business Times], "Shejiao Wangluo Da'e Facebook Jinru Zhongguo Wuda Caixiang," [Social Media Giant Facebook's Five Possible Ways to Enter China,] <https://business.sohu.com/20110429/n306668539.shtml>, reposted by Sohu April 29, 2011, accessed April 6, 2021.

⁸³ *Ibid.*

⁸⁴ China Internet Network Information Center (CNNIC), "Di Ershiqi Ci Zhongguo Hulian Wangluo Fazhan Zhuangkuang Tongji Baogao," [The 27th Statistical Report on China's Internet Development,] http://www.cac.gov.cn/2014-05/26/c_126548718.htm, released January 2011, repored by CAC May 26, 2014, accessed April 7, 2021.

⁸⁵ Wang Lin, "Tiaozhan Shejiao Bazhu, Naxie bei Tengxun Gandiao de Chanpinmen," [Challenging the Social Media Overlords, Those Products Defeated by Tencent,] *Huxiu Wang*, <https://www.huxiu.com/article/281433.html>, published January 16, 2019, accessed April 7, 2021.

⁸⁶ *British Broadcasting Corporation (BBC)*, "Instagram appears blocked in China," <https://www.bbc.com/news/technology-29409533>, published September 29, 2014, accessed April 7, 2021.

California. During Lu's visit, Zuckerberg ostentatiously displayed Xi Jinping's *The Governance of China* on his desk,⁸⁷ and was quoted as saying that copies were bought for his colleagues to help them "understand socialism with Chinese characteristics".⁸⁸

The Facebook helmsman's efforts to court high-ranking Chinese politicians paid off about a year later. In September 2015, at the 8th Sino-U.S. Internet forum in Seattle, Zuckerberg, the husband of a Taiwanese American, was heard having a conversation with Xi Jinping in Mandarin. A couple of days later, at a banquet held in Washington D.C., Zuckerberg offered Xi the privilege of giving a Chinese name to his soon-to-be-born first child, which Xi politely refused.⁸⁹ Following their meeting, Zuckerberg also posted a photo of him talking to Xi on Facebook, calling it "a meaningful milestone" in this life.⁹⁰ In addition to the public affair offensive, roughly at the same time Facebook, with Zuckerberg's support, also quietly developed censorship tools to prevent certain posts from showing up in users' news feeds based on their geographic location, with the intent of using them for Mainland Chinese users.⁹¹ According to Facebook employees, the software was to be handed over to their future Chinese partners to monitor popular user-shared

⁸⁷ Taylor Adam, "Why would Mark Zuckerberg Want Facebook employees to read the Chinese president's book?," *Washington Post*, <https://www.washingtonpost.com/news/worldviews/wp/2014/12/08/why-does-mark-zuckerberg-want-facebook-employees-to-read-the-chinese-presidents-book/>, published December 8, 2014, accessed April 7, 2021.

⁸⁸ *Zhongguo Wang (China News)*, "Lu Wei Kaocha Lianshu, Zhakeboge Bangongzhuo Fang Xi Jinping Zhuzuo," [Lu Wei Visited Facebook, Xi Jinping's Book Found on Zuckerberg's Desk,] <https://chinadigitaltimes.net/chinese/373889.html>, reposted by *China Digital Times* December 7, 2014, accessed April 9, 2021.

⁸⁹ Yi Lin, "Zhake Boge Wuchuanfang de Zhongguo Qingjie," [Zuckerberg's Restless China Complex,] *Voice of America*, <https://www.voachinese.com/a/zuckerberg-china-tiktok-20200901/5565153.html>, published September 1, 2020, accessed April 9, 2021.

⁹⁰ Perlez Jane, "A Chat in Chinese with Mark Zuckerberg, as Tech Giants Jostle for Face Time," *New York Times*, <https://cn.nytimes.com/world/20150925/c25xizuckerberg/dual/>, published September 25, 2015, accessed April 7, 2021.

⁹¹ Isaac Mike, "Facebook Said to Create Censorship Tool to Get Back into China," *New York Times*, <https://cn.nytimes.com/usa/20161123/facebook-censorship-tool-china/dual/>, published November 23, 2011, accessed April 9, 2021.

topics and stories, and the project “picked up momentum” in 2015 with additional hands added from other parts of the company.⁹²

Facebook’s high-level public relations approach did reap some tangible results on March 19, 2016, when Liu Yunshan, the fifth-ranking member of the CCP’s seven-man Politburo Standing Committee – the party-state’s top decision-making body – from 2012 to 2017, privately received Zuckerberg in Beijing.⁹³ During the meeting, Liu offered accolades to Facebook for its “advanced technology and managerial methods” and expressed his hopes that “Facebook would strengthen communications and share its experience with Chinese Internet companies, enhance mutual understanding, and improve the Internet to better serve people around the world.”⁹⁴ However, to a seasoned media professional, Liu’s remarks were not direct evidence that Beijing would be finally admitting Facebook into China.⁹⁵

Perhaps because the meeting with Liu Yunshan did not yield any outcome for Facebook, the American social media giant tried a different and stealthier way. In May 2017, a photo-sharing app named Colorful Balloon (*Caise Qiqiu*) appeared on the Chinese Apple Store. It resembled Facebook’s Moments app in terms of both function and appearance, but was released by Youge Internet Technology, a company registered in China. Facebook denied any involvement in launching Colorful Balloon, but Youge’s business registration information showed otherwise. Youge, a Beijing-based company, was established barely two months before the app’s release,⁹⁶

⁹² Ibid.

⁹³ *Xinhua*, “Liu Yunshan Huijian Lianpu Gongsi Chuangshiren Zhake Boge,” [Liu Yunshan Met Facebook Founder Zuckerberg,] http://www.xinhuanet.com/politics/2016-03/19/c_1118382522.htm, published March 19, 2016, accessed April 9, 2021.

⁹⁴ Ibid.

⁹⁵ Ye Bing, “Liu Yunshan Wu Zhake Boge, Lianshu Jinzhongguo Meixi,” [Liu Yunshan Meets Zuckerberg, Facebook in China no Hope,] *Voice of America*, <https://www.voachinese.com/a/voa-news-china-facebook-20160320/3246090.html>, published March 20, 2016, accessed April 10, 2021.

⁹⁶ Qian Tongxin, “Buyuan Fangqi Zhongguo Shichang, Facebook ‘Quxian Qianxing’,” [Unwillingness to Give up Chinese Market, Facebook ‘Zigzags’ Forward,] <https://www.yicai.com/news/5330604.html>, *Diyi Caijing* [China Business Network], published August 14, 2017, accessed April 9, 2021.

and the company's owner and executive, Zhang Jingmei, as her own Facebook profile shows, was Facebook's chief representative and head of business development in Greater China.⁹⁷ Moreover, Facebook seemed to have taken measures to keep this launch low profile. For instance, when photos were posted on other Chinese social media networks through Colorful Balloon, viewers could not directly download the app, but had to instead go to the app store, which limited the distribution to fewer users.⁹⁸ A couple months later however, the application vanished from app stores across China.⁹⁹

It has been speculated that one of the reasons Facebook reoriented its market entrance strategy from high-level publicity to stealth service launching was because Lu Wei, who possibly arranged Zuckerberg's meeting with Liu Yunshan,¹⁰⁰ stepped down as director of CAC in June 2016 and was purged in November 2017.¹⁰¹ Another blow to Facebook followed in September 2017 when the company's newly acquired instant messaging app WhatsApp was blocked in China in the run-up to the CCP's 19th National Congress, which would unveil the top leadership for the

⁹⁷ Profile from Zhang Jingmei's Facebook page: <https://www.facebook.com/jingmei.zhang.7>, accessed April 09, 2021.

⁹⁸ Mozur Paul, "In China, Facebook Tests the Waters with a Stealth App," *New York Times*, <https://cn.nytimes.com/business/20170814/facebook-china-moments-colorful-balloons/dual/>, Published August 14, 2017, accessed April 10, 2021.

⁹⁹ Mozur, Paul, "Executive Behind Facebook's China Charm Campaign Is Out", *New York Times*, <https://cn.nytimes.com/china/20180123/facebook-china/dual/>, published January 23, 2018, accessed April 10, 2021.

¹⁰⁰ For western entrepreneurs, meeting with China's top leadership requires arrangements and sponsorships from their top lieutenants. According to Henry Paulson's account, in preparation for China Mobile's 1997 overseas IPO, his meeting with Zhu Rongji, then vice minister, was arranged by Zhu's lieutenant and protégé Wang Qishan. Paulson Henry, *Dealing with China: An Insider Unmasks the New Economic Superpower*, New York: Twelve, 2015, p. 8. A *New York Times* journalist mentioned that, according to China's lower-level tech officials, despite some bureaucrats being open to Facebook providing services in China, resistance towards Facebook's admission into China came from top leadership in the CCP Politburo's standing committee, which could be the propaganda and ideology tsar Liu Yunshan and/or the Party boss Xi Jinping. Mozur Paul, "Facebook Navigates an Internet Fractured by Governmental Controls," *New York Times*, <https://cn.nytimes.com/business/20170918/facebook-government-regulations/dual/>, published September 18, 2017, accessed April 10, 2021. Regardless of who it was, it is evident that, as the Google case will show immediately, a top leader's personal attitude and preferences could decide a multinational company's fate in China.

¹⁰¹ Gao Charlotte, "China's Former Internet Czar Lu Wei under Investigation," *The Diplomat*, <https://thediplomat.com/2017/11/chinas-former-internet-czar-lu-wei-under-investigation/>, published November 22, 2017, accessed April 12, 2021.

following five years. The exact reason was unclear,¹⁰² but the timing did coincide with a whistleblowing Chinese billionaire exiled to New York who repeatedly made podcasts and videos that alleged corruption amongst China's top leadership.¹⁰³

With the loss of political endorsement from China's top decision-makers, Facebook tried a strategy some western telecommunication and Internet giants had attempted before – seeping into the Chinese market through non-core businesses. As a filing on China's National Enterprise Credit Information Publicity System shows, Facebook (Hong Kong) Limited registered a subsidiary in Zhejiang Province named *Lianshu* – a literal translation of the site's name in Chinese – on July 18, 2018. The company was set up as an innovation hub to support local start-ups and developers.¹⁰⁴ Zhang Jingmei, the director of Youge Technology that had secretly launched Colorful Balloons a year ago, acted as *Lianshu*'s legal person and CEO.¹⁰⁵

The composition of *Lianshu*'s five-person board showed that it was wholly Facebook-owned. In addition to Zhang Jingmei, Facebook's vice president and associate general counsel Damian Yeo served as the chairman,¹⁰⁶ while David William, who joined Facebook in 2009, was *Lianshu*'s vice president and secretary. Another board member, Susan Taylor, was Facebook Inc.'s chief accountant. Additionally, former NDRC employee Shuai Peng was hired to handle *Lianshu*'s government relationships, due to his previous work with the administrative approvals of

¹⁰² WhatsApp uses end-to-end encryption which makes state surveillance more difficult if not inaccessible. I thank Dr. Colin Bennet for pointing this out when reviewing my dissertation.

¹⁰³ *Radio Free Asia*, “China Disrupts WhatsApp, Fines Service Providers Ahead of Party Congress,” <https://www.rfa.org/english/news/china/disrupts-09262017123111.html>, published September 26, 2017, accessed April 12, 2021.

¹⁰⁴ Cadell Cate, “Facebook Plans Innovation Hub in China despite Tightening Censorship,” *Reuters*, <https://www.reuters.com/article/us-china-facebook-subsiary-idUSKBN1KE1JF>, published July 24, 2018, accessed April 13, 2021.

¹⁰⁵ Li Shuaifei, “Facebook Zaihua Zhuce Duzi Gongsi: Yaozai Zhejiang Jianli Yige Chuangxin Zhongxin,” [Facebook Registers a Wholly Controlled Company in China, And Plans to Build an Innovation Center,] *Leifeng Wang*, <https://www.leiphone.com/news/201807/JxOWGesQxmyk7PHy.html>, published July 25, 2018, accessed April 14, 2021.

¹⁰⁶ Caixin Data, “Lianshu Keji (Hangzhou) Youxian Gongsi,” [Facebook Technology (Hangzhou) Limited,] <https://s.ccxe.com.cn/entities/companies/803113888>, accessed April 14, 2021.

transactions related to e-government and information security.¹⁰⁷ However, *Lianshu* was hastily withdrawn several days later due to “a disagreement between officials in Zhejiang who accepted the registration, and national Internet regulator, CAC, which was angry because it had not been consulted more closely beforehand.”¹⁰⁸ In a press conference that took place a month later, Liu Liehong, deputy director of CAC, denied that any business license had been issued to Facebook’s short-lived Chinese subsidiary.¹⁰⁹

Despite being barred entrance from the Chinese market for over a decade, Facebook found a way to indirectly tap into China’s booming economy by serving as a platform for Chinese firms to make online advertisements targeting audiences outside China. In fact, being allowed to publish advertisements on Facebook is the predominant revenue source for many Internet companies, including Facebook.¹¹⁰ In 2019 alone, 98% or US\$ 69.7 billion of Facebook’s revenues that year came from advertising,¹¹¹ and advertisement projectors from China were Facebook’s largest group of spenders after the United States. Facebook sold \$5 billion a year worth of advertisement space to Chinese ad-makers and earned US\$ 24.1 billion in advertising sales in 2018 despite the website being blocked in China.¹¹² In its regular SEC filing, Facebook did not disclose the exact

¹⁰⁷ Abkowitz Alyssa, “Facebook Taps Former Chinese Official to Woo Beijing on Access,” *Wall Street Journal*, <https://www.wsj.com/articles/facebook-taps-former-chinese-official-to-woo-beijing-on-access-1504867218>, published September 8, 2017, accessed April 15, 2021. Caixin Data, “Lianshu Keji (Hangzhou) Youxian Gongsi.”

¹⁰⁸ Mozur Paul, “China Said to Quickly Withdraw Approval for New Facebook Venture,” *New York Times*, <https://www.nytimes.com/2018/07/25/business/facebook-china.html>, published July 26, 2018, accessed April 15, 2021.

¹⁰⁹ State Council, “Xinwenban jiu Diwujie Shijie Hulianwang Dahui Youguan Qingkuang Li Choubai Gongzuo Jinzhan Juxing Fabuhui,” [The Information Office Holds a Press Conference On Issues Regarding the Preparation of the 5th World Internet Conference,] http://www.gov.cn/xinwen/2018-09/28/content_5326577.htm#allContent, published September 28, 2018, accessed April 15, 2021.

¹¹⁰ For social media companies like Facebook, profit largely depends on user base and their ability to surveillance users’ online behaviors, capture data, and promote commercial advertising and manipulation. I thank Dr. Colin Bennett for offering this point.

¹¹¹ Iyengar Rishi, “Here’s How Big Facebook’s Ad Business Really is,” *Cable News Network (CNN)*, <https://www.cnn.com/2020/06/30/tech/facebook-ad-business-boycott/index.html>, published July 1, 2020, accessed April 16, 2021.

¹¹² Dave Paresh and Katie Paul, “Facebook Defies China Headwinds with New Ad Sales Push,” *Reuters*, <https://www.reuters.com/article/us-facebook-china-focus-idUSKBN1Z616Q>, published January 7, 2020, accessed April 16, 2021.

number but vaguely stated that, “we generate *meaningful* [emphasis added] revenue from a limited number of resellers representing advertisers based in China.”¹¹³ The company mainly sold advertising for Chinese businesses from its Hong Kong office, and in 2017, it set up a new engineering team in Singapore to focus on its lucrative Chinese advertising business despite the major setbacks it was facing when trying to enter the Chinese market at that time.¹¹⁴

The Chinese government and state news media also use Facebook as a platform to have their messages heard beyond China’s borders. Each quarter, the party-state spends “hundreds of thousands of dollars to buy Facebook ads via state-run media outlets.”¹¹⁵ Facebook, along with other social media channels, have been widely mobilized by Chinese government agencies, state-owned media, and diplomats to spread misinformation and propaganda, engage with international audiences, and influence global narratives on such topics as human rights abuses in Xinjiang,¹¹⁶ China’s territorial disputes,¹¹⁷ and the handling of the Coronavirus pandemic.¹¹⁸ But even though overseas collaborations have not spilled over into Mainland China, Facebook.com, Instagram, and

¹¹³ Facebook, Form 10-Q Quarterly Report, <https://investor.fb.com/financials/sec-filings-details/default.aspx?FilingId=14302237>, released July 31, 2020, accessed April 16, 2021.

¹¹⁴ Dave and Paul, “Facebook Defies China Headwinds with New Ad Sales Push.”

¹¹⁵ Mozur Paul, “China Spreads Propaganda to U.S. on Facebook, a Platform it Bans at Home,” *New York Times*, <https://cn.nytimes.com/china/20171109/china-facebook/dual/>, published November 9, 2017, accessed April 17, 2021.

¹¹⁶ For a report on the Chinese party-state’s political use of Facebook and other social media banned in China to engage with global audiences, see Zhang Albert, Jacob Wallis, and Zoe Meers, “Strange bedfellows on Xinjiang: The CCP, fringe media, and US social media platforms,” Australian Strategic Policy Institute, <https://www.aspi.org.au/report/strange-bedfellows>, published and accessed March 30, 2021.

¹¹⁷ See, for instance, *BBC*, “Facebook Uncovers Chinese Network Behind Fake Expert,” <https://www.bbc.com/news/world-asia-china-59456548>, published and accessed December 2, 2021.

