Regulatory Challenges to China’s Telecommunications Industry from a wider Institutional Perspective

WAN Yan
School of Economics and Management
Beijing University of Posts and Telecommunications

Abstract: Through successive reforms over the past ten years, competition has been introduced into the previously state-monopolized telecommunications sector in China. However, the overall pace of change in regulatory regime has been lagging behind the development of competition. Unlike most of current analysis on China’s telecommunications regulation which have neglected the overall institutional environment, we address the regulatory issues from a wider institutional perspective. We argue that, based on proper understanding of regulation, the government has to work simultaneously on laying a sound legal foundation, establishing independent regulatory bodies, and developing appropriate regulatory capacities. We stress that regulatory reform in that direction is made possible with China’s recent move to advance rule of law and improved overall all social-political environment.

Keywords: Restructuring, Regulatory Reform, Capacity, Institution

1. Introduction

In 1994 when state monopoly of telecommunications service industry was the norm in most countries even in more advanced market economies, China Unicom was established as a direct competitor with then state monopoly, the operation arm of the Ministry of Posts and Telecommunications. Over the past ten years, China’s telecommunications industry has been going through successive comprehensive reforms aimed at introducing competition. Through unbundling services, separating mobile services, splitting the fixed line network into two overlapping regional networks, and by corporatizing state-owned companies into companies of diversified ownership structure, the Chinese government has managed to turn the telecommunications industry from a state monopoly into a competitive industry. At the same time, the Chinese government has restructured government departments responsible for regulating an increasingly competitive telecommunications sector amid fast technology changes. However, the reform on the government side to establish a new regulatory system has been lagging behind the development of competition in the sector. This has resulted in increasing number of disputes between telecommunications operators and large number of consumer complaints not being dealt with in an effective manner.

There are many discussions on the various reasons for the slow moving regulatory reform in China, but most of them actually missed the crucial point about the important influence of the overall social-economic institutional environment on introducing new
regulatory regime. The fundamental issue is that concept of transparent, independent, professional, credible and accountable regulatory body for the telecommunications industry is a significant departure from the traditional models of hierarchical administrative systems inherited from a planned economy. By putting the regulatory issues into the overall social economic environment in China, this paper argues that the government has to work simultaneously on laying down a sound legal foundation, establishing independent regulatory bodies, and developing regulatory capacities. This is a very urgent issue as China moves to open its telecommunications sector according to a schedule agreed upon during China’s accession to the WTO in 2001. At the same time, with the fast development of new technologies, a more effective and flexible regulatory regime is desired by service providers and investors as to regulation of entry, pricing and quality of services. It is also desired when that government needs to develop a fair and cost-efficient system for universal services amid the intensified competition between different service providers. Bolder regulatory reform in that direction is made increasingly possible since the overall social-economic and legal institutional environment is changing as the Chinese’ government has been committed to promote rule-of-law in the next ten years.

The paper is organized as follows. First we discuss the proper understanding of regulation and describe the general trend of regulatory reform in network industries when competition is introduced in those traditional state monopolies. It is stressed that the “transplantation” of the independent regulator model into China should take into account the fact that China has a long tradition of hierarchical administrative systems. Then we present what changes have been made in the regulatory system in China’s telecommunications sector and analyze regulatory challenges lying ahead. Putting the regulatory issues into the overall social economic environment in China, we argue that the government has to work simultaneously on developing a sound legal foundation, establishing independent regulatory bodies, and building regulatory capacity so as to provide a good regulatory regime for the industry which expects further radical changes with fast changing of technologies and intensified competition. In the conclusion part, we briefly discuss the impact of the change of the overall legal and administrative environment on the deepening regulatory reform in China’s telecommunications industry.

2. Regulatory Reform for Restructured Network Industries

2.1. The Proper Understanding of Regulation

Any discussions on regulation or regulatory reform in China must start with the proper definition of regulation. In its essence, regulation means direct government intervention of private activities in the interest of broadly defined “public interest”. Originated in network industries in the 19th century US, government regulation was intended for addressing market failures result from incomplete competition in networks, notably the railway industry (Henry, 2001; Gao & Qin, 2003). Gradually expanded to address various types of market failures because of incomplete competition, asymmetrical information, or externality in a mostly private companies dominated free market economy, “government regulation of business is a ubiquitous feature of the American economy”. As a means of state intervention of business practice of private companies, regulation is also “a uniquely American approach to the political control of market process”, making USA the biggest regulatory state in the
world (Glaeser & Shleifer, 2003). Compared with the hierarchical line ministry model found in other developed market economies such as France and Japan, the regulatory system model is normally represented by independent regulatory bodies empowered by law or delegated by the government to enforce rules. The prototypes of these regulatory bodies are various regulatory commissions at both the federal level and state level in the USA. These regulatory bodies have the power to regulate business entry, prices, quality of goods and services, protection of environment, work safety and health issues based on either specific laws or broadly defined rules. The defining features of this regulatory system after century long change and improvement include the following categories.

