Telecommunications Policy 36 (2012) 929–942

Contents lists available at SciVerse ScienceDirect

Telecommunications Policy

URL: www.elsevier.com/locate/telpol

Deconstructing the myth of Alipay Drama—Repoliticizing foreign investment in the telecommunications sector in China

Wei Shen*

Shanghai Jiao Tong University Law School, 800 Dongchuan Road, Minhang District, Shanghai 200240, China

ARTICLE INFO

Available online 13 November 2012

Keywords:
Foreign investment
Alipay dispute
VIE structure
Regulations
Political economy analysis

ABSTRACT

Alibaba's dispute with Yahoo and Softbank over Alipay's ownership in 2011 again brought China's telecoms law and foreign investment policies into the spotlight. Although China has officially opened up its telecoms services sector to foreign investors according to its WTO Agreement, foreign investors are still experiencing various difficulties when they enter the Chinese market. Recent years have witnessed some new regulatory movements tackling the variable interest entity structure (or the VIE structure) adopted by foreign investors in investing into China's telecoms industry. This article reviews the VIE structure and Chinese regulatory counter measures, and offers a political economy insight to Chinese telecoms policy changes. In addition, the article attempts to review the struggles between regulators and regulatees in the business community through the lens of economic regulatory/development model with Chinese characteristics.

1. Introduction

The People's Republic of China (PRC or China) became the second largest economic power in the world in 2010 (Pilling, 2010). As the world's fastest-growing and most populous telecommunications and Internet market, in the first three quarters of 2011, China's overall telecoms business revenues reached RMB 734.26 billion (MIIT, 2011), which not only attracts foreign investors to invest and but also motivates Chinese entrepreneurs to capitalize on the foreign funding (Einhorn, 2000).

In spite of China's promise to open itself more in its telecoms industry to foreign investors as per a fixed schedule, foreign investors still encounter various difficulties in practice. As a result, foreign investors continuously make great efforts to rely upon creative transactional models to have a bite of China's lucrative telecoms sector, which in turn attracts increasingly strong regulatory opposition. The struggle between the regulator and the regulated deserves some attention not only because foreign investors need to work out reliable and feasible transactional models to access Chinese market but also that the struggle reflects the problematic sides of industrial regulation and its underlying rationale, which is opposite to the unbundling or deregulatory trend in the telecoms sector in other jurisdictions (Baldwin, Cave, & Lodge, 2012), and, deep down, demystifies the extent to which the Chinese government is committed to the rule of law in its governance.

The article is structured as follows. Section 2 briefly examines China's telecoms laws and policies relating to foreign investment in the 21st century. Section 3 discusses the use of the VIE structure by foreign investors in order to circumvent restrictive Chinese laws governing foreign investment in the telecoms sector. This part also looks into the recent dispute among Alibaba, Yahoo and Softbank over Alipay as a case study and assesses the legality and enforceability of the VIE structure. Some measures taken by the government in tackling the VIE structure are also discussed in this part. Section 4 offers

* Tel.: +86 13122037971.
E-mail address: shenwill2@gmail.com

0308-5961/$ - see front matter
http://dx.doi.org/10.1016/j.telpol.2012.08.008

the rationale for policy intervention with the VIE structure. The policy considerations are grouped under the headings of economic, industry specific and political perspectives. Section 5 discusses the general defects in China's regulatory system and explains the reasons why the business community is discontent with the regulatory regime in China. A tentative conclusion will be followed in Section 6 with a purpose of envisaging possible evolutions in years to come.

2. China's telecoms regulatory regime after its WTO's accession

China's accession to the World Trade Organization (WTO) on 11 December 2001 marked a new chapter of foreign investment in China. The significance of this event was to outline a legally binding roadmap for China to further liberalize and modernize its economy and foreign investment regime. As a result, many restrictions on foreign investment were removed, the principle of national treatment was more extensively implemented, and the regulation and supervision of foreign investment activities were more subject to legal rather than administrative means. However, those rules and regulations in relation to the telecoms industry largely remained unchanged and the administrative supervision and interference was and is still the habitual practice of the government.

Upon its accession to the WTO, China was obligated to open to foreign investment some sectors of its economy that were previously closed. Telecoms industry was one of those. Under China's WTO Agreement, foreign investors shall immediately be allowed to acquire up to a 25% equity in telecoms businesses. This ratio would be increased to 49% within three years after China's accession to the WTO. China also agreed that foreign businesses would be permitted to operate inter-city networks meaning that foreigners would no longer be limited to furnishing operational activities in China's urban areas. In addition, China promised to open its leased-line services market. Since then the State Council, China's cabinet, has introduced a number of regulations on the administration of foreign-invested telecoms enterprises allowing joint ventures to invest and conduct activities in a broad range of areas which are to be phased in over a period of years. The most influential legislation relating to foreign investment in China's telecoms industry is the Regulations for the Administration of Foreign-Invested Telecommunications Enterprises (the Foreign Invested Telecoms Regulations), issued by the State Council on 11 December 2001 and further amended on 10 September 2008, according to which the ultimate foreign equity ownership in a value-added telecoms services business must not exceed 50%.

Nevertheless, in practice, it has been extremely difficult for foreign-invested enterprises (FIEs) to obtain telecoms operating licenses even though the foreign equity is less than 50%. Based upon this author's anonymous enquiries to MIIT (Ministry of Industry and Information Technology, the successor of the Ministry of Information Industry, MII), practically speaking, the MIIT has rarely approved an application for foreign investment into a PRC telecoms business. It was reported that until 2008 China had granted 22,000 telecoms operating licenses but only 7 of them were granted to FIEs (Kong, 2008). Table 1

Table 1
List of key regulations in the 21st century imposing restrictions on foreign investment in the telecoms sector.

Key regulations	Time	Key restrictions
PRC regulations of telecommunications	25 Sep 2000	Specific procedures for investing and operating in the telecoms business in the PRC by foreign organizations or individuals as well as organizations or individuals of Hong Kong, Macao and Taiwan shall be separately formulated by the State Council.
Administrative measures for telecommunications business operating licenses	Promulgated on 26 Dec 2001, amended on 1 March 2009	An e-commerce service provider must obtain an inter-province value-added operating license, which is issued by the MII, in order to provide wireless value-added services on a national basis; or an intra-province value-added operating license to provide such services within a province.
China's WTO agreement	11 Dec 2001	Foreign investors shall immediately be allowed to acquire up to a 25% equity in telecoms businesses. This ratio would be increased to 49% within three years after China's accession to the WTO.
Regulations for the administration of foreign-invested telecommunications enterprises	Promulgated on 11 Dec 2001 and amended on 10 Sep 2008	The ultimate foreign equity ownership in a value-added telecoms services business must not exceed 50%.

*Complied by the author.

3. VIE structure—Deconstructing the myth of Alipay drama

3.1. How and why is a VIE structure used?

Foreign investors have worked out an artful transactional model – the VIE structure, – to participate in Chinese telecoms industry while enjoying various tax, regulatory and legal benefits, among others, probably most importantly, avoiding regulatory restrictions that prohibit foreign investment from being involved in the sector.[1] Many China-based

[1] Notice on Strengthening the Administration of Foreign Investment in the Operation of Value Added Telecoms Services (issued by MII in 2006).