

WILL CHINA ALLOW ITSELF TO ENTER THE NEW ECONOMY?

I. INTRODUCTION

The development of the Internet in China presents a direct conflict between two of the country's interests: its present desire to become a global economic power and its traditional desire to control access to information. Historically, China has been wary of outside influences. In many ways the Internet embodies everything that China has ever feared—a free flow of uncensored, uncontrolled, outside information, ideas, and news. However, China has also made a commitment to enter the world's stage as an economic power. The Internet and e-commerce are currently the most dynamic worldwide industry and the most popular pathway to wealth. On the other hand, development of this industry will require an influx of foreign capital that will inevitably cause tension with longstanding protectionist policies. Notwithstanding these fundamental conflicts, the potential for Internet growth everywhere, and particularly in a country as populous as China, is tremendous.

II. HISTORY

China is one of the oldest nation-states in the world. For thousands of years, China was ruled by successive dynasties.¹ Long closed off to the rest of the world, it was forced open by the British in the 1840 Opium War.² It became a republic for the first time in 1912.³ In 1949, after years of fighting, communist forces ultimately defeated nationalist forces and took control of the country.⁴ The new government, modeled after the Soviet Union's, was called the People's Republic of China.⁵ Under the new government, China was once again

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1. See O. EDMUND CLUBB, 20TH CENTURY CHINA 9 (2d ed. 1964).

2. See Mark B. Baker, *Forgotten Legal China*, 17 HOUS. J. INT'L L. 363 (1995).

3. See IMMANUEL C.Y. HSU, THE RISE OF MODERN CHINA 575 (2d ed. 1975).

4. See *id.* at 761.

5. See *id.*

closed off from the rest of the world.⁶ China finally began to open up again with the implementation of its recent “open door” reforms.⁷

Development of the Internet began in 1969 when the U.S. Defense Department endeavored to create a computer network that would remain viable in the event of nuclear attack.⁸ This secure network to support military research was entitled the Advanced Research Projects Agency Network (hereinafter “ARPANet”).⁹ It was designed so that if any portion of the network were to become inoperable, a message could be rerouted, and thus could still be delivered.¹⁰

The network had spread to England and Norway by 1973, and it continued to spread further with the adoption of a standard communication protocol in 1983, eventually becoming known as the “Internet.”¹¹

The Internet in China has a comparatively short history. In 1995, the Chinese made their first real attempt to utilize Internet technology with the China Education Research Network, which connected approximately one hundred Chinese universities to a global Internet link.¹² As China came to realize the importance of modernization in this area, it embarked to strengthen its communication infrastructure.¹³ Plans included nearly doubling the phone line switching capacity of its system and offering more specifically Internet-oriented services.¹⁴ Over the past several years, the Chinese government has begun to take an active role in the development of the Chinese Internet industry and is even using advertising campaigns to encourage use of the Internet by its citizens.¹⁵

Despite this recent enthusiasm, there remains a deep concern for too free a flow of potentially corrupting information. China has tradi-

6. See Baker, *supra* note 2.

7. See Jay Zhe Zhang, *Securities Markets and Securities Regulation in China*, 22 N.C.J. INT'L L. & COM. REG. 557, 558 (1997).

8. See Scott E. Feir, *Comment: Regulations Restricting Internet Access: Attempted Repair of Rupture in China's Great Wall Restraining the Free Exchange of Ideas*, 6 PAC. RIM L. & POL'Y J. 361, 363 (1997).

9. See *id.*

10. See *id.*

11. See *id.*

12. See *id.* at 365.

13. See *id.*

14. See *id.* at 365. China committed 60 billion dollars over five years to making telecommunications infrastructure upgrades with the goal of having 420 million phone lines by 2010.