- **Fairness**: The rules should be neutral and fair so that all stakeholders will be treated equally.
- **Transparency**: the rules, decisions making process and results should be made public and open to all.
- **Professionalism**: people with expertise in laws, economics, engineering etc. should be employed to deal with difficult issues in economic and legal affairs.
- **Independence**: the regulatory bodies should be independent of any business interests as well as protected from any political influences.
- **Credibility**: the regulatory bodies should be able to implement rules by penalizing those who break the rules thus help to create the expectation that all rules will be observed.
- **Accountability**: the regulatory bodies should be made accountable for their decisions by the institutionalized routines of regulatory procedures and through appeal clauses.

With these principles built into a modern regulatory regime, governments have a wide range of duties in economic regulations and social regulations that have facilitated the proper function of the market which in turn promoted economic growth and social development in those more developed economies (OECD, 2002). In the case of China, the government’s intervention of business has been pervasive and, to a large degree, by discretion rather than following clearly defined rules (Yu et. al, 2002). Therefore, regulatory reform in China is more about changes government’s arbitrary intervention into regulation by rules than merely increasing government’s ex ante intervention.

### 2.2. Regulatory Reform Should Accompany with the Restructuring of Network Utilities

Generally, this US type of regulatory regime was not the norm even among the developed economies, or OECD member countries, before 1980s. Counties such as UK, France and Germany have been long relying on line ministries to carry out government functions of interfering business operations. It was not until early 1980s when UK started to privatize state-owned companies did UK introduce the US style of regulatory regime at first in network industries and public utilities such as telecommunications and water. It has become imperative for countries to establish a new regulatory regime following the above-mentioned general principles when they changed state monopoly of network industry into private companies competing with each other. Since they have long tradition of rule of law, most of those OECD member countries have not many difficulties in establishing new regulatory systems, although they have a different context in both political systems and culture tradition. New Zealand have tried an alternative model in the telecommunications and electricity industries since 1980s by introducing competition without establishing sectoral regulatory bodies other than the general competition authority. The development of those industries
demonstrates that the model is not working as planned, since issues such as interconnections can not be effectively dealt with ex post by litigation and court resolution. As a result, the New Zealand government has been re-introducing sectoral regulatory bodies in both the telecommunications and electricity industries.

Korea and Japan might be the exceptions in OECD countries since their socio-political systems are quite different from the Anglo-American model or even the continental European model. These two countries have also started to introduce the new and modern regulatory systems since the end of the 20th century, probably out of their own needs to revitalize the domestic economy which was either in long recession or hit hard by the Asian financial crisis in 1997.

The regulatory reform has accompanied the market liberalization process in OECD countries over the past two decades. Actually, amid the global de-regulation wave since 1980s, these countries have had considerable innovations in designing new regulatory systems, especially in UK, which by far has come to the closest to the US in both their legal systems and their social traditions. The changes in regulatory policies have a sweeping effect in changing governments in these countries and the impact is far reaching. It has warranted the decade long research program within the OECD to systematically explore the ways to improve regulations in these countries. The fundamental message is, we can either have public owned network utilities operating as monopolies, or we have private companies competing in the network industries, but closely regulated by specialized sectoral regulators (Henry wt. al, 2001; OECD, 2002). This message has not received due attention in China when the government restructured the telecommunications and regulatory issues were not dealt with systematically. Although China has established the first independent regulator for the network industries, i.e., State Electricity Regulatory Commission, there are a lot of important elements missing in the system.

3. Regulatory Reform in China’s Telecommunications Sector

3.1. Progresses Made

China’s reform in the telecommunications sector started with the introduction of China Unicom. The experience was frustrating in the first few years because of the lack of effective regulation. Actually, at that time, the telecommunications industry was monopolized by the Department of Telecommunications of the Ministry of Posts and Telecommunications. China Unicom had to compete with a body that served at the same time as the regulator and policy maker.