¹¹⁸ For a peer-reviewed report on Beijing’s use of English-language state media accounts on Facebook to engage with the English-speaking world, see, Molter Vanessa, Renee Diresta, “Pandemics and Propaganda: How Chinese State Media Creates and Propagates CCP Coronavirus Narratives,” *Misinformation Review*, <https://misinforeview.hks.harvard.edu/article/pandemics-propaganda-how-chinese-state-media-creates-and-propagates-ccp-coronavirus-narratives/>, published June 8, 2020, accessed April 17, 2021. Strick Benjamin, Olga Robinson, Shayan Sardarizadeh, “Coronavirus: Inside the pro-China Network Targeting the US, Hong Kong and an Exiled Tycoon,” *BBC*, <https://www.bbc.com/news/blogs-trending-52657434>, published May 28, 2020, accessed April 17, 2021.

WhatsApp – the company’s hallmark services – remain unavailable within the Great Digital Firewall at the time of writing.

6.7 Google: Googling its Chinese Way

Google began offering a Chinese-language version of its search engine in 2000. However, it was slow and sporadically unavailable to Mainland users because its servers were located outside China. As a result, all traffic to and from Google had to travel through China’s international gateway Internet service providers (ISPs), while the traffic or content filtration performed by the Chinese authorities often caused disruption.¹¹⁹ When the number of Chinese netizens reached around 33.7 million (a miniscule 2.6% of the population) in 2002,¹²⁰ Google was suddenly banned in China.¹²¹ Visits to the site were instead redirected to its Chinese competitor Baidu, a Google imitator founded in 2000 by Li Yanhong, a 1996 graduate of the University of Buffalo with a Masters in Computer Science. When Google’s operations in the Chinese market were too inefficient and fragmented to win over a sizable portion of Chinese users, Baidu began expanding at breakneck speed into the Chinese Internet search engine market. Turbocharged by the ODFD that global investors had poured into the company and the proceeds of its 2005 VIE-styled IPO on the New York Stock Exchange (NYSE), Baidu’s market share in China skyrocketed to 62.1% in

¹¹⁹ Schrage Elliot, “Testimony: The Internet in China,” <https://googleblog.blogspot.com/2006/02/testimony-internet-in-china.html>, published February 15, 2006, accessed April 19, 2021.

¹²⁰ CNNIC, “Zhongguo Hulian Wangluo Fazhan Zhuangkuang Tongji Baogao (2002/1),” [Statistical Report on China’s Internet Development (January 2002),] <http://www.cac.gov.cn/files/pdf/hlwtjbg/hlwlfzkdctjbg009.pdf>, accessed April 19, 2021. p.4

¹²¹ Rosencrance Linda, “Google Says its Chinese Searchers Were Redirected to Baidu,” *Computerworld*, <https://www.computerworld.com/article/2539441/google-says-its-chinese-searches-were-redirected-to-baidu.html>, published October 18, 2017, accessed April 19, 2021.

2006.¹²² In contrast, after reaching a height of 34.8% in 2003, Google’s share continued to fall to 25.3% in 2006.¹²³

To enhance its competitiveness in the Chinese market, Google officially entered the country in 2005, setting up an engineer center in Shanghai that May and purchasing the domain name google.cn. Adopting a middle ground between its “don’t be evil” corporate culture and China’s censorship requirements, Google offered two variants of its search engine for China – unfiltered Chinese-language versions of google.com, Gmail, and Blogger that protected the privacy and security of users’ information, and a localized google.cn subject to the Chinese government’s informational censorship demands.

The localized google.cn with servers inside China was officially launched on January 25, 2006. However, Google decided not to apply for an ICP license as the MII required. Instead, it rented one from its license-holding Chinese partner ganji.com, possibly because the American company was discouraged by the MII’s cumbersome registration procedures. However, this workaround was soon spotted and exposed. Barely a month after Google.cn’s official debut in China, *China Commercial Times* (*zhongghua gongshang shibao*), a newspaper run by a non-governmental chamber of commerce affiliated with the CCP’s United Front Worker Department, published an article on February 21, 2006 that accused Google of entering China through backdoor means.¹²⁴ The American Internet giant was accused of contravening MII regulations for foreign companies providing ICP services in China to be Sino-foreign joint ventures and to have obtained the MII’s approval beforehand. Google’s corporate structure in China was said to be illegal, thus

¹²² *Xinhua*, “Baidu Reinforces Dominance in Online Search Market,” <http://www.china.org.cn/english/BAT/181695.htm>, reposted by *China Org* September 20, 2006, accessed April 20, 2021.

¹²³ *Ibid.*

¹²⁴ He Xiaoli, “Google Weihe Fanqiang Jinru Zhongguo?,” [Why did Google Enter China Through a Backdoor?] *Zhongghua Gongshang Shibao*, [Greater China Commercial Times] <http://tech.sina.com.cn/i/2006-02-21/0951846943.shtml>, reposted by Sina February 21, 2006, accessed April 20, 2021.

not only being unfair for other foreign entrants like Microsoft and Yahoo which went through a lengthy application and approval process that took one or two years, but also a threat to the authority of China's Internet regulations. Moreover, Google was accused of being deceitful because China's business registration rules stated that an ICP license holder's website must exhibit an indicator of government approval in the form of a red shield inscribed with a hyperlink that directs the user to a page with the information on the registered office location and business scope. However, Google's shield is grey and lacks any inscribed link, making it a fake.

The ICP crisis led to Google engaging with the Chinese government for two months to find a solution. CEO Eric Schmidt went to Beijing in April 2006 to lobby the Beijing municipal government, NDRC, and MII. It was decided that Google had to immediately apply for a joint venture to fulfill all regulatory requirements. Lee Kai-fu, the head of Google China, would later acknowledge that this crisis and the time spent waiting for approval cost Google precious market shares in China:

Although the vast majority of users inside China could still use Google.com's Chinese-language services, its servers were outside China, meaning Internet interruption still happened at times. But before the ICP joint venture was approved, google.com could not be directed to google.cn. The interrupted connection had a huge impact on Internet users in Mainland China, with some users being disappointed by the quality of the Chinese-language versions, leading them to question Google China's inaction.¹²⁵

After a six-month processing, the Beijing Commerce Bureau approved Google's joint venture application in November 2006. Thus, the Guxiang Information Technology Company was established as a joint venture between Google and Beijing Feixiangren Information Technology Company, the Chinese company that operated ganji.com and shared its ICP license with Google. Another six months later, Guxiang received its ICP license from the MII on June 20, 2007. For

¹²⁵ Lee Kai-fu, *Shijie Yinni Butong: Lee Kaifu Zizhuan*, [Making a World of Difference: The Kai-fu Lee Story,] Beijing: Zhongxin Chubanshe, 2009. Chapter 10, p.282.

commentators on China's Internet sector, the joint venture was merely a puppet established solely to obtain an ICP license.¹²⁶ However, the cost of the market share and revenue during the one-year processing time was immeasurable.

After obtaining its ICP license, Google witnessed a gradual growth in the Chinese market in 2007 and 2008. Its market share in searching – the firm's core business – rose from 23.4% to 27.8%, faster than Baidu which only increased by 2.9% but still dominated the Chinese market with around 63% in 2008.¹²⁷ Google's troubles did not stop there though. In March 2008, YouTube, Google's video-sharing network, was blocked after Beijing denounced a video shared on this platform showing Chinese security forces beating Tibetans in Lhasa as “a lie”.¹²⁸

A much heavier blow came in May 2009. According to a U.S. embassy staff report later disclosed by Wikileaks, Li Changchun, the fifth-ranking member of the Politburo Standing Committee who oversaw China's entire propaganda, ideological control, and censorship apparatus from 2007 to 2012, searched his own name on the uncensored Google.com, found “results critical of him,” became infuriated, and decided to act against the American company.¹²⁹

Politically motivated attacks on Google soon followed. The state-owned telecom services oligopolies – China Mobile, China Unicom, and China Telecom – were instructed not to conduct

¹²⁶ Ye Yiqiao and Yang Lai, “Guge Tuichu Fengbo, Zhongzifang Weihe Shisheng?” [The Crisis of Google's Pullout, Why was its Chinese Joint Venture Investor Voiceless?], *Zhongguo Qingnianbao* [*China Youth Daily*], http://zqb.cyol.com/content/2010-04/02/content_3164451.htm, posted April 2, 2010, accessed April 21, 2021.

¹²⁷ Tan Qi, “Li Yanhong Foure ‘Guge Tuichu Chengjiu Baidu’, Dan Shuju Dale Tade Lian,” [Li Yanhong Negates “Google's Pullout Made Baidu”, But Data Slapped His Face,] *DT Caijing*, <https://dtej.com/datainsight/2454>, published February 15, 2016, accessed April 17, 2021.

¹²⁸ Branigan Tania, “China Blocks YouTube” *The Guardian*, <https://www.theguardian.com/world/2009/mar/25/china-blocks-youtube>, published March 25, 2009, accessed April 17, 2021.

¹²⁹ Sabbagh Dan, “Wikileaks: Google Attacks Ordered by Li Changchun,” *The Guardian*, <https://www.theguardian.com/world/2010/dec/05/the-us-embassy-cables-china>, published December 5, 2010, accessed April 17, 2021. In contrast, an American president, nominally the most powerful person in the U.S. or even the world, was powerless to prevent his social media accounts from being suspended or banned by American Internet platforms. See, for instance, Wong Julia, “Facebook to Suspend Trump's Account for Two Years,” *The Guardian*, <https://www.theguardian.com/us-news/2021/jun/04/facebook-donald-trump-oversight-board-instagram>, published and accessed June 4, 2021.

any business with Google.¹³⁰ But a more coordinated and devastating wave of attacks came weeks later. On June 18, 2009, Google was featured on a TV show called “Focus Report” (*jiaodian fangtan*) broadcasted in primetime on China’s national and state-controlled broadcaster China Central Television (CCTV).¹³¹ The show accused Google of “propagating pornographic and vulgar information.”¹³² Being criticized for displaying pornographic content in search results was not new to Google. In January and April that year, Google, among many other China-based Internet companies such as Baidu, Sina, Sohu, and NetEase, had been condemned by a semi-official organization called the Illegal and Bad Internet Information Report Center (*hulianwang weifa he buliang xinxi jubao zhongxin*) – an agency affiliated with the Internet Society of China – for “containing massive amounts of pornographic and vulgar content that undermined social morals and impaired the mental and physical health of teenagers.”¹³³

But this time was different – Google was singled out. The company’s leadership in China was summoned to a hotel conference room by dozens of government officials. After being shown pornographic pictures found on a Google search, Google China’s leader Lee Kaifu was given three orders: the first was to clean up pornographic and vulgar search results -- a routine request made by regulators. However, this time two additional ones were imposed. One was to remove the function on google.cn that allowed and enticed inside China users to access the uncensored

¹³⁰ Lister Tim, “WikiLeaks: Chinese Attacks on Google Came from the Top,” *CNN*, <http://www.cnn.com/2010/WORLD/asiapcf/12/05/wikileaks.china.google/index.html>, published December 6, 2010, accessed April 17, 2021.

¹³¹ Sina, “Jiaodian Fangtan Baoguang Guge Chuanbo Seqing he Disu Xinxi,” [Focus Report Exposed Google Disseminating Pornographic and Vulgar Information,] <http://tech.sina.com.cn/i/2009-06-18/21123192612.shtml>, published June 18, 2009, accessed April 18, 2021.

¹³² *Ibid.*

¹³³ *Zhongguo Wang (China News)*, “Zhongguo Gongbu Zhengzhi Hulianwang Disuzhifeng Shoupi Baoguang Wangzhan Mingdan,” [China Exposed First Batch of Web Pages Targeted by Rectification of Online Vulgarness] http://www.china.com.cn/v/zhuanti/zzds/content_17163411.htm, published January 5, 2009, accessed April 18, 2021; *Ibid.*, “China Exposed Tenth Batch of Web Pages Targeted by Rectification of Online Vulgarness,” <http://www.chinanews.com/gn/news/2009/04-10/1640621.shtml>, published April 15, 2009, accessed April 18, 2021.

google.com. The other was to suspend the associative word search -- the search function that instantly offers fully developed search queries when users type just a few characters into the search box.¹³⁴ According to Lee Kai-fu, the affair in 2009 was Google's "worst crisis" since they started operating in the Chinese market.¹³⁵ Lee even approached Gary Locke, the newly appointed Secretary of the Department of Commerce, for help in negotiating with the Chinese side.¹³⁶

To meet Chinese regulatory demands regarding the issue of pornography, Google China shelved the regular work for hundreds of their engineers and sales staff, and assigned them to sift through pornographic information. For Lee Kai-fu, this was an impossible task because Google's core competitiveness came from grabbing and indexing the largest number of websites. Moreover, according to Lee, while pornographic websites and keywords could be screened, pictures were much more difficult to deal with. On June 24, google.com and its associated services, such as Gmail, Google Docs, and Google Photos, became unavailable in China. The next day, Google's Chinese leadership was summoned again by Chinese regulators who voiced their approval of Google's actions but also expressed dissatisfaction with Google's rectification progress. As a solution, Google's engineers in Beijing suspended the associative word search function. Moreover, as shown in Figure 6.1 below, the team redesigned google.cn by eliminating the "all websites", "websites in Chinese language", "websites in simplified Chinese", and "websites inside China"

¹³⁴ According to Google's leadership, this function was a China-born innovation that was later globally applied in other languages, as the search team found that Chinese users type in shorter queries due to the difficulty of typing Chinese characters. Levy Steven, *In the Plex: How Google Thinks, Works, and Shapes Our Lives*, New York: Simon Schuster, 2011. p.306.

¹³⁵ Ming Shuliang, "Guge 'Xiaodu'," [Google's 'Disinfection',] *Caijing*, <https://magazine.caixin.com/2009-07-20/100081532.html?p3>, published July 20, 2009, accessed April 18, 2021.

¹³⁶ Luo Yan and Jianguang Bao, "Guge Tuichu Zhongguo Fengbo," [The Crisis of Google's China Pullout,] *Huanqiu Qiyejia*, [Global Entrepreneurs,] <http://tech.sina.com.cn/i/2010-01-28/18283814732.shtml>, reposted by *Sina* Januray 28, 2010, accessed April 19, 2021.

options – ones that, according to the Chinese authorities, lured Chinese Internet users to uncensored pages.¹³⁷

Figure 6.1 The Google Home Page in Mainland China Before (left) and After (right) the 2009 Crisis



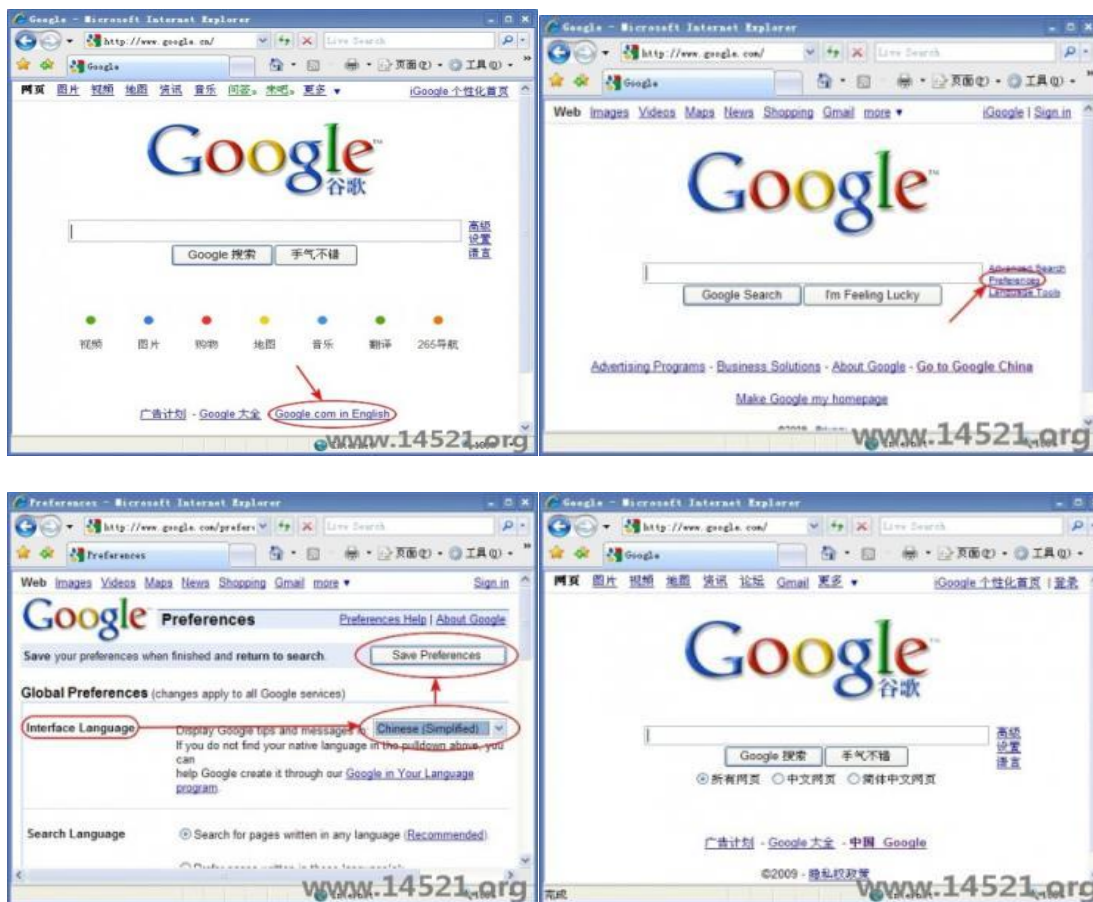
Source: Yueguang Boke, “Cong Google Shouye Bianhua Kan Hulianwang Sanshinian Fengyunlu,” [Viewing Internet’s Development in Thirteen Years from Google’s Portal Page Change], <https://www.williamlong.info/archives/2376.html>, published October 23, 2010, accessed May 08, 2022.