15. See *id.* at 366.

tionally strictly controlled free expression and dissemination of information.¹⁶ To address these concerns, the government has enacted the use of a “firewall” system that effectively blocks access to parts of the Internet for Chinese users.¹⁷ The system will allow Chinese users unlimited access to an internal network of other Chinese users, but they will have to obtain approval to access an outside service provider.¹⁸ Internet Service Providers (hereinafter “ISPs”) are charged with the task of using their router devices to filter out banned sites by blocking their IP addresses.¹⁹ Outside commentators doubt the ability of the Chinese authorities effectively to control information on the Internet with this type of technology, and have suggested that China will only be able to achieve its desired level of control by frightening the people into silence and compliance.²⁰

Much of the design for Chinese Internet control is embodied in regulations issued on January 23, 1996.²¹ These regulations require that all international Internet contact be performed through approved “channels.”²² The regulations also establish a system of application and monitoring to be carried out by the government.²³ Companies that are involved in a violation of these regulations, or any other state laws or administrative regulations via their Internet activities, are held liable under these regulations.²⁴

III. CHINESE INTERNET INDUSTRY

In order for the Internet industry to flourish in China, an influx of capital is necessary. This capital will probably not be available

16. See John H. Taylor, III, *The Internet in China: Embarking on the “Information Superhighway” With One Hand on the Wheel and the Other Hand on the Plug*, 15 DICK. J. INT’L L. 621, 622 (1997).

17. See John T. Delacourt, *Recent Development: The International Impact of Internet Regulation*, 38 HARV. INT’L L.J. 207, 216 (1997). See also Taylor, *supra* note 16, at 635-636 (chronicling the Chinese government’s efforts to block access to certain sites. Approximately 100 sites were banned in 1996, ranging from sexually explicit sites to major U.S. media sites to sites containing information about Hong Kong and Taiwan).

18. See Delacourt, *supra* note 17, at 217.

19. See Taylor, *supra* note 16, at 637-38 (further stating that experts have warned that this is not a use that the routers were designed for and may potentially cause problems).

20. See Taylor, *supra* note 16, at 638.

21. See Text of Interim Internet Management Rules, Xinhua News Agency, Feb. 2, 1996, translated by F.B.I.S., available in World News Connection <<http://wnc.fedworld.gov>>. See also Feir, *supra* note 8 (discussing these regulations at length).

22. See 1996 Regulations Art. 5.

23. See 1996 Regulations Arts. 7-8.

24. See 1996 Regulations Arts. 13-15.

domestically, but will likely come from a variety of other sources. The future playing field for this investment game will be in large part determined by the present players. An examination of the period from September 1999 to March 2000 demonstrates the struggle between the desire to develop the Chinese Internet industry and the effort to maintain control of information, while providing insight into the future direction of Chinese Internet industry investment.

A. The Players

Chief among the players that will shape the industry are the Chinese Ministry of Information Industry, the Chinese Securities Regulatory Commission, the World Trade Organization (hereinafter "WTO") joint venture investors, and foreign firms that operate by circumventing Chinese regulation.

1. *WTO*. The WTO was established on January 1, 1995, in the General Agreement on Tariffs and Trade's (hereinafter "GATT") Uruguay Round.²⁵ The WTO has a variety of functions. It administers the WTO Trade Agreement, serves as a forum for ongoing multilateral trade negotiations, facilitates dispute resolution, reviews policies and practices of members, and participates with the World Bank and International Monetary Fund in economic policy making.²⁶ Today the WTO is primarily a treaty-driven organization.²⁷

The WTO entrance procedure has required, and will likely continue to require, China to make both economic and cultural concessions. While China has already made an entrance agreement with the United States, it must make similar agreements with other member governments before becoming a WTO member state.²⁸ As of November 15, 1999, agreements were completed between China and twelve of the member states in addition to the United States, including Japan and Australia.²⁹ Negotiations were still ongoing with

25. See General Agreement On Tariffs and Trade: Multilateral Trade Negotiations Final Act Embodying the Results of the Uruguay Round of Trade Negotiations, Apr. 15, 1994, Legal Instruments – Results of the Uruguay Round vol. 1 (1994), 33 I.L.M. 1125 (1994).