In 1998 and 2002, the Chinese government launched two more rounds of restructuring in the telecommunications sector. The mobile service was unbundled, and the fixed line network was split into two regional networks sharing the national backbone network and allowed to enter into each other’s territories. Now China has 6 major telecommunications service companies, each operates on one sector, except that China Unicom offers both fixed line and mobile services (Wan, 2001)

The reform of these “monopolized industries” have not been carried out in a systematic way in that the government failed to introduce new regulatory regime to regulate corporatized or privatized companies which have considerable monopoly power. Until late 1990s, the restructuring of the network industries has been piecemeal. Un-regulated companies excised
monopoly power over essential facilities and therefore distorted competition, and discouraged new entry in network industries such as electricity industries and railways. Having realized the drawbacks of the piecemeal reform, the State Council decided in 1998 to speed up restructuring of the network industries, in particular electricity industry, airlines, railways and telecommunications, in a comprehensive way. The government established the guiding principles of the reform in network industries as to separate government from enterprises, and at the same time to “push through management system reform, introduce competition, reduce administrative approval, and to establish proper relationship among government, companies and market according to the requirement of a socialist market economy”. However, there was no explicit plan for introducing new regulatory systems, like UK did in early 1990s when network industries were de-regulated and privatized. The comprehensive reform of the telecommunications in 1998 created a government department, the Ministry of Information Industry, which assumes both policy role and regulatory role.

In 1998, the Chinese government merged the Ministry of Posts and Telecommunications and Ministry of Electronics Industries to form a new Ministry of Information Industries (MII). MII is both a policy body and a regulatory body for China’s information industry which include all sectors of information and communications technologies (ICT) and services. In terms of MII’s regulatory functions, the Bureau of Telecommunication Regulation within the MII is the primary unit for that work, while the Department of Pricing Clearance, Department of Comprehensive Planning also play important roles. Of its regulatory role, MII is responsible for regulation of entry, pricing, interconnection, quality of services and universal services provision in the telecom sector. The regulation of market entry remains the authority of the State Council.

Regulation of telecommunications services is based on the government decree “Telecommunications Ordinance of the People’s Republic of China” signed by the Premier in 2000. According to this Ordinance, MII is the primary agency for pricing regulation, while NDRC has to be consulted and reported to when any key decisions on price regulations are to be made. With the competition in the telecommunications sectors intensifies, disputes among carriers and between service providers and consumers have been in constant rise in interconnections and in pricing. In making decisions on issues ranging from resolving interconnection disputes to price regulations, MII holds experts hearing sessions, some kind of quasi-public hearing in that experts will be invited to make comments or express opinions on proposed decisions. Other parties whose interests are at stake will also have the opportunities to present their cases. To cope with the increasing amount of work load, the MII has established a vertically integrated model with provincial bureaus of telecommunications reporting directly to the Bureau in Beijing. Also in 2003, MII has jointly issued a document with another 5 government ministries to strengthen regulation of interconnections. The issuing of the joint document has shown that some administrative authorities have to rely on for effective regulation since not all supporting institutions are there to support for regulatory reform. This is the typical Chinese solution, since the Chinese administrative system, above all, has still inherited some legacy of a planned economy. MII has also been designated as the main institution charged with the task of drafting China’s Telecommunications Law. It also has established an expert-panel to assist MII draw up the most import law for China’s fast growing telecommunications market.
Since the pace of technology progress has been quickened, timely and appropriate regulation requires not only the improvement of organizational capacities but also the motivation of the people working for the regulatory agency. New techniques such as incentive pricing regulation should be introduced. Regulation of universal service has to be strengthened, as the entry regulation should be relaxed for both the investment in mobile telecom and in broadband network deployment. MII has been conducting intensive investigations on the role of regulation in a fast changing industry, hoping to improve the quality of telecommunications regulation.