However, the company did not completely follow Beijing’s orders. The removal was more of a workaround to appease the Chinese regulators, but savvy Chinese Internet users could still use a backdoor to access uncensored content. As Figure 6.2 below indicates, to access the unfiltered results, Chinese netizens could go to the English-language Google, which was still available inside China before 2014, albeit unstable and slow; click on “preferences”; and make “Chinese (simplified)” their preferred language under the “interface language” section.¹³⁸

¹³⁷ Yueguang Boke [Moonlight Blog], “Cong Google Shouye Bianhua Kan Hulianwang Shisannian Fengyunlu,” [Viewing Google’s 13-Year History from the Changes in its Portal Page,] <https://www.williamlong.info/archives/2376.html>, published October 23, 2010, accessed April 19, 2021.

¹³⁸ Yueguang Boke, “Jiejue Zhongwen Guge de Taiozhuan Wenti,” [Solving the Issue of Automatic Direction to Google.cn,] <https://www.williamlong.info/archives/1840.html>, published June 24, 2009, accessed April 19, 2021.

Figure 6.2 Steps to Access Unfiltered Chinese-language Search Results on Google after the 2009 Crisis



Source: see footnote 138

In fact, Lee was caught in a dilemma between the company's leaders in California and the Chinese authority in Beijing. The regulators' demands for Google to block search results from outside Mainland China was like asking Google to completely shut down google.com for inside China users, which the American headquarters did not agree to.¹³⁹ As the figures above show, Google's team in China did not suspend the site completely in its "rectification" process, but instead hid it behind the main interface, although the associated word search function of google.cn was now gone.¹⁴⁰ Such delicate measures still hurt Google's operations and expansion in the Chinese market though. According to an industrial analysis, if the associative word search could not be resumed, Google's brand image would be compromised and user traffic would shrink, eventually leading to unavoidable cuts in its advertising revenues.¹⁴¹

Lee's dilemma was a good example of how American corporate control was incompatible with Chinese regulatory demands. Beijing's calls for Google to shut down google.com in Mainland China was beyond Lee's power. Following Beijing's orders would betray the commitment Google made to the U.S. Congress to always have a link to the standard google.com available on localized versions worldwide.¹⁴² Inside Google, an anti-censorship force existed from the very beginning. When Google entered China, a high executive engineer forbade Chinese engineers from visiting some of the original codes; and Sergey Brin, the Soviet-born co-founder of Google, loathed informational censorship.¹⁴³ However, the company found itself torn between China's booming Internet market and Beijing's increasing repressiveness.

¹³⁹ Levy, *In the Plex: How Google Thinks, Works, and Shapes Our Lives*, pp.306-8.

¹⁴⁰ Ming, "Guge 'Xiaodu'."

¹⁴¹ Ibid.

¹⁴² Levy, *In the Plex: How Google Thinks, Works, and Shapes Our Lives*, p.306.

¹⁴³ Luo and Bao, "Guge Tuichu Zhongguo Fengbo."

In December 2009, hackers attacked Google's corporate servers to steal source code and access the Gmail accounts of Chinese political dissidents.¹⁴⁴ Sergey Brin led a team to investigate the issue and soon found that these attacks originated from the Chinese government. On January 12, 2010, Google announced that it would pull out of Mainland China.¹⁴⁵ Chinese officials called Google's Beijing office to confirm if this was a joke, as no foreign company had done this before – “they just leaved quietly.”¹⁴⁶ In March 2010, google.cn was completely shut down and visitors were redirected to google.com.hk, an uncensored site subject to China's Great Firewall.¹⁴⁷ Unsurprisingly, traffic to Google from Mainland China plunged precipitously.¹⁴⁸

Despite seeing its core search services being banned inside Mainland China, Google could theoretically still provide other services in China like Google Maps. But in May 2010, China's State Bureau of Surveying and Mapping released a policy demanding that Internet mapping and positioning services providers apply for operating licenses; those who failed to obtain one would be suspended by the end of the year.¹⁴⁹ Moreover, foreign-invested companies were forbidden from conducting such businesses independently and were required to cooperate with Chinese ones through joint ventures. Google used its Guxiang joint venture to apply for the license in November

¹⁴⁴ Schmidt Eric and Jonathan Rosenberg, *How Google Works*, New York: Grand Central Publishing, 2014. p.143 and p.148.

¹⁴⁵ Branigan Tania, “Google Challenge to China over Censorship,” *The Guardian*, <https://www.theguardian.com/technology/2010/jan/13/google-china-censorship-battle>, published January 13, 2010, accessed April 18, 2021.

¹⁴⁶ Schmidt and Rosenberg, *How Google Works*, p.150.

¹⁴⁷ Drummond David, “Guanyu Guge Zhongguo de Zuixin Shengming,” [The Latest Statement Regarding Google China,] <https://www.google.com/press/new-approach-to-china/update.html>, made March 23, 2010, accessed April 20, 2021.

¹⁴⁸ For more detailed information about Google's bumpy and frustrated operations in China, see, Levy, *In the Pex: How Google Thinks, Works, and Shapes Our Lives*, Chapter Six “Guge: Google's Moral Dilemma in China,” pp.271-318.

¹⁴⁹ State Bureau of Surveying and Mapping, “Hulianwang Ditu Fuwu Zhuanye Biaozhun,” [Industrial Standards on Online Map Service Provision,] http://www.gov.cn/zw/gk/2010-05/18/content_1608070.htm, issued May 10, 2010, accessed April 20, 2021. Tengxun Keji [Tencent Technology], “Guojia Cehuiju Yanchang Guge Weiruan Ditu Paizhao Shenqing Shijian,” [State Bureau of Surveying and Mapping Prolonged Processing Time for Google and Microsoft's Application,] <https://tech.qq.com/a/20101127/000111.htm>, published November 27, 2010, accessed April 20, 2021.

2011, but the deal was still “under investigation” [read as *de facto* rejection but on paper pending] until February 2012.¹⁵⁰ According to Song Zhichao, deputy director of the State Bureau of Surveying and Mapping, Google’s application was rejected for two reasons: it lacked qualified personnel, and its servers were not located inside China.¹⁵¹

Google explored other channels for tapping into the Chinese market by investing in China-based, Chinese controlled, and VIE-structured Internet firms, thus making it an ODFD contributor. In 2013, Google’s parent, Alphabet, founded a private equity company called Google Capital. A year later, Google Capital co-led a US\$ 38 million investment with a Chinese venture capital firm into a manufacturer of high-speed materials used in computer servers.¹⁵² In 2018, Google Capital invested US\$ 30 million into Manbang, a truck-hailing company, and poured \$550 million into JD.com, an e-commerce giant.¹⁵³

Along with their financial investments in Chinese Internet start-ups, Google opened an artificial intelligence (A.I.) center in Beijing at the end of 2017 and hired more than 600 employees,¹⁵⁴ but it was limited to A.I. research and development. Regarding its search engine and app store, Google made no progress, although it secretly launched a “Dragonfly” project to

¹⁵⁰ *Xinhua*, “Hulianwang Ditu Paizhao Fafang Wancheng, Guge Ditu Zizhi Zhengzai Shenpi,” [Online Map Licenses Already Issued, Google Map’s Qualification Still Under Examination,] http://www.gov.cn/jrzq/2012-02/01/content_2056293.htm, reposted by the State Council February 1, 2012, accessed April 20, 2021.

¹⁵¹ *IT Shangye Xinwen* [IT News], “Google Ditu Zizhi Shenqing Reng Beika,” [Google Map’s Qualification for Application Still Sticked,] <https://www.traveldaily.cn/article/58379>, reposted by *Travel Daily* February 13, 2012, accessed April 20, 2021.

¹⁵² Cheung Sonja, “Google Capital Makes First China Investment, Backs InnoLight,” *Wall Street Journal*, <https://www.wsj.com/articles/BL-VCDB-15564>, published September 29, 2014, accessed April 21, 2021.

¹⁵³ Temsamani Karim, “A Strategic Partnership with JD.com,” <https://blog.google/around-the-globe/google-asia/partnering-jdcom/>, released June 18, 2018, accessed April 21, 2021.

¹⁵⁴ Tejada Carlos, “Google, Looking to Tiptoe Back into China, Announces A.I. Center,” *New York Times*, <https://cn.nytimes.com/business/20171214/google-ai-china/dual/>, published December 14, 2017, accessed April 21, 2021.

conform to China's censorship requirements that same year.¹⁵⁵ The project was leaked by a whistleblowing engineer in September 2018 and was terminated in 2019 amid public outcry.¹⁵⁶

Google is still trying to find ways to enter China, but its “don't be evil” motto is hard to adhere to amidst these efforts.¹⁵⁷

6.8 Apple and iCloud, Gone with the Party-State Wind?

Apple is one of the few international information companies with sustained growth and presence in the Chinese market, which accounts for a quarter of their worldwide sales.¹⁵⁸ But using Apple devices like the iPhone, iPad, iPod, Mac, or Apple Watch involves Apple-provided services. For instance, the App Store allows users to browse, download, and install approved apps that are hosted on Apple's operating systems. As one of the company's flagship services, Apple Store entered the Chinese market in 2010, soon finding that China had the highest number of Apple product downloads.¹⁵⁹

Another flagship service, iCloud, enables users to store, share, and download personal content like documents, photos, videos, emails, and music from the remote data centers that host them. Originally, Chinese Apple users accessing iCloud would first be connected to the U.S.-based

¹⁵⁵ Smith Noah, “Google's Prototype Chinese Search Engine Links Searches to Phone Numbers,” *The Guardian*, <https://www.theguardian.com/technology/2018/sep/18/google-china-dragonfly-search-engine>, published September 19, 2018, accessed April 22, 2021.

¹⁵⁶ Gallagher Ryan and Lee Fang, “Google Suppresses Memo Revealing Plans to Closely Track Search Users in China,” *The Intercept*, <https://theintercept.com/2018/09/21/google-suppresses-memo-revealing-plans-to-closely-track-search-users-in-china/>, published September 21, 2018, accessed April 22, 2021.

¹⁵⁷ Even in its home country the U.S based on Edward Snowden's revelations about Google and other American Internet companies involvement in U.S. National Security Agency's PRISM project. See, for instance, Collins Katie, “Edward Snowden says Facebook, Amazon and Google Engage in ‘Abuse’,” *CNET*, <https://www.cnet.com/tech/industry/edward-snowden-says-facebook-amazon-and-google-engage-in-abuse/>, published November 4, 2019, accessed April 22, 2021.

¹⁵⁸ Nicas Jack, Raymond Zhang, and Daisuke Wakabayashi, “Censorship, Surveillance and Profits: A Hard Bargain for Apple in China,” *New York Times*, <https://cn.nytimes.com/technology/20210518/apple-china-censorship-data/dual/>, published and accessed May 18, 2021.

¹⁵⁹ Tengxun Keji, “Pingguo Yizai Quanqiu 155ge Guojia he Diqu Tigong App Store, Ni Zaizeng 20ge Guojia,” [Apple Already Provides App Store in 155 Countries or Regions Worldwide, Planning to Expand to Another 20,] <https://tech.qq.com/a/20200324/020202.htm>, published March 24, 2020, accessed April 21, 2021.

data center before being redirected back to China,¹⁶⁰ but this changed in 2014 when the Chinese authorities sent hackers to obtain usernames, passwords, and data from Apple's iCloud services.¹⁶¹ Apple CEO Tim Cook brought this issue to former NDRC leader Ma Kai, but the Chinese government did not act on it.¹⁶² As a result, Apple was forced to gradually migrate the data of Mainland Chinese users to state-owned carrier China Telecom.

In September 2015, Apple began releasing its own music, movies, and e-books.¹⁶³ In that fiscal year, the company recorded US\$ 58.7 billion in revenue from all of China (including Hong Kong and Taiwan), which accounted for around 25% of their global revenue,¹⁶⁴ surpassing Europe and making China Apple the second largest market after the Americas.¹⁶⁵ Exponential growth in the Chinese market led to Apple increasing its presence there by opening 14 new Apple stores to sell devices in Chinese cities.¹⁶⁶ However, Apple soon encountered a strong headwind from the Chinese government as the company gradually rolled out its devices and services in China.

¹⁶⁰ Liang Junhao, "Yunshang Guizhou Lianhe Zhongguo Dianxin Tianyiyun, Zaiwei Pingguo iCloud Yuncunchu Tisu," [Guizhou-Cloud Big Data Joins Hands with China Telecom's Tianyi Cloud, Providing Faster Services for Apple's iCloud Storage,] Chao'ngeng Wang, [Expreview,] <https://www.expreview.com/62880.html>, published July 18, 2018, accessed April 21, 2021.

¹⁶¹ GreatFire.org, "China Collecting Apple iCloud Data; Attack Coincides with Launch of New iPhone," <https://en.greatfire.org/blog/2014/oct/china-collecting-apple-icloud-data-attack-coincides-launch-new-iphone>, published October 20, 2014, accessed April 21, 2021.

¹⁶² BBC, "Zhongguo Fuzongli Makai Zai Beijing Jiejian Pingguo Zongcai Kuke," [Chinese Vice Premier Ma Kai Received Apple CEO Cook,] https://www.bbc.com/zhongwen/simp/china/2014/10/141022_china_tim_cook, published October 22 2014, accessed April 22, 2021.

¹⁶³ Apple, "Apple Brings Apple Music, iTunes Moves & iBooks to Customers in China Starting Today," <https://www.apple.com/newsroom/2015/09/30Apple-Brings-Apple-Music-iTunes-Movies-iBooks-to-Customers-in-China-Starting-Today/>, released September 30, 2015, accessed April 22, 2021.

¹⁶⁴ Richter Felix, "The Size of Apple's Chinese Business," *Statista*, <https://www.statista.com/chart/13246/apple-china-revenue/>, published February 18, 2020, accessed April 22, 2021.

¹⁶⁵ Popper Ben, "Apple's Second Biggest Market is Now China, not Europe," *The Verge*, <https://www.theverge.com/2015/4/27/8505063/china-is-now-apples-second-biggest-market>, published April 27, 2015, accessed April 22, 2021.

¹⁶⁶ Regarding the rollout of Apple Stores in China, the company's expansion was relatively mild before 2015, with most of them based in Beijing and Shanghai. The first store opened in Beijing in 2008, with two more opening in 2010 in both Beijing and Shanghai. Another two appeared in Shanghai in 2011, three others in Beijing, Shenzhen, and Chengdu in 2012, another Shanghai one in 2013, and three more in 2014 in Beijing, Chongqing, and Wuxi. Afterwards, Apple counted 12 new stores in 2015 and 14 new ones in 2016, along with booming iPhone sales. By the end of 2021, the company owned 43 retail stores in Mainland China, most of which located in Eastern and costal metropolises. iNews, "A look at the Distribution of Apple Stores in China, and Discover the Characteristics of Apple's Consumption," <https://inf.news/en/tech/2c84a36146eaf7092b91d0b5291b2552.html>, published and

On April 22, 2016, the iTunes Movies and iBooks services became unavailable in China after the authorities ordered them to be taken offline.¹⁶⁷ The direct cause was a policy document co-issued by the MIIT and State Administration of Press, Publication, Radio, Film, and Television (SAPPRFT) that took effect a month earlier and forbade companies with non-Chinese equity participation from providing online publishing services.¹⁶⁸ Using nebulous language, the policy stated that if a Chinese online publishing entity wanted to cooperate with foreign-invested firms in providing such services, SAPPRFT must be consulted beforehand, and all their domain names, servers, and storage devices must be located inside China.¹⁶⁹ That same year, Tim Cook visited China several times to sign a secret agreement with Beijing worth US\$ 275 billion. In the deal, Apple pledged to use more components from Chinese suppliers in their devices by way of increasing their cooperation with Chinese software firms, and to help Chinese universities with research, development, and training.¹⁷⁰ This was done to appease Chinese regulators, who were disgruntled with how Apple's exponential growth in China had not contributed enough to the Chinese economy, and to save declining iPhone sales caused by a regulatory crackdown. Apple also poured US\$ 1 billion into the OFC-registered fundraising vehicle of Didi, a China-based ride-

accessed March 30, 2022.

¹⁶⁷ Healey Nic, "China Shuts Down iTunes' Movies and iBooks services, Report Says," *CNET*, <https://www.cnet.com/tech/tech-industry/china-shuts-apple-itunes-movies-and-ibooks-services/>, published April 22, 2016, accessed April 22, 2021.

¹⁶⁸ SAPPRFT and MIIT, "Wangluo Chuban Fuwu Guanli Guiding," [Provisions on the Administration of Online Publishing Services,] http://www.cac.gov.cn/2016-02/15/c_1118048596.htm, issued February 4, 2016, effective from March 10, 2016.

