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# Market performance of Chinese telecommunications: new regulatory policies

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## Abstract

The structure, conduct, and performance of Chinese telecommunications are analyzed to determine reform's impact on policy objectives. Recent performance suggests that a more comprehensive reform is needed. However, China's fragmented policy environment makes large-scale reform difficult. Further deregulation of the telecommunication industry requires several related initiatives: reduction of entry barriers, creation of a universal service fund (to defuse stakeholder concerns regarding access), and formation of a cross-sector antitrust regulatory agency (with a special interest in promoting competition where feasible). While these policies could further complicate decision making in a fragmented institutional environment, each initiative is directed at neutralizing powerful stakeholders who can block or delay reform.

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## 1. Introduction

Recent reforms in Chinese telecommunications have led to significant capacity investment, which has promoted service expansion and the introduction of new technologies. However, improved sector performance requires changes in industry structure and incumbent behavior. The next stage of policymaking requires a coordinated approach that addresses three major problems.

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The first problem is a market structure with substantial incumbent market power. When an incumbent exercises market power, telecommunications customers face high prices and a narrow range of service options. The second problem in China is one of cross-subsidies: from the telecom sector to postal services and from urban to rural areas. Future claims on subsidies will come from citizens in some rural areas who are not served by telecommunications companies at present. The current system of regulatory taxation creates constituencies who wish to maintain entry barriers and protect transfers to rural areas.<sup>1</sup> The third problem involves anticompetitive behavior by an incumbent. Predatory actions and interconnection delays harm entrants and ultimately limit consumer choice. Stakeholders benefiting from current arrangements support high entry barriers and a de-emphasis of multiple centers of initiative. A new cross-sector antitrust authority would be a powerful advocate for remedies and reforms to promote telecommunications competition.

A framework for analyzing policy initiatives is presented to demonstrate that the three problems cannot be dealt with in isolation. China's reform experience to date has brought lessons for policymakers that will help shape the next stage of reform. Of course, institutional conditions in China place constraints on the nature of policy initiatives. Another feature influencing telecommunications developments is how international perceptions affect foreign investment and international business alliances. General economic conditions and resource availability in input markets also have implications for the timing of investments in the industry.

These features all affect basic industry conditions, which in turn influence industry structure, corporate conduct, and market performance. Of course, public policy determines industry structure (through the erection or reduction of entry barriers) and affects the behavior of market participants. While retail pricing behavior is often the focus of attention, other aspects of corporate conduct (like interconnection) have an even greater impact on industry performance and associated customer satisfaction. The next section incorporates these features into a comprehensive framework for analyzing prospects for change.

## **2. Framework for analyzing policy initiatives**

Each nation has unique characteristics that make it difficult to generalize from its experiences. Nevertheless, the political economy of reform has similar patterns, despite being embedded in different institutional settings. China has a huge telecommunications market with substantial commercial opportunities, which attracts potential entrants. However, as in most countries, it is difficult for political leaders to put aside the legacy of a dominant incumbent supplier. China Telecom has had powerful supporters within the government, as well as the value of brand name, managerial expertise, and knowledge of demand patterns. China Telecom was allowed to dominate the market for many years under the protection of the former Ministry of Posts and Telecommunications (MPT), even after the initiation of the telecommunications restructuring in China (Yan, 2001).

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<sup>1</sup>In 2002, China Post completed its separation from the former governmental PTT structure. Post and telecommunications now operate independently in China. Hence the cross-subsidy from the telecom sector to postal service has been addressed.

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