26. See Sue Ann Mota, *The World Trade Organization: An Analysis of Disputes*, 25 N.C. J. INT'L L. & COM. REG. 75, 76 (1999).

27. See Don Wallace, Jr. & David B. Bailey, *Exceptions and Conditions: The Inevitability of National Treatment of Foreign Direct Investment with Increasingly Few and Narrow Exceptions*, 31 CORNELL INT'L L.J. 615, 629 (1998).

28. See Elizabeth Olson, *Many Steps to Go Before China Can Become a Full Member*, N.Y. TIMES, Nov. 16, 1999, C11.

29. See *id.*

twenty-eight other members, including the European Union (hereinafter "EU"). The EU is requiring changes in Chinese regulation of telecommunications to ensure non-discriminatory treatment of foreign firms and more transparent implementation.³⁰ This has proved to be a difficult concession for the Chinese to make, and thus far, WTO entrance negotiations between China and the EU have not been successful.³¹

2. *Ministry of Information Industry.* The Ministry of Information Industry (hereinafter "MII") is the Chinese agency that has taken the most active role in attempting to regulate the Chinese Internet industry. Traditionally, the MII has controlled the telecommunications sector. At present, the MII, under the leadership of Wu Jichuan, is attempting to extend its control to the new Internet industry as well.³² Commentators have speculated that the ministry's motive derives from the fear that a failure to regulate the Internet would diminish the importance of the MII's telecommunications sector, and as a result the importance of the ministry itself.³³ Other commentators have characterized the regulatory motive as primarily an effort to control information: "These new Internet ventures throw up new problems for the Chinese government's efforts to control information. And that is the government's priority. . . ."³⁴

Regardless of its motives, the MII is clearly one of the most important players in determining the shape of the Chinese Internet industry. It is likely that the MII will continue in its effort to regulate all facets of the industry.

3. *Chinese Securities Regulatory Commission.* The Chinese Securities Regulatory Commission (hereinafter "CSRC") is a relative newcomer on the Chinese political scene. Stock markets in China were only allowed in 1992 as a so called "experiment," subject at any time to being discontinued, by then Chinese leader Deng Xiao-Ping.³⁵

30. See Wallace & Bailey, *supra* note 27, at 617.

31. See text accompanying note 70.

32. See Bruce Einhorn, *Big Brother May Crush China's Web Dreams*, BUS. WK, Feb. 14, 2000, at 64.

33. See *id.*

34. Duncan Clarke (China analyst) (*cited in China Moves to Further Control Information*, EXCHANGE TELECOMMUNICATIONS NEWSLETTER, Sept. 17, 1999) (stating that information control trumped WTO membership as a government goal).

35. See Gao Xiqing, *The Perceived Unreasonable Man – A Response to Fang Liufang*, 5 DUKE J. COMP. & INT'L L. 271, 274 (1995).

Currently, China has two national securities exchanges and numerous other regional exchange centers.³⁶ As of 1996, 390 companies were listed on the Shanghai Exchange with an aggregate market capitalization of 634.77 billion yuan.³⁷

Chinese law requires prospective securities issuers to be approved by its overseeing ministry or local government, which then makes the decision whether to submit the application to the CSRC.³⁸ If the CSRC approves the application through a merit based approval process, then the company may finally apply to be listed on one of the exchanges.³⁹

The CSRC enacts its regulations against a background of relatively new and unrefined company law.⁴⁰ The novelty of both the securities and corporate law in China creates a somewhat unpredictable environment for investors. Furthermore, it is important to remember that while the Chinese Securities System may resemble the U.S. system in many ways, this system is not operating in a vacuum, but in China, a country having virtually no experience with a market system.⁴¹

4. *Joint Venture Investors.* As a condition of the November 1999 WTO entrance agreement between the United States and China, once China is a member of the WTO, foreign investors will be allowed to be 49% owners of ISPs and ICPs, with this level rising to 50% in two years. Although the government will regulate the industry, foreign investment will be allowed.⁴²