¹⁶⁹ Ibid. Article 10 and 12

¹⁷⁰ Ma Wayne, "Inside Tim Cook's Secret \$ 275 Billion Deal with Chinese Authorities," *The Information*, <https://www.theinformation.com/articles/facing-hostile-chinese-authorities-apple-ceo-signed-275-billion-deal-with-them>, published and accessed December 7, 2021.

hailing company in fierce competition with Uber.¹⁷¹ This helped Didi win their pricing war with Uber and kick the American company out of China.¹⁷²

In 2017, Apple started to remove some VPN apps – software designed to help Chinese users skirt the country’s Internet filters and access websites blocked in China – from its Mainland store.¹⁷³ In a statement, Apple noted that the Chinese government had announced that all developers offering VPNs needed to obtain a government license, and that they were being “required to remove some VPN apps in China that do not meet the new regulations,” although these apps would remain available in other markets.¹⁷⁴ The regulation Apple cited was the January 2017 *Cybersecurity Law*, which said that app developers must register with the government, or else criminal penalties would be applied to both the hosts and developers. Since then, “tens of thousands of apps” have vanished from the Chinese Apple store.¹⁷⁵

Measures to tighten control over cyberspace only pushed Apple to work closer with Beijing. In January 2017, the MIIT issued a decree urging local affiliations to investigate companies providing cloud services and to eliminate illegal business activities.¹⁷⁶ An ultimatum was given: companies that failed to obtain a MIIT-issued license by January 1, 2018 would be shut down. For

¹⁷¹ BBC, “Pingguo 10yi Meiyuan Touzi Zhongguo Dache Fuwu Didi Chuxing,” [Apple Invested US \$1 Billion in China’s Ride Hailing Company Didi,] https://www.bbc.com/zhongwen/simp/business/2016/05/160513_apple_didi_investment, published May 13, 2016, accessed April 23, 2021.

¹⁷² Regarding how governmental restrictions pushed Uber out of China, see, for instance, Kirby William, “The Real Reason Uber is Giving Up in China,” *Harvard Business Review*, <https://hbr.org/2016/08/the-real-reason-uber-is-giving-up-in-china>, published August 2, 2016, accessed April 23, 2021; Salomon Robert, “Why Uber Couldn’t Crack China,” *Fortune*, <https://fortune.com/2016/08/07/uber-china-didi-chuxing/>, published August 7, 2016, accessed April 23.

¹⁷³ ExpressVPN, “Apple Removes VPN Apps from China App Store,” <https://www.expressvpn.com/blog/china-ios-app-store-removes-vpns/amp/>, released July 29, 2017, accessed April 23, 2021.

¹⁷⁴ Mozur Paul, “Apple Removes Apps from China Store That Help Internet Users Evade Censorship,” *New York Times*, <https://cn.nytimes.com/china/20170730/china-apple-censorship/dual/>, published July 30, 2017, accessed April 24, 2021.

¹⁷⁵ Nicas et al., “Censorship, Surveillance and Profits: A Hard Bargain for Apple in China.”

¹⁷⁶ MIIT, “Guanyu Qingli Guifan Hulianwang Wangluo Jieru Fuwu Shichang de Tongzhi,” [Notice on Cleaning Up and Regulating the Internet Connection Markets,] <http://www.scio.gov.cn/xwfbh/xwfbh/wqfbh/35861/36970/xgzc36976/Document/1559330/1559330.htm>, released and effective from January 17, 2017.

the MIIT, cloud services, technically known as Internet Resource Collaboration Services (IRCS), fell into the IDC subsector, which was classified under the VATS subsector, meaning it was not open to foreign investors as per China's WTO promises and thus had to be operated by a purely domestic Chinese license-holding company. As an industrial source succinctly and insightfully summarized, "the regulatory gist is twofold: data must stay in China, and data-related business must be operated by a wholly Chinese-owned and controlled firm".¹⁷⁷

The start of the crackdown on foreign ownership in data operations was discernable even two years before the official release of China's *Cybersecurity Law*. In a draft of the law publicly released in June 2015 for feedback, one clause stated "personal information or important data from operations within the mainland territory of the People's Republic of China shall be stored in Mainland China."¹⁷⁸ – a stipulation retained in the final version. For Apple, this particular clause meant the electronic information Apple devices produce, transmit, and store must stay in China, and that Apple must allow a Chinese company to manage the data of Chinese users.

Although it was the central authority that declared data sovereignty, it was a provincial government with business acumen that sensed the opportunity to run Apple's data center in China and share profits with the American firm. In February 2016, Guizhou, a hinterland western province, was awarded a "Big Data trail zone" by the central government, the first one nationwide. Thus, a governmental organization called Big Data agency was set up to solicit investors. With the *Cybersecurity Law* in progress, Guizhou's provincial authorities interpreted it as a sign that all foreign companies with data business in China would soon seek a Chinese partner. To prevent this opportunity from slipping away, executive vice governor Qin Rupei drafted and chaired a special

¹⁷⁷ *Caixin Zhoukan*, "Yunzhanzheng 2.0," [Cloud War 2.0,] <https://weekly.caixin.com/2017-12-01/101178846.html?p6>, published December 4, 2017, accessed April 24, 2021.

¹⁷⁸ *Xinhua*, "Wangluo Anquan Fa," [Cyber Security Law,] http://www.xinhuanet.com/politics/2016-11/07/c_1119867015.htm, passed November 7, 2016, effective from June 1, 2017. Article 37.

squad to approach Apple. Two months later, Tim Cook held a meeting with Guizhou’s party boss Sun Zhigang in Guiyang during an undisclosed leg of one of his several official trips to China that year.¹⁷⁹

The negotiations between Guizhou officials and Apple entrepreneurs were tough. For about two years, several dozen rounds of negotiations took place. In fact, the Guizhou provincial government was not the only organization interested in hosting iCloud. Other competitors included the oligopolistic telecom SOEs of China Mobile, China Telecom, and China Unicom, and Internet behemoth Alibaba. Due to their existing specialization in cloud technology, these companies all had superior operational experience and technology compared to Guizhou’s corporate candidate: Guizhou Cloud Big Data (GCBD) – a company founded in November 2014 and completely owned by the Guizhou government’s economic and information technology commission.¹⁸⁰ As a newly established company, GCBD had no technical experience and lacked the talent pool to run Apple’s data services. In fact, GCBD’s cloud computing technology was acquired from Alibaba through a strategic partnership signed barely two years ago. The company did not even have any facilities to host data servers. GCBD had been renting server rooms from China Mobile, China Telecom, and China Unicom, and was receiving technological support from two Chinese IT equipment manufacturers, Inspur and Huawei.¹⁸¹

Eventually, Apple chose to partner with GCBD despite it being the least qualified candidate. But why? The answer, according to a government official from Guizhou, was that the province’s

¹⁷⁹ Su Bin, “Dabai Sanda Yunyingshang he Hulianwang Jutou, Yunshang Guizhou Ruhe Naxia Binggou iCloud Dadan?” [Defeated the Big Three Telecom Operators and Internet Tycoons, How did Guizhou Cloud Big Data Win Apple’s Big iCloud Deal?], *Diyi Caijing*, <https://www.yicai.com/news/100123754.html>, published February 25, 2019, accessed April 25, 2021.

¹⁸⁰ Sina, “Xieshou Pingguo de ‘Yunshang Guizhou’ Hefang Shengsheng? Cengshi Ali Zhongdian Xiangmu,” [Who is the Guizhou Cloud Big Data that Joined Hands with Apple? A Former Alibaba’s Key Project], <http://tech.sina.com.cn/it/2017-07-12/doc-ifyhwehx5793475.shtml>, published July 12, 2017, accessed April 25, 2021.

¹⁸¹ Su, “Dabai Sanda Yunyingshang he Hulianwang Jutou, Yunshang Guizhou Ruhe Naxia Binggou iCloud Dadan?”

stature as the first nationwide Big Data Trial Zone was a “natural magnet for multinational corporations,” and such political prestige made it easier to obtain the necessary licenses for operating Internet businesses.¹⁸² With its all-rounded support from the provincial authorities, GCBD was also “the only candidate that came to the negotiation table with an executable plan (*zhixing fang'an*),” whereas the other corporate competitors could only offer an “ideational framework (*kuangjia silu*).”¹⁸³ But the negotiations were still bumpy; the crux laid in whether Apple was willing to cooperate exclusively with GCBD in China.

The deal was clinched on July 12, 2017. The Strategic Cooperation Agreement between Apple and Guizhou’s government granted GCBD the “only partner (*weiyi hezuo huoban*)” in Mainland China that could operate iCloud services.¹⁸⁴ According to an estimate by a MIT-affiliated think tank, iCloud business alone could bring GCBD stable revenues of over US\$ 1 billion per year.¹⁸⁵ At the signing ceremony, Ma Ningyu, director of the Guizhou Big Data Bureau, commented that the presence of iCloud in Guizhou was “an exemplary case of the province’s cooperation with an international technological titan in accordance with China’s *Cybersecurity Law*”.¹⁸⁶

¹⁸² Wu Yangyang and Jiayi Lu, “Yunshang Guizhou Shiruhe Dabai Sanda Yunyingshang Naxia Pingguo iCloud Dadan?” [How did Guizhou Cloud Big Data Win Apple’s iCloud Deal from the Big Three Telecom Operators?], *Diyi Caijing*, <https://finance.sina.com.cn/chanjing/gsnews/2019-02-25/doc-ihrfqzka8890592.shtml>, published February 25, 2019, accessed April 25, 2021.

¹⁸³ *Ibid.*

¹⁸⁴ State Council Information Office, “Guizhou Juxing Pingguo Gongsi iCloud Zhanlue Hezuo Kuangjia Xieyi Fabuhui,” [Guizhou Holds Press Conference on its Strategic Framework Agreement with Apple’s iCloud,] <http://www.scio.gov.cn/xwfbh/gssxwfbh/xwfbh/guizhou/Document/1558278/1558278.htm>, released July 12, 2017, accessed April 25, 2021.

¹⁸⁵ He Xinghui, “Pingguoyun Piaoluo Guizhou, Weilai Bupaichu iCloud Fuwufei Xiatiao Keneng,” [Apple’s Cloud Dropped in Guizhou, Possibility of Lower Service Fees Cannot be Ruled Out,] *Keji Ribao*, [Science and Technology Daily,] <https://www.chinanews.com.cn/m/cj/2018/01-17/8425782.shtml>, reposted by China News January 17, 2018, accessed April 26, 2021.

¹⁸⁶ *Haoqixin Ribao* [Q Daily,] “iPhone Yonghu Shuju Banhui Zhongguo, Pingguo Tuoxiele,” [iPhone Users’ Data Moved Back to China, Apple Compromised,] <https://www.163.com/dy/article/CP5RTR0H051280SH.html>, reposted July 12, 2017, accessed April 26, 2021.

The localization of iCloud meant the data of Mainland Chinese users would be migrated to a company wholly owned and controlled by the state. On January 10, 2018, Apple informed Mainland Chinese users, via emails and notifications, that their data would be moved to GCBD.¹⁸⁷ Accordingly, iCloud service fees would also be payable to Aipo Cloud Technology¹⁸⁸ – a licensed fee-collecting SOE fully owned by GCBD. On its official website, Apple stated that GCBD would provide iCloud services for Mainland China, and notified users that “when iCloud is enabled, your content will be automatically sent to and stored by GCBD, so you can later access that content or have content wirelessly pushed to your other iCloud-enabled devices or computers.”¹⁸⁹ Users were also sent a message saying, “you understand and agree that Apple and GCBD will have access to all data that you store on this service, including the right to share, exchange and disclose all user data, including content, to and between each other under applicable law.”¹⁹⁰ Finally, users were told that all requests to delete their iCloud account and Apple ID would be sent to “GCBD Support at Electronic Information Industry Park of Gui’an New Area, Guizhou province.”¹⁹¹

Profits from managing iCloud would be shared between Apple and Aipo Cloud. As Diagram 6.1 below shows, Apple’s Guizhou firm was registered as a foreign-invested company under Apple’s South Asia branch in the district where GCBD was located. This firm would provide technological support, consulting, data processing, and equipment imports and exports to Aipo Cloud,¹⁹² and the relationship was established via *contracts* rather than equity ownership.

¹⁸⁷ Zhu Jiang, “Pingguo: Zhongguo Dalu iCloud Fuwu Jiang Zhuanyou Yunshang Guizhou Fuze Yunying,” [Apple: Mainland China’s iCloud Services Will be Operated by Guizhou Cloud Big Data,] *Renmin Wang*, [People’s Daily Online,] <http://finance.people.com.cn/n1/2018/0110/c1004-29756512.html>, published January 10, 2018, accessed April 25, 2021.

¹⁸⁸ The change only affected users who set China as their home country on Apple devices and did not impact users who selected Hong Kong, Macau or Taiwan.

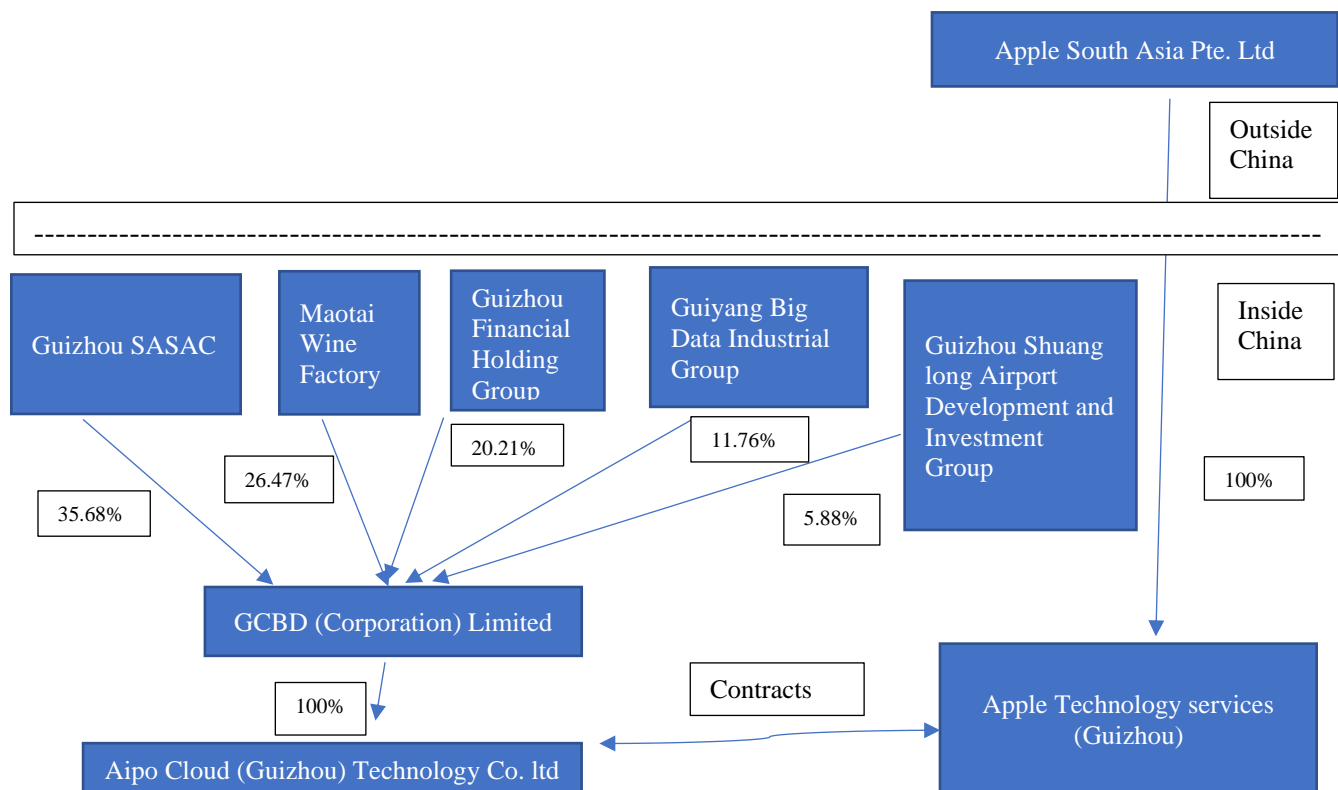
¹⁸⁹ Apple, “iCloud Operated by GCBD Terms and Conditions,” <https://www.apple.com/legal/internet-services/icloud/en/gcbd-terms.html>, last accessed April 25, 2021.

¹⁹⁰ *Ibid.* Section V. Content and Your Conduct, E. “Access to Your Account and Content”

¹⁹¹ *Ibid.* Section VII. Termination, A. “Voluntary Termination”

¹⁹² Fan Li, “Pingguo Jishu Fuwu (Guizhou) Youxian Gongsi Luohu Gui’an Xinqu,” *Guizhou Ribao* [Guizhou Daily,]

Diagram 6.1 Equity Structure of iCloud's operator in China



In February 28, 2018, iCloud services in Mainland China became officially operated by GCBD. But at that moment, the company was not even ready to handle the task at hand, as the data center was still under construction and would not be completed until 2020. As a makeshift solution, GCBD rented cloud capacities from China Telecom to run the data of Apple users.¹⁹³ Later in 2018, the Guizhou government reshuffled GCBD's shareholders. As Diagram 6.1 shows, ownership that was previously under the complete authority of the provincial economic and information technology commission was transferred to five other state-owned entities, with the State-owned Assets Supervision and Administration Commission (SASAC) being the *de facto* controlling entity with about one-third of the shares and an ultimate beneficial ownership of 62.15%.¹⁹⁴ As a state owned enterprise, GCBD's directors are directly nominated and appointed by the Guizhou CCP Committee.¹⁹⁵

Having data centers located in China had far-reaching impacts for Apple and its Chinese users. One was that the cryptographic keys needed to unlock an iCloud account, previously stored in the U.S., were now stored in China for Chinese iCloud accounts. According to legal experts, this meant that Chinese authorities did not need to use the American judiciary system to seek information on iCloud users. Previously, any government or law enforcement authority seeking to access a Chinese iCloud account needed to first go through the U.S. legal system.¹⁹⁶ But now, by

¹⁹³ Ren Xiaoyuan, "Zhongguo Dianxin Jiangwei iCloud Dazao Haomiaoji Tiyan," [China Telecom will Give iCloud Millisecond Experience,] *Beijing Qingnian Bao*, [Beijing Youth Daily], http://epaper.yinet.com/html/2018-07/18/content_296381.htm?div=-1, published July 18, 2018, accessed April 26, 2021.