3.2. Challenges Lie Ahead

With the regulatory powers distributed in different government departments, the current institutional arrangement is not tuned to the complex landscape of competition in the telecommunications industry. There lacks an effective mechanism to demarcate the roles of various departments and to coordinate their rulings. Government departments have to be properly empowered to take actions to enforce regulations, while being checked so that they can not excises too much discretion. There also lacks necessary resources to MII to carry out effective regulation, since to address issues such as interconnection, settlement rate, pricing policies etc. require certain amount of expertise and resources. As a result, regulation is still not carried in a transparent way so further entries have been put off. Price regulation is very outdated to the extent that most of the telecommunications companies simply conveniently ignore the existing rules, causing the regulator (MII) to lose its credibility as a regulator. Consumer rights not properly protected, with too many customer complaining. A consensus has researched that further regulatory reform is badly need if China is to encourage the fast development of the telecommunications industry.

To address the regulatory issues in China’s telecommunications, we can learn from other countries experiences and lessons. By following some core principles for modern regulatory systems, China needs to advance the regulatory reform or institutions building in the following field.

- Develop a Sound Legal Framework

To develop a modern regulatory system, a primary legislation has to be made so that the rights of the government in intervening private business activities can be legitimized. In the case of telecommunications, a primary telecom law has to be passed and it defines the rights and obligations of all the stakeholders involved in the industry. It has also to explicitly establish the role and power of a regulator in the industry, defines the regulatory procedure, institute an appeal mechanism so that the regulator’s power is checked. The Chinese government has been preparing for China’s Telecommunications Law for years now and drafts have been made. It is hoped that this primary law will serve to legitimize and empower the regulator to carry out its duty

- Establish Appropriate Organizations

Although it may not be absolutely necessary to establish an independent telecommunications regulator similar to FCC in the US and Oftel in the UK, certain kind of organization is required to be established to be responsible solely for regulation telecommunication, since the sector is fast moving and very complex. The Directorate of Telecommunications Administration within MII is not modeled in that way, neither in mentality nor in expertise nor in resources. However, it is possible to make the Directorate
more autonomous and command more resources. In due course, MII can give up its policy role to another government department responsible for more macroeconomic and strategic policies so MII can be turned into a regulator.

- **Build Adequate Capacity**

  One reason for independent regulatory bodies is to develop required skills to deal with information asymmetry between the regulator and the regulated. For most of the line ministries, including MII, do not have the required skills to carry out effective regulation. It is, therefore, important for the regulator (currently MII) to quickly develop adequate capacity for regulation. In capacity, it means not only the skills and expertise of the staff of the regulator, but also the routinezed regulatory procedure that embeds and embraces the principles of fairness, transparency, independency, professionalism, credibility and accountability. At the technical level, it requires the regulatory to establish a high power efficient information management system for managing regulatory information, to develop adequate pricing methodologies, to understand the changing cost structure of the network etc. Anyway, regulation is a practical matter.

  These changes at the legal, organizational and capacity level have to be carried in a coordinated way.

4. **Concluding Remarks**

  Developing appropriate regulatory systems for the telecommunications industry is in line with the general social and political trend in China, since the Chinese government has been committed to establish a transparent, competent and accountable government that can help to realize a “Harmonized Development” strategy. The overall economic, legal and political environment is favorable to the much-needed regulatory reform in the telecommunications industry.

  In the 16th CCP congress, it was established that the government’s role in an open market economy should be re-defined. Broadly speaking, the government should assume the followings in a market economy:
  - Economic adjustment
  - Market regulation
  - Social administration
  - Public service

  To establish necessary institutions and develop relevant organization capacities to perform those functions require systematic and far-reaching reforms in both legal systems and institutional arrangement. This can be viewed as an ongoing process of constant reform in the social and economic system, but it has very important indication that economic reform has now reached a stage that some of fundamental issues about system building and institution innovation should be addressed.

  In line with this movement towards a law abiding administrative system, China has quickened the pace of economic reform and the building up of a sound legal system. The reform of the administrative approval system started in late 2001, and this coordinated effort has resulted in the large-scale reduction of items requiring administrative approval. With the passing of the Administrative License Law in 2003, and the amendment to the Constitution in 2004, the effort to build a rule-of-law society has reached a new stage when the State Council published the “Outline for Advancing Administration in accordance the Law” in April 2004.
These primary legal reform and legislations demonstrate that China is now in the process to develop a legal system and institution environment that supports an effective market system, including establishing appropriate regulatory regimes for economic, financial and social regulation. The creation of new independent regulators for the de-regulated network industries, financial industries and for the concern of work safety is one of the overall efforts to create a pro-market, rule based administrative system, a system that functions in accordance with the law. This process will be long and lasting, and we are right at the very beginning.

REFERENCES