Under this system, foreign investors will be able to join with Chinese investors to invest in Internet companies. Joint venture investing in the industry has already begun. International Data Group (hereinafter "IDG") has taken the lead in infusing venture capital

36. See Zhang, *supra* note 7, at p. 559.

37. See *id.*

38. See *id.* at 573.

39. See *id.*

40. See Gao Xi-Qing, statements at a conference at Fuqua School of Business, Duke University, Mar. 23, 2000.

41. See Minkang Gu & Robert C. Art, *Securitization of State Ownership: Chinese Securities Law*, 18 MICH. J. INT'L L. 115, 116 (1996) (stating that the Chinese government has not lost its commitment to state ownership of the means of production, it only desires, through its reforms, to enhance the productivity of state-owned enterprises).

42. See *China-ISPs should be licensed by the Ministry of Information Industry*, CHINA BUSINESS INFORMATION NETWORK, Jan. 6, 2000.

into the market.⁴³ IDG has put much of its capital into e-commerce companies.⁴⁴ In return for a one million dollar investment, IDG typically takes a twenty-five percent stake in the enterprise.⁴⁵ Early assessment shows that this investment has been very successful for both IDG and the enterprises, with many enterprises that planned to go public at the year 2000.⁴⁶

The history of joint venture investments in other sectors of the economy provides little indication of what the future might hold for this type of Internet investment.⁴⁷ For example, foreign investment in the retail industry was once severely regulated.⁴⁸ Yet, in spite of the national laws to the contrary, foreign investors, encouraged by enthusiastic local officials, began to invest in the industry.⁴⁹ Although none of these ventures had the proper licenses, and indeed in many cases, foreign firms were majority owners in the ventures, the Chinese government ultimately succumbed to pressures from both the ventures themselves and the local governments.⁵⁰

However, in 1998, forty firms pursued the same strategy followed in the retail industry, and ignored Chinese telecommunications regulations in making deals with China Unicom.⁵¹ These investors had a very different experience than those in the retail industry, because all of these deals were all eventually declared illegal.⁵² This illustrates the lack of investment predictability in this arena. There are several other negative aspects of joint venture investing in China. For example, U.S. businesses investing in Sino-foreign joint ventures have traditionally experienced shortages of skilled workers and managers, poor infrastructure, poor quality control, and foreign exchange short-

43. See Leslie Chang, *One U.S. Investor Leads Pack in Chinese Internet Deals*, WALL ST. J., Feb. 1, 2000, at A18.

44. See *id.*

45. See *id.*

46. See *id.*

47. See generally Zhang Yuqing, *Like Bamboo Shoots After a Rain: Exploiting the Chinese Law and New Regulations on Sino-foreign Joint Ventures*, 8 J. INTL. L. BUS. 59 (1987).

48. See *IT Clashes with Legislation as China Moves to IT Maturity*, Asia Computer Weekly, Dec. 6, 1999; see also Xiqing, *supra* note 35, at 278 (acknowledging the problem of conflicts between central and local regulatory agencies).

49. See *IT Clashes with Legislation as China Moves to IT Maturity*, ASIA COMPUTER WEEKLY, Dec. 6, 1999.

50. See *id.* This illustrates how taking local partners can help insure foreign investors against political risks.

51. See *id.*

52. See *id.*

ages.⁵³ While it appears that joint ventures are probably a viable source of capital, it is doubtful that this sole source of foreign capital will be sufficient to fuel the entire industry.

5. *Foreign Investors.* Some foreign investment capital will try to access the potential of the industry without subjecting itself to the vagaries of Chinese regulation and bureaucracy. Sohu.com provides a clear example of one business trying to accomplish this goal. Sohu.com is foreign-owned, and thus would run afoul of the fifty percent cap on foreign investors as an ICP.⁵⁴ In an attempt to pull itself outside the reach of the language of the rule, Sohu.com began to aggregate content from seventy strategic partners.⁵⁵ Sohu.com holds no stake in these partners, but some supply content exclusively to Sohu.com.⁵⁶ This was an attempt to classify itself as an “aggregator” as opposed to a “provider of content”⁵⁷ and thus avoid investment regulations, which at present have only been applied to ICPs and ISPs. Whether this new classification that Sohu.com has invented for itself will keep it outside of the rule remains to be seen. The availability of this type of investing will depend on what loopholes can be found by investors in the Chinese regulations, and how tenaciously the Chinese choose to enforce these regulations.