¹⁹⁴ Qichacha, "Yunshang Guizhou Dashuju (Jituan) Youxian Gongsi," [Guizhou Cloud Big Data (Group) Corporation Limited,] <https://www.qcc.com/firm/c101c1ee07db38d4280a904d6daebe0.html>, accessed April 26, 2021.

¹⁹⁵ Zhao Yibo, "Yunshang Guizhou Dashuju Jituan Qiaoran Chengli, Maotai 4.5yi Rugu," [Guizhou Cloud Big Data Corporation Established Quickly, Maotai Invested RMB 450 Million,] *Xinjing Bao*, [Beijing News,] <https://tech.sina.com.cn/it/2018-11-01/doc-ifxeuwwt0127306.shtml>, reposted by Sina November 1, 2018, accessed April 27, 2021.

¹⁹⁶ In March 2016, Apple refused the FBI's demands to unlock the iPhone 5C of a shooter who killed 14 people in December 2015. Apple's refusal led to a lawsuit. Ironically, the company kowtowed to the Chinese regime barely two years later by handing out the iCloud data of Chinese consumers. For more information, see, Nakashima Ellen, "Apple Vows to Resist FBI Demand to Crack iPhone Linked to San Bernadino Attacks," *Washington Post*,

referring the party-state's own laws and policies, public authorities could ask Apple to hand over iCloud data for Chinese users,¹⁹⁷ which raised concerns from activists and academics about the aggravation of human rights abuses. Apple's encryption keys were delivered to the Chinese government barely eight months after the *Cybersecurity Law* took effect. Apple's engineers acknowledged that having data centres inside China allowed the government to "access emails, photos, documents, contacts, and locations of Chinese customers".¹⁹⁸ The American company's statement on the issue was that "while we advocated against iCloud being subject to these laws, we were ultimately unsuccessful," and "discontinuing it [iCloud] would give a bad user experience and actually lead to less data privacy and security for its Chinese customers."¹⁹⁹

Paralleling what has happened to the fruit in the company's logo, Beijing took a big bite of Apple as it made inroads into the Chinese market.

6.9 Concluding Remarks

This chapter has demonstrated a key component of capital filtration used against *industrial investors* from the Global North that attempt to enter China through FDI and compete with local Chinese counterparts to gain a foothold in China's information services market. Procedurally and ostensibly, the provisions that Beijing unveiled before China's accession to the WTO in 2001 served as a pledge of its membership commitment. It offered an "overdue" policy framework of telecom service regulations and a roadmap for foreign investors. But in reality, the concessions acted as a glass door to keep foreign industrial investors out, and coerced them to relinquish

https://www.washingtonpost.com/world/national-security/us-wants-apple-to-help-unlock-iphone-used-by-san-bernardino-shooter/2016/02/16/69b903ee-d4d9-11e5-9823-02b905009f99_story.html, published February 16, 2016, accessed April 29, 2021; Wikipedia, "FBI-Apple Encryption Dispute," https://en.wikipedia.org/wiki/FBI%E2%80%93Apple_encryption_dispute.

¹⁹⁷ Nellis Stephen and Cate Cadell, "Apple Moves to Store iCloud Keys in China, Raising Human Rights Fears," *Reuters*, <https://www.reuters.com/article/us-china-apple-icloud-insight-idUSKCN1G8060>, published February 23, 2018, accessed April 29, 2021.

¹⁹⁸ Nicas et al., "Censorship, Surveillance and Profits: A Hard Bargain for Apple in China."

¹⁹⁹ Nellis and Cadell, "Apple Moves to Store iCloud Keys in China, Raising Human Rights Fears."

corporate control in order to benefit from China's booming information sector. As an engineer from a MII think tank pointed out, "many details remained incomplete and unfeasible", and the cumbersome inter-ministerial approval process inhibited the zeal of foreign investors seeking to enter China. Thus, the opening of China's telecom market was only "in principle" and "on paper".²⁰⁰

Generally speaking, the FDI-restrictive hurdles that Beijing erected for foreign industrial investors had three stages. Firstly, at the *pre-entry* stage, equity caps obligated foreign entrants to form joint ventures with Chinese partners, thus limiting their autonomous corporate decision-making power. A stringent national security review mechanism was also placed to ensure that foreign investors did not circumvent joint venture requirements by merging and acquiring Chinese companies. Secondly, at the *entrance* stage, regulators placed opaque, cumbersome, and nebulously worded red tape criteria to increase the market-entry processing time. Thirdly, by the *post-entrance* stage, the few multinational corporations that did obtain a permit and form a Sino-foreign joint venture found that local operations were severely constrained by licensing and technology transfer requirements from multiple government agencies with overlapping authority.

Capital seeks profits, and evidently the repressive, discriminatory, and haphazard regulatory environment did not discourage globally renowned Internet giants from trying to enter China's vast and lucrative market. This inevitably led to their collaboration with the Chinese authorities through various methods such as adhering to their demands for informational censorship (as Google's google.cn and dragonfly projects, and Apple's removal of VPN apps have shown), sharing Chinese users' data and fees with the state (as Apple's decision to work with a local government to manage iCloud in China has demonstrated), and pleading for China's top leadership

²⁰⁰ Chen, "Oumei Shi Yunyingshang Jiti Youshui, Seyou Dianxin Waizi 49% Dixian."

to grant an entry permit (as Facebook's tortuous, frustrated, and ultimately ill-fated strategy has revealed).

To borrow the words of a Chinese Internet entrepreneur, any multinational Internet company seeking to enter the Chinese market must “pay the tuition fee (*jiao xuefei*),” and arguably the lesson that they have learned is twofold. First, they have to abandon corporate control in the Chinese market and resort to using a local Chinese management team, as demonstrated by Apple's localization of iCloud (something Google tried around 2009 and 2010 and failed in).²⁰¹ However, the decision to “operate locally, produce localized content, and use local teams” is of course a “very painful process” for these multinational companies.²⁰² Second, they could generate investment in their capacity as financial investors. Examples can be found in Google and Apple: Google Capital, the Internet giant's private equity arm, decided to invest in Manbang and JD.com, while Apple invested US\$ 1 billion into Didi. In other words, international industrial giants unable to operate independently in China or even physically enter the country can still tap into China's information bonanza by giving cash to their VIE-structured Chinese counterparts, holding non-controlling shares issued by their competitors' offshore SPVs, and becoming ODFF rentiers who would recoup dividends or interests.

But for either option, a Faustian bargain with the Chinese regime that compromises their liberal values is inevitable.

²⁰¹ As mentioned in Chapter 5, Yahoo's six years of experience in China, which ultimately led to it selling its inside China assets to Alibaba in 2005, is also an example.

²⁰² Zhang Fan, “Yahu Zhongguo Sanbuqu (Yahoo's Trilogy in China),” *Caijing*, <https://magazine.caixin.com/2005-08-22/100080999.html>, August 22, 2005, reposted by *Caixin*, accessed April 30, 2021.

Chapter 7: Conclusion

As Susan Strange, a pioneer scholar in international political economy pointed out, the reception and transfer of credit is one of the key elements -- often transformative and decisive -- that have long-term implications and impact for not only firms' growth and competitiveness, but also at the broader scale of international economic and political relations.¹ The previous chapters have disaggregated the categories of foreign investment flow and discussed their associated pros and cons for China's unique political and economic setting. I conceptualized capital filtration as authoritarian and developing China's Janus-faced developmental and globalization strategy to maximize the benefits while minimizing the drawbacks associated with global capital inflow. I showed that the offshore domesticated foreign finance (ODFF) indicated the hands-off, cosmopolitan and globalist cheek involving state facilitation of China-based and Chinese-controlled companies' *outward* extension onto the global capital markets for fundraising purposes, thus forging a neo-triple alliance with global financial elites. I also showed that the other hidden cheek was iron-fisted, xenophobic and nationalistic, concerning the public authority's persistent repression on international industrial investors' *inward* penetration into the Chinese market. An integration of the two parts explains why the boon of foreign capital in China-based information companies does not incur a bane to China's national economy and regime security.

In concluding this project, this chapter extends the discussions and findings summarized above in three directions. By positioning my research into extant studies on China's information industry, I first show how my methodological choice of placing foreign capital inflow as the level and unit of analysis opens the door for a new approach by integrating authoritarian control and sectoral modernization into a unified intellectual picture, thus proposing a new direction to investigate

¹¹ Strange, Susan. *States and Markets*. London: Printer, 1988. p.30

Chinese political economy at the intersections of the global capitalist political economy. In the following two sections, I place my research findings and their revelations into the broader context of comparative political studies and discuss two theoretical and conceptual values they add. One refers to the conceptualization of the state's role in the developmental process in comparison to previous generations of developers in general and the developmental states in East Asia in particular. The other refers to the relationship between formal and informal institutions. Regarding the implications this project has for future studies of China's information industry, In Section Four, I encourage future students to stay on the track of state-firm relationships and explore the role of the Chinese Communist Party (CCP)'s Party organizations inside VIE-structured, ODFD-using, Chinese-controlled, but non-state held Internet companies. This project's theoretical and empirical findings are also highly relevant to the ongoing movements and debates around the future of ODFD. Therefore, the last section analyzes the recent policy changes in 2021 and 2022 and offers suggestions on where and how to observe the future evolution of the neo triple alliance against the backdrop of increasing Sino-U.S. rivalry.

7.1 Authoritarian Control over Cross-border Capital Flow as the Unit and Level of Analysis

Methodologically, this project has conducted a single-sector study focusing on the information sector in China.² Its largely qualitative, systematic, and historical treatment traces specific processes that lead to political outcomes and detects causal mechanisms behind empirical phenomena. It pinpoints a single industry, i.e. the information service sector, and explores its growth and transformation over two decades. Arguably, studies taking the entire country as the unit of analysis unavoidably only manage to sketch the broad strokes of the dynamics between

² For how a single case study can make theoretical contribution, see Rueschemeyer, Dietrich. "Can One or a Few Cases Yield Theoretical Gains?" In *Comparative Historical Analysis in the Social Sciences*, 2003.

state and economic actors, and such pursuit of breadth unavoidably compromises its depth. To quote Stephen Haggard and Tun-jen Cheng, two scholars on the East Asian political economy, “all developing countries exhibit some sort of division of labor between local firms, multinational corporations, and state-owned enterprises. The explanatory problem is to account for sectoral variations and differences in the relative power of the three actors across countries.”³ Moreover, states rarely adopt an indiscriminate strategy to foster all industries. Moving the level of analysis both empirically and theoretically from the country-level to the industry-level provides a more poignant picture of the challenges and opportunities faced by specific political and economic actors, and how they cope with them.

Furthermore, a major distinction that this project has made in comparison to the extant literature lies in its empirical focus on informational *services* in terms of telecommunication and Internet businesses excluding traditional media and information and communication technology (ICT) equipment. A broad industry, the information sector involves various technologies, products, and services in sub-sectors such as semiconductor,⁴ telecommunication, electronic devices, and internet-based content and services. Further adding to this confusion are the diverse modifiers that are often used indistinguishably, interchangeably, if not inappropriately, to modify this sector -- just to name a few, ICT, wireless communication, internet, digital, social media etc. They have led to popular and conceptual confusions among conventional media, informational services, and ICT

³ Haggard, Stephen and Tun-jen Cheng, “State and foreign capital in the East Asian NICs” in, Frederic. Deyo (ed.), *The Political Economy of the New Asian Industrialism*. Cornell University Press. 1987. p.85

⁴ From a technical perspective, the semiconductor subfield could be further divided into three sub-areas. Chip design and fabrication, both of which require sophisticated technology, are the value center and technological engine of the entire ICT sector. The assembly and testing of semiconductor products are more labor intensive, less technologically intensive, and therefore peripheral to the ICT’s value chain. For more information, see Fuller, Douglas. *Paper Tigers, Hidden Dragons: Firms and the Political Economy of China’s Technological Development*. NY: Oxford University Press, 2016.

manufactured goods. As underscored in Chapter 1, informational services have two qualities that conventional media⁵ cannot match – *information generation and transmission*.⁶

But more importantly, this project has also underlined two key conceptual differences between informational services and informational equipment despite their large number of practical entanglements. One lies in the fundamental difference between the manufacturing (second) and service (tertiary) industry. Equipment makers produce physical goods that users see, touch, and feel. Their manufactured products (such as towers, transmitters, and chips) are installed into the network that is owned and managed by information service providers, or sold (such as laptops, tablets, cellphones, wearable electronics devices) to end-use consumers. However, information service provision and consumption such as the operation of communications networks or the usage of computer software and smart phone applications is *intangible*.

To use an analogy, the information services companies are akin to those managing the municipal roads or inter-provincial highways or those transit companies delivering passengers; whereas equipment manufacturers are akin to companies that produce engines, brakes, cements, and stones, which are used to build either vehicles or roads. Such conceptual and industrial disentanglement helps to distinguish my research from the extant literature, which has investigated

⁵ Work on the impact of marketization and globalization on Chinese conventional media, see, for instance, Chin-Chuan Lee ed., *Power, Money, and Media: Communication Patterns and Bureaucratic Control in Cultural China*, Evanston, IL: Northwestern University Press, 2000; Lynch, Daniel C., *After the Propaganda State: Media, Politics, and “Thought Work” in Reformed China*, Stanford, CA: Stanford University Press, 1999; Zhao, Yuezhi, *Media, Market, and Democracy in China: Between the Party Line and the Bottom Line*, Urbana: University of Illinois Press, 1998.

⁶ As mentioned in Chapter 1, compared with other historical means that human beings have been using to convey information, be it face-to-face talk, written letter, telegraph, fixed-line phones, information technology, more mobile and portable, reduces the time and space in information transmission and enables a transmission of a mixed form of oral, written, audio, and visual languages faster and to a larger scale of audience. Moreover, mobile technology allows users to individualize information, propagating messaging, bi-directional or multi-directional, synchronic or asynchronic, with an ease compared with one-way directional message convey conventional media such as newspaper, radio, and TV, thus enormously enhancing the interactivity, efficiency, and flexibility in information generation.

the authoritarian control facet and sectoral development facet of China's information industry in a distant and fragmented fashion.

In terms of the globalization of China-based firms, existing studies are primarily interested in when, where, how, why China-based multinationals invested overseas,⁷ or the variegated economic, social, and political impact that Chinese investments brought for recipient societies⁸ -- originally the developing world,⁹ but increasingly the industrialized Global North.¹⁰ In contrast, I take a step back and investigate another dimension of internationalization – the acquisition of foreign investment – and deconstruct this term by underscoring the globally-*funded* nature of Chinese companies. My research pays special attention to the source of corporate finance because it is the core of any business organization, without which no firm can exist, run, let alone expand.

⁷ See, for instance, Henry Wai-chung Yeung & Weidong Liu (2008) Globalizing China: The Rise of Mainland Firms in the Global Economy, *Eurasian Geography and Economics*, 49:1, 57-86; Alon, I., & McIntyre, J.R. (2008). *Globalization of Chinese Enterprises*. Palgrave Macmillan; Alon, I., & John F. Kennedy School of Government. (2009). *China Rules: Globalization and Political Transformation*. Palgrave Macmillan; Buckley, P. J. (2004). The role of China in the global strategy of multinational enterprises. *Journal of Chinese Economic and Business Studies*, 2(1), 1-25; Goldstein, A., & Pusterla, F. (2010). Emerging economies' multinationals: General features and specificities of the Brazilian and Chinese cases. *International Journal of Emerging Markets*, 5(3-4), 289-306; Holtbruegge, D., & Kreppel, H. (2012). Determinants of outward foreign direct investment from BRIC countries: An explorative study. *International Journal of Emerging Markets*, 7(1), 4-30; Li, Q. & Liang, G. (2012). *Political relations and Chinese outbound direct investment: Evidence from firm- and dyadic-level tests*. Research Center for Chinese Politics and Business Working Paper No. 19; Ramasamy, B., Yeung, M., & Laforet, S. (2012). China's outward foreign direct investment: Location choice and firm ownership. *Journal of World Business*, 47(1), 17-25. Shi, W. (2015). *The Political Economy of China's Outward Direct Investment*. Ph.D. Dissertation. University of California, San Diego.

⁸ Fishman, T. (2006). *China, Inc.: How the Rise of the Next Superpower Challenges American and the World*. Scribner; Kroeber, A. (2016). *China's Economy: What Everyone Needs to Know*. Oxford University Press. Nolan, P. (2001). *China and the Global Economy: National Champions, Industrial Policy and the Big Business Revolution*. Palgrave Macmillan. Shambaugh, D. (2013). *China Goes Global: The Partial Power*. Oxford University Press. Zweig, D. (2002). *Internationalizing China: Domestic Interests and Global Linkages*. Cornell University Press.

⁹ Cheung, Y., de Haan, J., Qian, X., & Yu, S. (2012). China's outward direct investment in Africa. *Review of International Economics*, 20(2), 201-220; Kolstad, I., & Wiig, A. (2011). Better the devil you know? Chinese foreign direct investment in Africa. *Journal of African Business*, 12(1), 31-50; Lee, C. K. (2017). *The Specter of Global China: Politics, Labor, and Foreign Investment in Africa*. The University of Chicago Press.