B. The Game

Examination of the six-month period from September 1999 to March 2000 can help reveal the current trends in Chinese Internet regulation and future directions for the industry. The events during this period of time demonstrate the power struggle between those players advocating more regulation and those desiring less. From an analysis of recent events, it appears that China is exhibiting a trend of moving towards less, rather than more, regulation.

1. *September.* In early September 1999, the MII took a hard-line on foreign investment in the Internet. Wang Lijian, MII vice-director of news office, stated that “[t]hese Internet companies including ISPs and ICPs, are using telecommunications lines to do val-

53. See Pat K. Chew, *Political Risk and U.S. Investments in China: Chimera of Protection and Predictability*, 34 VA. J. INT'L L. 615, 622 (1994).

54. See Matt Pottinger, *Sohu.com Takes Novel Approach to Nasdaq Listing*, REUTERS, Feb. 17, 2000, at <<http://biz.yahoo.com/rf/000216/bn4.html>>.

55. See *id.*

56. See *id.*

57. See *id.*

ueadded [sic] telecommunications business. . . Under these circumstances, according to the spirit of the original regulations, they are all prohibited from taking foreign investment;" Wang went on to make a statement that no doubt unnerved foreign investors, indicating that "there are some companies that already have foreign investment and have foreign investors; this is something the companies themselves will have to take responsibility for."⁵⁸

While Wang's announcement was ominous, the Internet industry was at least outwardly optimistic. Towards the middle of the month Charles Zhang, CEO of Sohu.com, a primarily U.S.-owned firm, stated that the MII was just trying to learn what the Internet was and how best to regulate it. "We provide a test case for the government to study . . . it's in the best interest of the government to promote China's information technology industry."⁵⁹ At this point, his firms Sohu.com and Sina.com, both foreign-registered, stated publicly that they wanted to raise foreign capital through public offerings on NASDAQ.⁶⁰

As September drew to a close, it was apparent that the government was not ready to concede. MII Minister, Wu Jichuan, stated that foreign ICP investment was banned.⁶¹ However, Minister Wu somewhat tempered his statements in a roundtable discussion during the last week of the month. He stated that "Of course, investors want to make money. We allow them to make money that is beneficial for all parties. Venture capitalists are welcome in China to help us develop the high-tech industry."⁶² He assuaged investor concerns, or perhaps only further confused investors in continuing, "I have never mentioned in my statements foreign investments in the Internet. I have never mentioned the content of the Internet. I talked about the ISPs and said that the current regulation does not allow foreign investment in operating telecommunications in China. Giving approval for the content is the responsibility of the broadcasting authorities."⁶³ This was the first time that the Ministry for Radio, TV and Film was mentioned in public as having a regulatory role in Internet content.

58. Matt Forney & Jason Dean, *Intel Ignores Chinese Curb on Investment in the Internet*, WALL ST. J., Sept. 17, 1999, at A11.

59. *Id.*

60. See *China-US Companies Eye for Chinese Online Market*, CHINA BUSINESS INFORMATION NETWORK, Sept. 22, 1999.

61. See *China-Yahoo! Admits Grey Areas in China Internet Venture*, CHINA BUSINESS INFORMATION NETWORK, Sept. 29, 1999.

62. *Uncertainty Over China Internet Legislation*, ASIA COMPUTER WEEKLY, Nov. 8, 1999.

63. *Id.*

Wu stated that his primary concern in this arena was creating employment for those who would lose their jobs as a result of technological changes in society. "That can also happen with e-commerce. The goods have to be delivered by real people, and we have to look into our own industry first."⁶⁴

Finally, a joint U.S. Foreign & Commercial Service and U.S. Department of State report opined that new regulations, when issued, would require ISPs to get a permit to do business, and would also require ICPs to be registered and recorded in the MII/PTA system.⁶⁵

2. *November.* In November, China came to an agreement with the United States that specified conditions for entry into the WTO. This Sino-U.S. agreement provided for 49% foreign ownership of ISPs and ICPs, rising to 50% after two years. Also, new regulations will impose a licensing regime on Internet businesses, under which ICPs will be managed both by the MII and by other government administrative bodies that might regulate content. ICPs must additionally have approval from relevant administrative departments before they can even apply to the MII to be connected with an ISP.⁶⁶

After the signing of the Sino-U.S. WTO entry agreement, AT&T announced plans to go ahead with a landmark Internet network services joint venture. MII minister Wu Juchuan had already granted the project a unique exemption from the rules barring foreign investment, which will remain in force until China completes the WTO entry process.⁶⁷

3. *December.* In reaction to increased foreign involvement, the Chinese State Press and Publication Commission announced new controls on the distribution of publications, including on-line publications. According to these guidelines, national distribution of publications will be limited to state-authorized distributors, and joint ventures with foreign investment will be further restricted to retail

64. *Id.*

65. See Shujuan Cao, *China - Internet Regulation*, International Market Insight, International Copyright, U.S. & Foreign Commercial Service and the U.S. Department of State, Sept. 27, 1999 (reprinted in National Trade Data Bank Market Reports, Sept. 27, 1999).

66. See *China-ISPs Should Be Licensed by the Ministry of Information Industry*, CHINA BUSINESS INFORMATION NETWORK, Jan. 6, 2000.

67. See *China-Approval Looms for Landmark AT&T Internet Project in Shanghai*, CHINA BUSINESS INFORMATION NETWORK, Nov. 25, 1999.

distribution only. The stated purpose of this action is to prevent the spread of state secrets.⁶⁸

4. *February.* As a response to the regulatory environment, Sohu.com, with U.S. investors such as IDG and Pacific Century Cyber Works, tried to recharacterize itself to avoid violating Chinese regulations. To accomplish this it dropped its original content and began to instead aggregate it from seventy strategic partners.⁶⁹

China's future WTO membership push stalled in February. Chinese and EU officials broke off talks on China's admission to the WTO. The EU advocated the ability of foreigners to have a controlling stake in telecommunications networks, and additional business licenses for European insurers.⁷⁰ In addition to refusing to meet the EU demands, China further stated that it would not enter the WTO unless the United States ends its annual reviews, a vestige of the U.S. sanctions imposed in the wake of the 1989 post-Tiananmen Square crackdown.⁷¹

5. *March.* In March, Lucent Technologies made a \$100 million deal to provide GSM mobile phone systems and Asynchronous Transfer Mode technology, which allows phone lines to carry sophisticated Internet services to several Chinese service providers, including China Unicom. This evidences the Chinese service providers' rush to roll out state networks before foreign competition is allowed as a condition precedent to entering the WTO.⁷²

IV. FUTURE OF THE INDUSTRY

The Internet industry in China will likely be shaped in the near future. Most likely, the same players that are presently affecting the system will continue to do so. These players will play a large role in molding the future form of the industry as they all push for their own conflicting interests.