¹⁰ Nolan Peter, *Is China Buying the World?*, 2013. Jackson, J. (2010). *Foreign investment, CFIUS, and homeland security: An overview*. Congressional Research Service. <https://sgp.fas.org/crs/homesec/RS22863.pdf> Meunier, S. (2014a). "Beggars can't be choosers": The European crisis and Chinese direct investment in the European Union. *Journal of European Integration*, 36(3), 283-302. Meunier, S. (2014b). Divide and conquer? China and the cacophony of foreign investment rules in the EU. *Journal of European Public Policy*, 21(7), 996-1016. Meunier, S. (2014c). A Faustian bargain or just a good bargain? Chinese foreign direct investment and politics in Europe. *Asia Europe Journal*, 12(1), 143-158. Milelli, C., Hay, F., & Shi, Y. (2010). Chinese and Indian firms in Europe: Characteristics, impacts and policy implications. *International Journal of Emerging Markets*, 5(3-4), 377-397.

Yet finance is beyond a simple intermediation between the suppliers and users of capital. Internationally, especially in the long run, the reception and transfer of credit through equity- or debt-based channels not only decides a firm's growth, competitiveness, and expansion, but also influences individual, commercial, and governmental preferences and actions, which eventually restructure international economic and political relations.¹¹ In the meantime, echoing concepts such as "liberalization without democratization"¹² and "authoritarian resilience"¹³, my arguments shed light on how and why authoritarian rulers' adoption of privatization, globalization, and marketization policies and participation in the neo-liberal world economy does not necessarily lead to political and institutional changes to democracy.¹⁴

7.2 Capital filtration in Comparative Perspective: State-brokered Development in the Era of Financial Globalization

As many scholars bemoan, China studies has long been an infertile site for theory building and (re)conceptual innovation in political science.¹⁵ Indeed, as early as three decades ago, a prominent political scientist specializing in Chinese politics has lamented that "concepts from comparative politics have been used to understand China, but China has not yet been used to help extend our understanding of comparative politics."¹⁶ As a humble effort to break away from this "Middle Kingdom Complex,"¹⁷ I positioned China's political and economic attributes into a

¹¹ Strange, *States and Markets*, p.30; Clark, Gordon, Adam Dixon, and Monk Ashby (eds.). *Managing Financial Risks: From Global to Local*. Oxford University Press, 2009.

¹² O'Donnell, Guillermo A., Philippe, C., Schmitter, and Laurence, Whitehead, *Transitions from Authoritarian Rule: Prospects for Democracy*, Baltimore: Johns Hopkins University Press, 1986.

¹³ Nathan, Andrew J., "Authoritarian Resilience," *Journal of Democracy* 14, no. 1 (2003): 6-17.

¹⁴ On a theoretical treatment of how and why the introduction of free markets does not inevitably lead to the decline of political dictatorship, see Ronald Wintrobe, *The Political Economy of Dictatorship*, 1998, Cambridge University Press, in particular chapters six to ten.

¹⁵ Tsai, Kellee. "China's Political Economy and Political Science," *Perspectives on Politics* 11, no.3 (2013):860-871. Also, Reny finds that political scientists specializing in China tends to see their work published in area-studies journals rather than mainstream political science ones. See, Reny, Marie-Eve. 2011. "What Happened to the Study of China in Comparative Politics?" *Journal of East Asian Studies* 11: 105-35.

¹⁶ Harding, Harry. 1984. "The Study of Chinese Toward a Third Generation of Scholarship." *World Politics*, 36 (January):284-309.

¹⁷ Kennedy, Scott. 2011. "Overcoming Our Middle Kingdom Complex: Finding Chinas Place in Comparative

broader comparative context, and made comparisons and contrasts of the state-capital relationship against the backdrop of developmental paths adopted by those previously less developed countries in general and the developmental states in particular.

The developmental state model has been the dominant explanatory framework in the study of the East Asian political economy.¹⁸ Having emerged in the 1980s and 1990s, this school of scholarship¹⁹ conceptualizes the state's role in promoting economic catch-up with empirical references from the economic "miracles" from Japan²⁰ and four newly industrialized "tigers" as such South Korea, Taiwan, Singapore, and Hong Kong.²¹ Basing their analysis of foreign capital in export-oriented sectors in East Asian economies, this school highlighted the state's capacity in regulating export-oriented investment and guiding them into national development purposes. Thus, the state-capital relationship was conceptualized as "governed independence",²² with state actors possessing an "embedded autonomy"²³ that is "governing the market."²⁴

Politics." In Kennedy Scott (ed.) *Beyond the Middle Kingdom: Comparative Perspectives on China's Capitalist Transformation*. Stanford: Stanford University Press, Chapter 1.

¹⁸ Tsai, China's Political Economy and Political Science, Perspectives on Politics, p.864. see Walter, Andrew and Xaiok Zhang (eds.) *East Asian Capitalism: Diversity, Continuity, and Change*. Oxford University Press.2012

¹⁹ Masahiko Aoki, Hyung-ki Kim, and Masahiro Okuno-Fujiwara (eds.), *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis*, Oxford: Clarendon Press, 1997; Mark Robinson and Gordon White (eds.), *The Democratic Developmental State: Politics and Institutional Design*, Oxford University Press, 1998; Meredith Woo-Cummings (ed.), *The Developmental State*, Ithaca: Cornell University Press, 1999.

²⁰ Johnson, Chalmers. *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*, Stanford University Press, 1982; Johnson, Chalmers. *Japan: Who Governs? The Rise of the Developmental State*, New York: W.W.Norton, 1995.

²¹ Frederic C. Deyo (ed.), *The Political Economy of the New Asian Industrialism*, Ithaca: Cornell University Press, 1987; Haggard, Stephan. *Pathways from the Periphery: The Politics of Growth in the Newly Industrialized Countries*, Ithaca: Cornell University Press, 1990; Gereffi, Gary and Donald L. Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia*, Princeton University Press, 1990. Amsden 1989, *Asia's Next Giant: South Korea and Late Industrialization*. New York: Oxford University Press..

²² Weiss, Linda. "Governed Interdependence: Rethinking the Government-Business Relationship in East Asia." *The Pacific Review* 8, no. 4 (1995): 589-616.

²³ Evans, Peter B., *Embedded Autonomy: States and Industrial Transformation*. Princeton, N.J: Princeton University Press, 1995.

²⁴ Wade, Robert, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*. Princeton, N.J: Princeton University Press, 1990.

Probably because of the geographical proximity and cultural resemblance, whether China's developmental trajectory and experience falls into the large group of "developmental state" has generated much scholarship.²⁵ Some projects illustrate that at least on the surface, with a strong state capacity to articulate economic priorities and achieve high economic growth and a single-party authoritarian regime to quash popular resistance, China fulfills the criteria laid out by its neighbors.²⁶ On the contrary, works that highlight China's divergence from such "family resemblance", regardless of their extent, point to its size in terms of geographic expanse and number of actors,²⁷ openness to FDI,²⁸ sub-national autonomy,²⁹ heavier reliance on SOEs,³⁰ and support from overseas ethnic networks.³¹

As the previous chapters have demonstrated, the state's role in the development of China's home-grown yet foreign-funded information sector both resembles and differs from the development state school. The similarity lies in East Asian developers' state autonomy and capacity to rein in FDI in sectors that it does not want foreign industrial penetration. Although the role of the capital system in developmental states is not homogenic, developmental states share a similarity of governmental opposition to FDI and openness to state-controlled foreign borrowing.

²⁵ In terms of the information sector, see Ning Lutao, *China's Rise in the World ICT Industry: Industrial Strategies and The Catch-up Developmental Model*, Routledge, 2012.

²⁶ Knight John, 2014, "China as a Developmental State," *The World Economy*, 37(10); White, Gordon. 1993. *Riding the Tiger: The Economic Reform in Post-Mao China*. Stanford University Press; Nee, Victor, Sonja Opper, and Sonia Wong. 2007. "Developmental State and Corporate Governance in China." *Management and Organization Review* 3(1): 19-53.

²⁷ Naughton, B., & Tsai, K.S. (Eds.). (2015). *State Capitalism, Institutional Adaptation, and the Chinese Miracle*. Cambridge University Press, p.17.

²⁸ Hsueh, Roselyn. 2011, *China's Regulatory State: A New Strategy for Globalization*, NY: Cornell University Press; Huang, Yasheng, 2003, *Selling China: Foreign Investment during the Reform Era*. New York: Cambridge; Wilson, Scott. *Remade in China: Foreign Investors and Institutional Change in China*. Oxford University Press, 2009.

²⁹ Breslin, Shaun. 1996. "China: Developmental State or Dysfunctional Development?" *Third World Quarterly* 17(4): 689-706; Ling Chen, *Manipulating Globalization: The Influence of Bureaucrats on Business in China*, Breznitz, Dan and Michael Murphree, *Run of the Red Queen, Government, innovation, Globalization and Economic Growth in China*, 2011. Segal, Adam. *Digital Dragon: High-Technology Enterprises in China*, 2003. Cornell University Press.

³⁰ Kroeber, A. (2016). *China's Economy: What Everyone Needs to Know*. Oxford University Press. Chapter 1.

³¹ Yeung, Henry Wai-chung, *Chinese Capitalism in a Global Era: Towards Hybrid Capitalism*, Routledge, 2004.

For instance, Korea had heavily relied on foreign loans and allowed almost zero FDI outside labor-intensive industries.³² As a result, FDI played a minor role in capital formation in developmental states.³³ Put differently, unlike affluent western democracies in which producer groups and firm-level variables determine public economic policy making,³⁴ in the global periphery, political authorities rather than entrepreneurs lead and steer socioeconomic change.³⁵ Therefore state involvement and its pivotal role is a given, in particular for East Asian developers generally and in China particularly, where a state-capitalist model has been undertaking various types of intervention in the economic transformation.³⁶

On the other hand, a core difference that distinguishes China's developmental experience and strategies from the developmental state family lies in the *timing* and *opportunities* emerging from the historical backdrop of the post-Cold War financial globalization.³⁷ Historically, the emergence of developmental states took place between the 1950s and 1980s. Their industrialization was marked by developing countries' resort to foreign capital in the form of inward FDI brought by Global North-headquartered MNCs or foreign loans lent by international banks.³⁸ The liberalized international capital market in general and the availability of Global North-based securities markets for Global Southern firms to raise funding in particular represents an important structural change that only became possible in the post-Cold War globalization era. Accordingly, Chinese

³² Amsden, *Asia's Next Giant: South Korea and Late Industrialization*, p.9

³³ Haggard and Cheng, *State and Foreign Capital in the East Asian NICs*, 1987.

³⁴ Hall, Peter and David Soskice, *An Introduction to Varieties of Capitalism*, 2001.

³⁵ Kohli, Atul. *The State and Development in the Third World*, Princeton University Press, 1986. p.12

³⁶ For a definition and different types of state capitalism, see Kurlantzick, Joshua, *State Capitalism: How the Return of Statism Is Transforming the World*. Oxford University Press 2016.

³⁷ Cook, Sarah, and Kellee S. Tsai. 2005. "Developmental Dilemmas in China." *In Japan and China in the World Political Economy*, (eds.) Saadia Pekkanen and Kellee Tsai. New York: Routledge, 45-66. Kroeber, *China's Economy: What Everyone Needs to Know*; Steinfeld, Edward. *Playing Our Game: Why China's Economic Rise Doesn't Threaten the West*, Oxford University Press, 2010.

³⁸ Vernon, Raymond. 1966, "International Investment and International Trade in the Product Cycle", *Quarterly Journal of Economics* 80 (2):190-207.

information companies could tap into the ODFF, a more convenient and less risky option that was not available for previous generations of late developers. ODFF complements rather than replaces existing and generous state financial support such as state-owned bank loans, national research and development funding, and public procurement as explanations of the rapid modernization of China's indigenous information sector.

The FDI-repressive and ODFF-permissive facets of capital filtration eventually raises the question of how to conceptualize the state's role in economic development. As I have demonstrated, the state's role in the developmental process should not be reduced to a single competent or meritocratic pilot agency composed of talented managerial staff committed to and capable of realizing the organization's transformative goal through effective policy implementation – a theoretical model that some early developmental state literature proposed with empirical observations drawn from Japan's industrialization experience.³⁹ Neither does it find state autonomy at a degree of becoming a dominating and predatory force *over* other societal actors to a degree that would *inhibit* economic development.⁴⁰ Rather, I proposed to locate the state in an *intermediary* context with business actors and focus on the state's triangular interconnections with domestic and foreign capital. This trilateral dynamism, of course, depends on multiple factors such as bargaining position, resources, skills, tactics that each party possesses, the negotiation agenda, and sophistication and administrative capability of the state.⁴¹

Acknowledging all these factors, my project has conceptualized a neo-triple alliance amongst Chinese authoritarian political elites, domestic capital, and global financial elites. Playing a pivotal

³⁹ Johnson. *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*; Johnson. *Japan: Who Governs? The Rise of the Developmental State*.

⁴⁰ Evans, Peter. Predatory, developmental and other apparatuses: A comparative political economy perspective on the third world state. *Sociological Forum*, 1989, 4(4), 561– 587.

⁴¹ Stopford, J., & Strange, S. *Rival States, Rival Firms Competition for World Market Shares*, Cambridge University Press, 1991; Chang, H.-J., *Globalization, economic development and the role of the state*. London: Zed Books, 2003, p.266.

and brokering role in this alliance, authoritarian elites in China have not only provided a better profit-generating environment and business convenience for foreign investors' inroads into domestic market,⁴² but simultaneously extended its control and manipulation across state borders into the global securities market.⁴³ Arguably, this is also a core difference that empirically distinguishes post-socialist-partially-market economy with a Communist party monopolizing political power⁴⁴ from the developmental states of South Korea and Taiwan, whose economic take-off is accompanied with political democratization.

It must be pointed out that for the late developing societies, any engagement with foreign capital from the Global North would inevitably incur some sort of dependency. However, the difference lies in the form, extent, degree, risks, and vulnerability of such dependency. Latin American NICs were dependent on foreign investments in either form of FDI from MNCs and FLS from banks, while developmental states were dependent on American aid and export market.⁴⁵ China's information industry has relied on ODFI. However, the new triple alliance helps to mitigate and externalize the risks and increase the costs for foreign economic agents, thus turning dependency into some sort of *interdependence*. For political and business elites in the late developing world who admire or envy Beijing's effectiveness in carrying out capital filtration, the likelihood of duplication eventually boils down to the possibility of building and managing a

⁴² Wu Guoguang and Helen Lansdowne (eds.), *China's Transition from Communism – New Perspectives*, London: Routledge, 2016, in particular Guoguang Wu, "'Repressive Capitalism' as the Institutional Crystallization of China's Transition," pp.190-210.

⁴³ The "developmental state" school literature did not highlight the regime change factor. And for a handful that picked up this theme, authoritarian control is found to be applied in the domestic sphere, such as against industrial workers and peasants. See, for instance, Jones, D. M. (1998) "Democratization, Civil Society, and Illiberal Middle Class in Pacific Asia," *Comparative Politics* 30 (2): 147-169, and Kay, C. (2002) "Why East Asia Overtook Latin America: Agrarian Reform, Industrialisation and Development." *Third World Quarterly* 23 (6): 1073-1102; Wade, R (1983), South Korea's agricultural development: the myth of a passive state, *Pacific Viewpoint*, 24 (1), pp.11-28.

⁴⁴ Pei, Minxin, *China's Trapped Transition: The Limits of Developmental Autocracy*, Cambridge MA: Harvard University Press, 2006., Kroeber, *China's Economy: What Everyone Needs to Know*

⁴⁵ Mahoney, James, and Diana Rodriguez-Franco, "Dependency Theory", in Lancaster, Carol and Nicholas Van de Walle (eds.) *Oxford Handbook of the Politics of Development*, Oxford University Press, 2018. Chapter 2, p.30.

similar kind of triple alliance, which is related to two questions: whether the host state has a high level of state autonomy that allows political elites to play various kinds of capital against each other (foreign v.s domestic, foreign industrial vs. foreign financial), and whether its domestic market is large enough to entice foreign investors' interests.⁴⁶

7.3 Manipulating Globalization, Globalizing Manipulation: Informal Institution as Authoritarian Elites' Power Magnifying Tool

My research finding of capital filtration as a set of *unarticulated* institutions contributes to the investigation of informal institution and historical institutionalism in the social sciences scholarship. To better convey this point, let us return to the ground-zero puzzle articulated in the Alibaba case in Chapter 1. In practice, the Chinese authority has a two-track treatment of foreign investment in the information sector, based on corporate identity (whether the company is Chinese-controlled) rather than simply geographic origin, and differentiates between non-Chinese-owned and -controlled industrial investors against “fake” foreign investors that are Chinese-owned and China-based acquiring ODFF under a foreign disguise. Then why not acknowledge the differential treatment officially, write this principle into law, or legally recognize the ODFF users as domestic companies formally?

The answer is twofold. One practical reason, as mentioned in Chapter 5, lies in the irreconcilable gap between the *de jure* WTO commitments that Beijing has made and its *de facto* interests. WTO agreements are lengthy and complex legal documents that govern a wide range of sectors, but “trade (in service) without discrimination” is one of the founding principles that Beijing had officially acknowledged, signed, and ratified. This principle requires signatory states to grant equal treatment to trading partners by treating them as co-nationals.⁴⁷ But international

⁴⁶ I thank Dr. Victor V. Ramraj for pointing out this “duplicability” question when reviewing my dissertation.