The continued WTO membership process will force the Chinese to make further concessions. If the EU continues to place such an

68. See *Market News- The Internet- Foreign Investment to be Allowed*, CHINA ECONOMIC REVIEW, Dec. 23, 2000.

69. See Pottinger, *supra* note 54.

70. See Craig S. Smith, *China and Europeans Break Off Talks on W.T.O. Membership*, N.Y. TIMES, Feb. 24, 2000, at A11.

71. See *id.*

72. See Matt Pottinger, *Interview-Lucent wins \$100 mln in China Deals*, REUTERS, Mar. 3, 2000, at <<http://biz.yahoo.com/rf/000303/ec.html>>.

emphasis on opening the industry to foreign competition, the Chinese will probably be forced to make changes accordingly.⁷³

While the WTO membership will have a liberalizing effect, the MII will counter this liberalization with new regulation and stricter enforcement. The MII is poised to secure a pivotal role in controlling the direction of the industry. Whether the ministry is motivated by the traditional impulse to control information or by the need to preserve its place in the power structure, its pattern of action to this point reveals that the ministry will strive to extend as much control over the Internet as possible. The period from September 1999 to March 2000 reveals a cycle of MII over-enforcement, followed by a change of law to temper the over-enforcement, followed once again by over-enforcement of the new rule. However, the overall trend seems to be towards net erosion of MII control. Minister Wu himself even acknowledges the need for foreign investors' capital.⁷⁴ Furthermore, forces in the government seem very dedicated to increasing foreign investment.⁷⁵ Thus, while it seems unlikely that the ministry will ever relent entirely in its struggle to control the Internet, gradual loss of control by the ministry is likely to continue.

The CSRC will likely continue to be a governmental agency focused on tempering over-control of the industry. The CSRC may play one of the larger roles in the process by continuing to fail to make any move to curtail the operations of companies such as Sohu.com. While Sohu.com primarily does business in China, it is registered abroad. The CSRC could, but apparently has no plans to try to limit this type of activity.⁷⁶ This openness could provide an outlet for internet companies that do not want to be concerned with Chinese Company law and desire easier access to foreign capital.

Joint venture investment seems likely to remain a viable alternative for investment. However, the amount of foreign capital that will enter the industry through this conduit is largely contingent on how heavily controlled the industry is. One advantage of joint venture investment is that the foreign investor shares the political risks of the

73. See Olson, *supra* note 28.

74. See *supra* text accompanying note 64.

75. See Zhaodong Jiang, *China's Tax Preferences to Foreign Investment: Policy, Culture and Modern Concepts*, 18 J. INTL. L. BUS. 549, at 551-52 (1998) (stating that the Chinese Government has demonstrated preferential tax treatment for foreign investors through the use of enterprise income tax, turnover taxes, and other applicable taxes).

76. See Gao Xi-Qing, statements at a conference at Fuqua School of Business, Duke University, Mar. 23, 2000.

project with Chinese partners.⁷⁷ Yet, heavy regulation would lead more investors to try to tap the market through enterprises such as Sohu.com or invest elsewhere.

Enterprises such as Sohu.com may be a factor in the industry, depending on both the ability of the companies to stay one step ahead of regulation and on how wide a net of regulation is thrown. At the moment, the prospects for these companies look promising since apparently the CSRC is not going to move to control them, and the MII seems to be relaxing its control a bit as well.

V. CONCLUSION

Overall, it seems likely that the Chinese Internet industry will obtain the foreign capital necessary for its growth. Gradual relaxation of controls on information dissemination seem likely as well. The Internet has the potential to greatly increase China's prominence as an economic power. Its enormous market once tapped is an extremely valuable resource, both for the Chinese and the world as a whole. The process of exploiting this resource may also have the corollary effect of helping to alleviate some of China's traditional fears of outside contact and information.

While firewall protections can in some way limit access to the internet, it seems unlikely that these type of protections can ever be entirely leak-proof. Leaks through the firewall may prove to be a problem that grows exponentially, for as holes open, they will not only whet Chinese appetites for outside information, but they may also provide Chinese hackers with access to a whole worldwide community of computer knowledge that might further their ability to create more holes in the firewall. Regardless, no firewall can be entirely impermeable, and the access that the Chinese are provided to the outside world cannot but help fuel internal demands for increased access.⁷⁸

The Chinese government has in the past exercised almost complete control over its domestic industries. This model of control seems particularly inappropriate in the new Internet economy. Even