⁴⁷ See, World Trade Organization, “Principles of the trading system,” https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

exposure of and foreign footprint into a strategically and politically important sector such as the information services one could put the security of an authoritarian regime at stake. Under such circumstances, clear-headed political elites have decided to, as one Chinese idiom captures “overtly comply with but covertly oppose (*yangfeng yinwei*)” its multilateral commitments in order to produce their preferred political and economic outcomes.

In other words, the gap between the state’s formal and written commitment and its informal awareness, permission, and support of violation of these commitments are intentionally and meticulously maintained because harmonization in either direction makes party-state elites worse-off. Should Beijing formalize this nationalistic, protectionist, and unwritten *modus operandi* into law, it would be tantamount to a reckless, brazen, and open disregard and violation of the very official promises it made for the WTO membership -- a reputational, economic, and legal cost that Beijing finds unwise and unwilling to bear. In the other direction, regulating all sources of foreign investment equitably as formally stipulated means that Beijing will inevitably grant equal treatment between ODFD and other forms of capital entry, in particular FDI. This indiscriminatory approach will oblige Beijing to choose one of the two following scenarios. One option is to allow foreign investors to use China’s own financial markets or own and control their assets in their invested information companies. But doing so will enhance the bargaining power of cash abundant and technology savvy foreign industrial; risk this critical industry being foreign dominated; and challenge Beijing’s informational control. Alternatively, to maintain inward capital control and weed out foreign corporate influence, Beijing will have to turn its back against the financial and economic globalization and embark on a sectoral self-reliance and -sustenance in a North Korean style.

At an ontological level, the other more profound and theoretical reflection this project attempts to make is that state institutions are by no means “humanly devised *constraints* [emphasis added] that shape human interaction.”⁴⁸ Such conceptualization neglects the informal aspects of institutions. Rather, as some Global South-based studies have correctly argued, institutions are also the *enablers* of political actors’ behaviors.⁴⁹ This informality means that, as previous chapters have shown, state-designed institutions regulating foreign capital inflow have a tacit dimension which covers “proposition and opinions shared by a group and so obvious to it that they are never fully or systematically articulated.”⁵⁰

Admitting institutions’ enabling function for political actors help us to transcend the formal and informal dichotomy. As Kelle Tsai, a prominent scholar of informal institutions in China pointed out, “historical institutionalism has contributed significantly to our understanding of institutional development, but avoided direct theorization of informal institutions, even while specifying modalities of endogenous institutional change that occur through distinctly informal pathways and practices.”⁵¹ Such negligence of informal institutions is remedied by a wave of research work on the politics in the vast Global South where informal politics prevail. Two scholars thus viewed informal institutions as “socially shared rules... *outside* [emphasis added] of officially sanctioned channels and public eye”⁵² in the form of traditional culture, personal networks, or

⁴⁸ North, Douglas, *Institutions, Institutional Change, and Economic Performance*, Cambridge University Press, 1990, p.3.

⁴⁹ Helmke, Gretchen and Steven Levitsky. “Informal Institutions and Comparative Politics: A Research Agenda.” *Perspectives on Politics* 2, no.4 (2004): 725-740. Wu, Guoguang. *China’s Party Congress: Power, Legitimacy, and Institutional Manipulation*. Cambridge University Press. 2015.

⁵⁰ Hirschman, Albert. 1977. *The Passions and the Interests: Political Arguments for Capitalism before its Triumph*. Princeton: Princeton University Press. p.69.

⁵¹ Tsai, Kellee. “Informal institutions and historical institutionalism,” p.20 in Fioretos, Orfeo, Tulia Falleti, and Adam Sheingate (eds.) *The Oxford Handbook of Historical Institutionalism*, Oxford University Press, 2016.

⁵² In their enlightening research paper, Helmke and Levitsky designs a typology of informal institutions based on their effectiveness and convergence or the divergence from formal institutions. Helmke and Levitsky, “Informal Institutions and Comparative Politics: A Research Agenda,” p.727.

social norms. Even though, as China specialist Tsai insightfully pointed out, by tying informal rules' functionality to formal ones, informal institutions are assumed as "pathological" deviations from or "irregular" additions to formal rules that embody legal rationality, which puts informal institutions in an inferior position compared with formal ones.⁵³

Quite to the contrary, I have argued against such a dichotomous view of formality and informality with one side co-opting and encroaching the other in a sense that "institutionalization" equals more formality in form of black-letter laws and legislation. Informal institutions are by no means pathological deviations from or ancillary additions to formal rules.⁵⁴ Instead, informal institutions can also be part of a state-designed strategy in their own standing that serves to produce particular and preferred political and economic outcomes. In other words, state actors create, adopt, and nourish informal institutions when a gap exists between formal legal stipulations and their practical interests and desires.

The uneven weight given to formal institutions is largely a legacy from Global-North-based studies that find constitution and law as the embodiment of rationality.⁵⁵ But as I have shown, in post-socialist authoritarian China, rationality comes from self-interested political actors' cost-benefit calculation and their attempt to combine domestic and international factors to maximize their well-being. In this regard, in a reverse way, formal institutions become auxiliary and complementary to informal ones. When practical needs arise, written laws and legislation were selectively interpreted and referenced as justification of politically motivated actions against foreign investors.

⁵³ Tsai, "Informal Institutions and Historical Institutionalism." Wang, Hongying. *Weak States, Strong Networks: The Institutional Dynamics of Foreign Direct Investment in China*, Oxford University Press, 2001.

⁵⁴ Wang, *Weak States, Strong Networks: The Institutional Dynamics of Foreign Direct Investment in China*; Tsai, Kellee. *Back-Alley Banking: Private Entrepreneurs in China*. Cornell University Press. 2002.

⁵⁵ Helmke and Levitsky, "Informal Institutions and Comparative Politics: A Research Agenda."

This manipulative usage of formal institutions is tellingly revealed by Beijing's brutal ending of China Unicom's CCF joint venture projects in 1999 and 2000. As Chapter 3 has shown, in order to speed up the company's "Red Chip" listing that would bring ODFD, Chinese telecom regulators cited written policies prohibiting foreign operation and management of telecom assets in China as legal justification – the very black-letter rules that they allowed foreign industrial investors to bypass in the early days of Unicom's financial acquisition from 1995 to 1997. Another relevant situation refers to the moment when Ministry of Post and Telecommunication (MPT) tried to transfer Guangdong Mobile's provincial cellular assets to the central government's coffer at the eve of China Mobile's IPO in 1997. Minister Wu Jichuan cited an outdated written policy and accused the Guangdong provincial government of its "wrongdoing" and "irregularity" in provincializing telecom assets without MPT's approval in the early 1990s. Ironically, in both cases, written policy documents were interpreted at will by the very people who had acquiesced to their contraventions in the first place.

Arguably, in any human society, rules are not rigidly pre-written, unchangeably implemented, and statically followed like a computer program. Rather, for any rule, there is always leeway for human interpretation. Political actors' interpretation and action further shape behaviors.⁵⁶ Formality and informality do not interact in a zero-sum dynamic with one co-opting, encroaching, or excluding each other. Rather, functionally they constitute and reinforce each other as integral components of a grand strategy and help political actors to achieve goals that are unattainable or even unthinkable if only one is adopted. Although formal institutions may change significantly in

⁵⁶ For ground-breaking research on the relationship between formal institutions and informal politics, see Wu Guoguang, *China's Party Congress: Power, Legitimacy, and Institutional Manipulation*. Cambridge University Press, 2015.

the short or mid term – as evidenced by China’s WTO accession and later relaxations of foreign equity cap -- informal institutions are more resilient, thus resistant to change.

7.4 A Future Direction in Investigating State-Firm Relationship: Party Organizations inside Chinese Internet Firms

This project has demonstrated the foreign capital acquisition and corporate structure dimension in terms of Beijing’s authoritarian control over telecom and Internet firms. Another research angle from which to explore the party state’s insertion into and control of Internet firms is the role of CCP party organizations that are established *inside* Internet firms.⁵⁷ The function of the party committee in state-owned enterprises (SOEs) is well studied in the extent literature.⁵⁸ However, an intriguing question and salient issue relates to the organization, roles, and functioning of the CCP in these younger, smaller and higher tech Internet firms with scant state ownership. Western media reports have revealed this issue and highlighted its importance.⁵⁹ It is found that along with their growth and expansion, many Chinese Internet companies have upgraded their

⁵⁷ According to Article 30 of the CCP Charter, a grassroots-level Party organization (*jiceng zuzhi*) shall be set up in any units such as enterprise, villagers’ committee, government organ, school, research institute, subdistrict and community, social organization, and the Army’s company if there are a minimum of three CCP members. And whether the grassroots-level organization is committee (*weiyuanhui*), general branch (*zong zhibu*), or branch (*zhibu*) depends on two factors: the number of party members and work-related needs. Normally, a party committee would be organized if there rare more than 100 party members in this unit; a general branch would be set up if CCP members range between 50 and 100; and a branch would be built if party members are more than 3 but fewer than 50. However, this norm could be broken with approval from superior CCP organizations. The State Council, “Zhonggong Zhongyang Yinfa ‘Zhongguo Gongchandang he Guojiajiguan Jiceng Zuzhi Gongzuo Tiaoli,’” [The CCP’s Central Committee Issued ‘Rules for the CCP and State’s Grassroot Organizations’], http://www.gov.cn/zhengce/2020-01/05/content_5466685.htm, published January 5, 2020, accessed May 05, 2022. Xinhua, “Constitution of the Communist Party of China,” http://www.xinhuanet.com/english/download/Constitution_of_the_Communist_Party_of_China.pdf, revised and adopted on October 24, 2017, accessed May 05, 2022.

⁵⁸ See, for instance Leutert, Wendy and Samantha Vortherms. “Personal Power: Governing State-Owned Enterprises.” *Business and Politics* 23, no.3 (2021):419-437; Leutert Wendy, “The Political Mobility of China’s Central State-Owned Enterprise Leaders.” *The China Quarterly* 233, (2018):1-21; Leutert, Wendy. “Firm Control: Governing the State-Owned Economy Under Xi Jinping.” *China Perspectives*, no.1/2 (2018):27-36.

⁵⁹ See, for instance, Feng Ashley, “We Can’t Tell if Chinese Firms Work for the Party,” *Foreign Policy*, <https://foreignpolicy.com/2019/02/07/we-cant-tell-if-chinese-firms-work-for-the-party/>, published February 07, 2019, accessed July 17, 2021. Jun, Chauncey. “What Communists Do in China’s Tech Companies,” *Inkstone*, <https://www.inkstonenews.com/opinion/chauncey-jung-what-communists-do-chinas-tech-companies/article/2176349>, published December 4, 2018, accessed March 15, 2021.

CCP (general) branches (*dang zhibu*) to party committees (*dang wei*).⁶⁰ Until 2018, according to Cyber Administration of China (CAC), China's top 100 Internet companies have "widely set up party organizations," and in recent years, according to Beijing's Internet Association, a government-organized and -affiliated non-profit organization, "Internet companies' consciousness in party-building is increasingly high, with firms applying for party organization inside the company almost every week."⁶¹

The CCP's weight inside a company is reflected by the hierarchical position of the party committee in the entire corporate structure. In Tencent, the party committee exerts a vertical control (*chui zhi guan li*) over ordinary party members. One research has found that for Chinese Internet companies, it is common that the companies' party bosses are also the corporate executives who are in charge of governmental affairs.⁶² In Tencent, Guo Kaitian, the party committee's general secretary, is also one of the vice presidents overseeing daily administration, legal affairs, and government relations. The remaining ten party committee members are either chief executives or departmental heads, out of which three deputy secretaries are concomitantly

⁶⁰ For instance, Tencent was founded in 1998. The Party branch was first established in 2003 with dozens of party members. In 2011 it was upgraded to CCP committee, which was affiliated to the Party Committee of Nanshan District of Shenzhen. As of September 2018, Tencent's CCP committee counted 13 general branches and 226 branches with more than 10,962 CCP members. Ma, Ningning and Bingqian Xu, "Rengong Zhineng, Duanshipin, Zhibo Gongzhu 'Zhijianshang de Dangjian'," [Artificial Intelligence, Short Video Clips, Live Stream Together Help 'Party Building on Finger Tips'], *Nanfang Dushi Bao*, https://news.southcn.com/node_17a07e5926/b35970c0f3.shtml, published and accessed June 24, 2021. Shoudu Hulianwang Xiehui Dangwei, "Kan Hulianwang Qiye Ruhe Chuangxin Dangjian Gongzuo," [A Glimpse at How Internet Companies Innovate in Party Building,] http://www.cfis.cn/2018-10/09/c_1123533409.htm, published October 09, 2018, accessed March 20, 2021; Cyber Administration of China, "Guangdong Tuidong Xingcheng Qizhua Gongguan Hulianwang Dangjian Gongzuo Xinggeju," [Guangdong Promotes a new All-Round E-Party Building Structure,] http://www.cac.gov.cn/2018-09/26/c_1123484258.htm, published September 26, 2018, accessed March 19, 2021.

⁶¹ Liu, Yun. Zhongfa Sun, "Woguo Hulianwang Qiye Yongdong 'Dangjianchao'," [A Wave of 'Party Building' Surges inside Chinese Internet Firms,] *Zhongguo Zuzhi Renshi Bao*, <http://www.zuzhirenshi.com/dianzibao/2018-03-26/1/c2694936-0c50-4a37-a4bc-b000da0ae751.htm?from=singlemessage>, published March 26, 2018, accessed March 17, 2021.

⁶² *Sohu*, "Nianxin Zuigao 64 Wan, Wangyi, Baidu, Didi Mianxiang Zhonggong Dangyuan Zhaopin Dangjian Jingli," [Annual Salary RMB 640,000, NetEase, Baidu and Didi Recruit Party Building Managers from CCP Members,] https://www.sohu.com/a/279674663_100000264, published December 04, 2018, accessed March 19, 2021.

vice presidents or general managers who oversee the companies' information security, Internet and media, and public relations. Such cross-appointment serves as the foundation of a "deep integration" between party building and corporate business.⁶³ The fact that the vice president overseeing Tencent's Internet services is concomitantly the deputy secretary of the company's party committee worked to guarantee that all Tencent-owned platforms, including QQ and WeChat that hosted over a billion users, "firmly spread the voice of the party and the government; positively advocate[d] socialist core values' correctly guide[d] public opinion; and foster[ed] positive Internet culture."⁶⁴

Sporadic evidence has also shown the party committees' roles inside Chinese Internet companies. For instance, under the party committee's leadership, Weibo – China's Twitter copycat – has set up a public opinion evaluation task force (*yuqing yanpan xiaozu*), which "meets weekly in order to timely discover and handle negative opinions in order to create a fresh cyber space."⁶⁵ The party committee in Baidu.com – China's Google wannabe – has assigned "technicians with CCP membership to take responsibility over certain core technological positions, thus making the positions safer and more reliable." Similarly, under the leadership of CCP committee inside the company, JD.com has organized a 200-member data security squad, all of whom are party members.⁶⁶ Over the years under the party's banner, this data security squad "has cleaned politically sensitive, violent, terrorist, pornographic information; screened 52.76 million user comments; added 1809 sensitive words to the system; and largely reduced the circulation of illegal and bad information."⁶⁷

⁶³ Liu, Yun. "Teng Xun: Dang 'Qiye' Daishang Danghui," [When the Penguin Bears the Party Symbol,] *Zhongguo Zuzhi Renshi Bao*, <http://zuzhirenshi.com/showinfo/4f235f23-b48c-4952-9cd7-0593de0420b7>, published March 29, 2018, accessed March 19, 2021.

⁶⁴ Ibid.

⁶⁵ Liu, "Woguo Hulianwang Qiye Yongdong 'Dangjianchao'."

⁶⁶ Shoudu Hulianwang Xiehui Dangwei, "Kan Hulianwang Qiye Ruhe Chuangxin Dangjian Gongzuo."

⁶⁷ *Renmin Wang*, "Jingdong Jituan Dangwei Shuji, Fuzongcai Long Baozheng: Dandang Dangzuzhi de Shidai

All in all, if more systematic studies can reveal how the party-state infiltrates this burgeoning and globalized sector *organizationally* through CCP organs,⁶⁸ then they can complement existing literature on the repertoire of authoritarian control over the private sector.⁶⁹

7.5 The Neo-triple alliance in the Shadow of Sino-American Rivalry: A New Variant of Capital Filtration?

So what about the sustainability and future of capital filtration as a strategy of China's globalizing information industry and the viability of the transnational neo-triple alliance that I have identified? In fact, the fate of whether China-based and Chinese-controlled companies could obtain ODFD is inseparable from political maneuvers in and the augmenting hostility between Beijing and Washington D.C. On the Chinese side, since 2020 the paramount leader Xi Jinping has launched waves of assault on the Internet sector, leading to a flurry of allegations such as antitrust offenses, data violations, and capital expanding from a disorderly fashion (*ziben wuxu kuozhang*) associated with service suspensions and exorbitant fines that costed investors around US\$ 1 trillion.⁷⁰ Such moves definitely hurt the transnational financial elites and the China-based

Shiming, Yinling Minying Qiye Jiankang Fazhan," [Jingdong's Part Secretary and Vice President Long Baozheng: Undertaking The Party Organization's Missions, Leading Private-owned Firms's Healthy Development,] reposted by All-China Federation of Industry and Commerce, http://www.acfic.org.cn/zsjg_327/nsjg/jjb/jjbgzhdzt/2018my5bq/2018my5bq_dj/201808/t20180830_55673.html, published August 30, 2018, accessed March 20, 2021.

⁶⁸ Yan, Xiaojun and Jie Huang, "Navigating Unknown Waters: The Chinese Communist Party's New Presence in the Private Sector," *The China Review*, Vol. 17, No. 2, June 2017, pp.37-63; Zhang, Han. 2015, "Party Building in Urban Business Districts: Organizational Adaptation of the Chinese Communist Party," *Journal of Contemporary China*, 24:94, 644-664.

⁶⁹ Additionally, extant literature has predominantly looked the issue of authoritarian infiltration of non state-owned enterprises through the lens of public-entrepreneur relationship, thus emphasizing issues such as the personal patron-client relation and businessmen holding positions in China's rubber stamp parliaments. See, for instance, Wank, David. *Commodifying Communism: Business, Trust, and Politics in a Chinese City* (New York: Cambridge University Press, 1999); Pearson, Margaret, *Chinas New Business Elite: The Political Consequences of Economic Reform* (Berkeley: University of California Press, 1997), Dickson, Bruce. *Red Capitalists in China: The Party, Private Entrepreneurs, and Prospects for Political Change* (New York: Cambridge University Press, 2003); Dickson Bruce, *Wealth into Power: The Communist Party's Embrace of Chinas Private Sector* (New York: Cambridge University Press, 2008). Holbig, Heike. "The Party and Private Entrepreneurs in the PRC," *Copenhagen Journal of Asian Studies*, Vol. 16 (2006), pp. 30-56; Hou, Yue. *The Private Sector in Public Office: Selective Property Rights in China*, Cambridge University Press. 2019.

⁷⁰ For more information, see a special report, The Economist, "Xi Jinping's Assault on Tech Will Change China's Trajectory," <https://www.economist.com/leaders/2021/08/14/xi-jinpings-assault-on-tech-will-change-chinas->

companies that they put money into. It is beyond this project's scope and mission to fathom the motivations behind this crackdown and the exact costs incurred. However, so far it can be observed that VIE as a funding source for Chinese Internet companies is left untouched. Put differently, although its regulatory actions might have shooed some foreign financial investors away and destabilized the alliance, Beijing does not intend to upend ODFF usage.

We can observe two regulatory signals from recently released policies in 2021. One trend is the Chinese regime's intention to tighten control over electronic *data* that are managed by the VIE users, which accordingly, takes the regulatory power from the Ministry of Industry and Information Technology (MIIT) to CAC. More precisely, the amended "*Cybersecurity Review Measures*", effective from February 2022, stipulated that Internet platforms with more than 1 million users must undergo an additional security approval conducted by CAC or its regional affiliates, with submission of the IPO prospectus and a revaluation report on impact on national security.⁷¹ The two more detailed data security-related drafts, released for public comments in October and November 2021 respectively,⁷² served to clarify CAC's extended power of cyber security examination by demanding that Chinese firms apply for a cyber security review with CAC or its local affiliates when merging, acquiring, or spinning off assets; when initiating IPOs outside China if they handle more than 1 million users' data; and when seeking IPOs on Hong Kong exchange. Moreover, CAC also demands Internet companies who would set up headquarters, operation centres, R&D centres overseas to report to the administration or any supervisory

[trajectory](#), published and accessed August 14, 2021.

⁷¹ Cyber Administration of China, "Wangluo Anquan Shencha Banfa," [Measures for Cybersecurity Review,] Article 7 and 8, http://www.cac.gov.cn/2022-01/04/c_1642894602182845.htm, released and accessed January 4, 2022.

⁷² In October and November 2021, CAC respectively released preliminary drafts of "Measures on Security Assessment of Cross-border Transfer of Personal Information" and "Measures for Cyber Data Security."

ministries beforehand. In this regard, CAS has eclipsed MIIT as the primary regulator of the informational services sector.

On the financial front, recent policy changes showed Beijing's continued *endorsement* instead of repression of ODFF. In December 2021, the State Council released a draft of measures regulating China-based and Chinese-controlled firms' indirect IPO and securities issuance overseas and sought public opinions.⁷³ Concomitantly, the China Securities Regulatory Commission (CSRC) released more detailed administrative measures.⁷⁴ Notably, neither document attempted to limit, let alone shut down ODFF that have been nourishing China-based and Chinese-controlled companies for over two decades. Rather, they represent CSRC's power gain vis-à-vis VIE-structured listing that it has long sought for. For instance, the State Council document stipulated that the definition of "domestic firms' indirect foreign listing (*jingnei qiye jingwai jianjie faxing shangshi*)" would be stipulated by CSRC.⁷⁵ CSRC inherited the spirit of "substance outweighs formality (*shizhi dayu xingshi*)" – one that has been used universally by various ministry-level regulators in telling "fake" VIE-structured and Chinese controlled foreign investors from non-Chinese-owned- and -controlled ones. The criteria proposed by CSRC -- those whose revenue, profits, (net) assets in Mainland China comprise more than 50% of total; and the managerial personnel or chief executives are mainly Chinese citizens or frequently reside inside China; and the business activities mainly take place in Mainland China -- indicated that it still

⁷³ China Securities Regulatory Commission (CSRC), "Guanyu jiu 'Guowuyuan Guanyu Jingnei Qiye Jingwai Faxing Zhengquan he Shangshi de Guanliguiding (Cao'an Zhengqiu Yijiangao) Gongkai Zhengqiu Yijian de Tongzhi'," [Notification on CSRC Openly Seeks Opinions on the State Council's Draft of Administrative Measures regarding Domestic Firms Issuing Securities Outside China,]

<http://www.csrc.gov.cn/csrc/c101981/c1662244/content.shtml> , released and accessed December 24, 2021.

⁷⁴ CSRC, "Guanyu 'Jingnei Qiye Jingwai Faxing Zhengquan he Shangshi Bei'an Guanli Banda (Zhengqiu Yijian Gao) Gongkai Zhengqiu Yijian de Tongzhi'," [Notification on Seeking Public Comments on the Draft of Record Filing Measures of 'Domestic Firms Issuing Securities Outside China'],

<http://www.csrc.gov.cn/csrc/c101981/c1662251/content.shtml>, released and accessed December 24, 2021.

⁷⁵ Ibid. Article 2.

equivocated over the VIE's legality issue. CSRC would handle VIE-structured indirect listing on a case-by-case manner, and recognize contractual arrangements as a form of corporate control.⁷⁶ It even openly stated in a press conference that VIE-structured firms could initiate their overseas IPO, but only after filing with CSRC.⁷⁷

In other words, the overall regulatory gist and pattern shared among various ministries is that China-based and Chinese-controlled firms' indirect foreign listing is unchanged: the sectoral supervising and regulating ministries' approval must be obtained, and non-Chinese investors must be passive investors who do not participate in corporate management.⁷⁸ Furthermore, CSRC managed to insert itself into the regulatory framework of VIE and substituting NDRC and MoFCOM in dominating the VIE-approval and governance. In the words of a veteran VIE analyst and lawyer who provide corporate restructure and IPO services, "whether [a filed indirect listing request is] regular or irregular is first decided by the ministries overseeing the applicant's industrial sector, and CSRC will file and approve if the supervisory ministries nod, and vice versa."⁷⁹

Another possible challenge to the stability of neo-triple alliance could come from a foreign state actor, in particular the U.S. Recent U.S. policies that aim to tighten regulations over the foreign listed companies could hurt Chinese information companies' ODFI acquisition. The "*Holding Foreign Companies Accountable Act*," signed into law in December 2020, could make their listing on American exchanges more difficult. In fact, the Chinese authority had long been

⁷⁶ Ibid. Article 23.

⁷⁷ CSRC, "Zhengjianhui Youguan Fuzeren Dajizhewen," [Responsible Persons from CSRC Answers Journalists' Questions,] <http://www.csrc.gov.cn/csrc/c100028/c1662240/content.shtml>, published and accessed December 24, 2021.

⁷⁸ National Development and Reform Commission, "Waishang Touzi Zhunru Tebie Guanli Cuoshi (Fumian Qingdan) (2021Ban)," [The 2021 Version of Special Administrative Measures for the Market Entry of Foreign Investment (Negative List)], <https://zfxgk.ndrc.gov.cn/web/iteminfo.jsp?id=18589>, released and accessed December 27, 2021.

⁷⁹ Li, Shoushuang, "Xinguizhixia de VIE: Yidao Sikai feikai de Men," [VIE under New REgulatory Rules : A Seemingly Opened Door,] *Caixin* Blog, <https://opinion.caixin.com/2021-12-29/101823429.html>, published December 29, 2021, accessed March 23, 2022.

preventing America's Public Company Accounting Oversight Board (PCAOB) from conducting auditing inspections on China-based and Chinese-controlled companies listed on American stock markets, with a pretext of national security protection.⁸⁰ Such lack of American regulatory oversight had caused some high profile financial fraudulent cases that involved China-based and Chinese-controlled assets listed on American stock exchanges, with the most recent Luckin Coffee one in 2020.⁸¹ Against this backdrop, the Act imposed a more stringent requirement on information disclosure and demanded that foreign companies hampering PCAOB from conducting inspections and auditing work for three consecutive years be banned from trading on U.S. stock exchanges.⁸² Moreover, Washington D.C. has forbidden certain U.S.-based financial investors from pouring money into overseas listed Chinese information companies, in particular state-owned and -controlled ones. For instance, under the federal government's direction, a retirement savings fund for American federal employees and military personnel already halted investing into Chinese companies that supported Chinese military, citing national security and investment risks.⁸³

However, such measures had an immediate yet moderate impact on ODFD acquisition in the "Red Chip" style. In March 2021, China Mobile, China Unicom, and China Telecom, the three state-owned telecom firms which issued American Depositary Receipt (ADR) on NYSE, were delisted from the U.S. stock markets following the president's executive order because of their

⁸⁰ Yue, Yue. "Shenji Digao de 'Mimi'," ["Secrets" in the Auditing Papers,] *Caixin Weekly*, <https://weekly.caixin.com/2022-03-19/101858171.html>, published and accessed March 21, 2022.

⁸¹ Another powerful tool refers to the Entity list upgraded by the U.S. Department of Commerce's Bureau of Industry and Security. By imposing licence requirements on listed entities, the American government restricts U.S. companies and persons from trading with the listed companies. As this project focuses on informational services, so the companies under investigation do not normally apply to this list. For more information, see, Bureau of Industry and Security, "Entity List," <https://www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern/entity-list>

⁸² Pisani Rob, "SEC Finalizes Rule that Allows it to Delist Foreign Stocks for Failure to Meet Audit Requirements," *CNBC*, <https://www.cnbc.com/2021/12/02/sec-issues-final-regs-that-allow-it-to-delist-foreign-companies-that-dont-comply-with-audit-rules.html>, published and accessed December 2, 2021.

⁸³ Franck, Thomas. "White House Directs Federal Pension Fund to Halt Investments in Chinese Stocks," *CNBC*, <https://www.cnbc.com/2020/05/12/white-house-directs-federal-pension-fund-to-halt-investments-in-chinese-stocks.html>, published May 12, 2020, accessed March 22, 2021.

“wayward” development and usage of surveillance technology in and outside China to inflict human-rights abuses and violate international treaties.⁸⁴ However, the delisting did not mean the end of the “Red Chip” variant of capital filtration and ODFF acquisition, because the telecom Big Three’s issuance on American stock markets was negligible; comprising 2.2%, 1%, and 0.57% of their total issued shares.⁸⁵ Instead, the vast majority of their shares are traded on the HKSE, and global investors, of course including American ones, could continue to hold their shares by exchanging them with the ones listed in Hong Kong.⁸⁶ In other words, as long as Hong Kong remained an open global financial hub, ODFF could still flow into Chinese information companies. Accordingly, whether the Sino-U.S. confrontation will spill over into Hong Kong’s financial markets is something that deserves to be watched closely.

Another question is whether a fourth variant of capital filtration could emerge in the future. With the souring bi-lateral relationship between Beijing and Washington D.C. and the difficulty of raising capital from U.S. securities market, in addition to the uncertainty over Hong Kong as an alternative, the neo-triple alliance is also looking at China’s domestic financial markets. In 2020, Beijing removed equity barriers for foreign financial companies operating in future goods, securities, and asset managements to operate inside China. Goldman Sachs, a key player in helping the Chinese regime in designing and promoting ODFF, immediately bought out the joint venture

⁸⁴ The White House, “Executive Order of Addressing the Threat from Securities Investments that Finance Certain Companies of the People’s Republic of China,” <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/06/03/executive-order-on-addressing-the-threat-from-securities-investments-that-finance-certain-companies-of-the-peoples-republic-of-china/>, released and accessed June 03, 2021.

⁸⁵ He Shujing, Caiping Liu, and Min Tan, “Zhongguo Dianxin Zhonghui A-gu,” [China Telecom Finally Returns to A-share Market,] *Caixin*, <https://weekly.caixin.com/2021-03-13/101674841.html>, published and accessed March 15, 2021.

⁸⁶ Barrett, Eamon, “The NYSE is set to delist 3 Chinese companies – but U.S. investors can still own shares,” *Fortune*, <https://fortune.com/2021/01/04/nyse-delist-chinese-companies-shares-investors/>, published and accessed January 4, 2021. After being delisted in the U.S. China Mobile initiated its domestic IPO in January 2022 in Shanghai raising an equivalent of US \$ 8.8 billion. Wang, Yidan, “Zhongguo Yidong Agu Shangshi Shouri Dazhang,” [China Mobile’s Share Price Spiked after IPO on China’s A-Share,] *Wall Street Journal*, <https://cn.wsj.com/articles/%E4%B8%AD%E5%9B%BD%E7%A7%BB%E5%8A%A8%E8%82%A1%E4%B8%8A%E5%B8%82%E9%A6%96%E6%97%A5%E5%A4%A7%E6%B6%A8-11641352243>

that it formed inside China for 17 years, completely owned and controlled it, and renamed it Goldman Sachs (China) Securities. Global North-based investment banks all lined up and increased their investment in China,⁸⁷ expecting to tap into China's domestic IPO underwriting and bonds and stocks trading market. So will Beijing's recent friendly gesture of courting transnational financial elites and strengthening this alliance somehow translate into a fourth variant of capital filtration? The answer can only be found by tracing how the three partners realign their strategic interests.

In the 1960s, when proposing policy prescriptions for the vast underdeveloped world to become rich, autonomous, and prosperous, scholars from the dependency school had advocated a "delinking" from a subordinate relationship with the capitalist Global North.⁸⁸ Ironically, around half a century latter, Donald Trump, the president of the U.S. -- the most powerful capitalist state in the world -- has used a synonym when proposing his idea of severing the U.S. economic relationship with China, the world's largest developing country.⁸⁹ The rosy outlook at the turn of the century and on the eve of China's WTO accession – as evidenced by former president Bill Clinton's optimistic claim that "[China trying to crackdown on Internet is] sort of like trying to nail jello to the wall"⁹⁰ – was smashed by the rise of a resilient, powerful, confident, and assertive

⁸⁷ See, for instance, Liu, Ruiyi. "Konggu Quanshang Zengzhi 9jia, 21jia Waizi Beijing Quanshang Paidui 'Houchang'," [Number of Foreign-controlled Securities Firms Increased to 9, 21 More with Foreign Background "Lining Up" For Entry,] *Zhengquan Ribao*, <http://www.news.cn/money/20211228/d5fb640fb11e47798521160a0850000b/c.html>, published and accessed December 28, 2021; *Reuters*, "Morgan Stanley nears full ownership of China ventures with stake buys," <https://www.reuters.com/business/finance/morgan-stanley-nears-full-ownership-china-ventures-with-stake-buys-2021-05-28>, published and accessed May 28, 2021.

⁸⁸ Amin, Samir, "A Note on the Concept of Delinking." *Review - Fernand Braudel Center for the Study of Economies, Historical Systems, and Civilizations*, no.3 (1987):435-444.

⁸⁹ On June 18 2020, on this personal Twitter account, U.S. president Donald Trump commented on the tension with Beijing by stating "a complete decoupling [emphasis added] from China. Wingrove Josh, "Trump tweets 'complete decoupling from China' remains an option," *Bloomberg*, <https://www.bnnbloomberg.ca/trump-says-complete-decoupling-from-china-remains-an-option-1.1452779>, published and accessed June 18, 2020.

⁹⁰ *New York Times*, "Full Text of Clinton's Speech on China Trade Bill", <http://movies2.nytimes.com/library/world/asia/030900clinton-china-text.html>, posted March 9, 2000, assessed

regime. China's political elites have not only successfully parlayed foreign capital into a world-class and domestically-controlled information industry, but also skillfully maintained an ironclad control over the flow and dissemination of informational content. Far more ambitious than these achievements, they have embarked on exporting this governance model elsewhere across the world⁹¹ and calling for the construction of a “community with a shared future for mankind (*renlei mingyun gongtongti*)”.⁹²

Ultimately, this project does not mean to give credit to the strategy of capital filtration or the formation and maintenance of the new triple alliance. It tries only to demonstrate that expecting capitalist globalization and information technology to make a hardcore and control-maniac authoritarian regime less repressive or even more democratic is nothing but wishful thinking and naïve illusion.

September 24, 2019.

⁹¹ Edelm Charles and David Shullman, “How China Exports authoritarianism,” *Foreign Affairs*, <https://www.foreignaffairs.com/articles/china/2021-09-16/how-china-exports-authoritarianism>, published and accessed September 16, 2021.

⁹² The idea was first openly elaborated on foreign occasion during Xi's keynote speech at the Palace of Nations in Geneva on January 18 2017. Xi Jinping, “Gongtong Goujian Renlei Mingyun Gongtongti,” [Join Hands to Build a Community with a Shared Future for Mankind,] <http://cpc.people.com.cn/n1/2017/0120/c64094-29037658.html>, published January 18, 2017, accessed March 24, 2021.

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