77. See Chew, *supra* note 53, at 620.

78. But see Wang Jisi, *Global Viewpoint: Internet in China: A new fantasy?*, BANGKOK POST, Nov. 12, 2000. This article argues that while there may be breaks in the firewall the Internet will not have a liberalizing effect on China. He states that the average Chinese web-user does not fit the demographic profile of a political activist. Furthermore he states that there is better access to radical, nationalistic writings than more liberal pro-western materials—perhaps due to selective censorship on the part of the Chinese government.

in the west, Internet companies are striking in their tendency to fall outside of typical business models. If the boardrooms of corporate America seem befuddled at times by this new industry, surely Chinese bureaucrats will not be in any better position to manage this industry effectively. In the U.S. Internet industry companies are developing new management strategies to manage this new industry. If this ability and desire to innovate does indeed prove to determine the winners and losers in the industry, then central control will be an inefficient management technique. At this point the industry is so volatile, and there is so much uncertainty about which techniques of doing business and which particular firms will ultimately be successful, that it would be unwise for China to mandate any particular manner of doing business. This would be, in effect, putting all of its bets on one horse in a race where the outcome is very uncertain. No one at this point has the ability to effectively predict the best way to approach the Internet industry. It would be impossible for China to micromanage effectively an industry that no one can understand.

Another argument can be made that the Internet industry in China can only be developed through trial and error. In the United States, Wall Street has struggled to predict which firms are developing products that will eventually prove profitable. Potential technological advances, consumer preferences, and a myriad of other variables will eventually determine which firms' products and approaches will work in the American economy.⁷⁹ Therefore, for China to go with one approach may lead to its failure to maximize the power of its internet industry by failing to try unorthodox methods that might ultimately be the most effective and efficient ways in which to use its resources.

It should be noted that what works in America will not necessarily work in China. It would be a mistake for the Chinese government merely to survey the experiences of countries that are ahead of it on the development curve, and apply those lessons directly to China. For example, there are obviously fundamental differences between potential American and Chinese Internet users. Beyond the ideological and social differences between these two populations there are other practical differences. While in America, a large part of the

79. For example, look at the performance of one of the U.S. Internet industry's biggest players, Amazon.com. Investors have continued in their belief in the potential of this firm despite the fact that the e-tailer has yet to post profits. Presumably intelligent investors have placed faith in coming profits that the Amazon business model and consumer profits have not yet delivered.

commercial transactions in the Internet are made using credit cards, credit cards are much less prevalent in China.⁸⁰ This is a challenge that the Chinese will be unable to look to the U.S. experiment for guidance in overcoming and must develop a response to on their own.

Access to computers and the Internet is another problem that the Chinese must tackle if they are to maximize the potential of their Internet industry. The number of Chinese Internet users that was 16.9 million in July of 2000 is growing, but is still relatively small.⁸¹ It is even more enlightening to look at statistics that measure how well connected Chinese enterprises are to the Internet. Of the top 100 Chinese enterprises 26% did not have a website. Most of the websites contain a simple Chinese introduction to their enterprise, and just 28% among those who have set up websites had one that was characterized as "OK."⁸² Half of China's small and medium-sized enterprises do not have computers at all.⁸³ Clearly the future development of the Chinese Internet industry will be closely tied to increased access to both computers and the Internet.

The Chinese Internet industry clearly faces many challenges in the coming years. While there is potential for China to use this new medium to vault itself onto the stage as a world power, there still remains the possibility that the Chinese government will squander this opportunity out of anxiety for what the Internet could do to its tight grasp on information. It seems likely, though, that China will take advantage of this opportunity to advance itself economically. What social consequences this undertaking might have will be interesting to see.

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80. *See China-Visa-Consumer Debtors Help Boost Demand*, CHINA DAILY, Apr. 5, 1999. Visa currently has only 12 million cardholders in China accounting for 46.7 billion dollars in 1998.

81. *See Jisi*, *supra* note 78.

82. *See Internet and E-commerce in China*, ASIAINFO DAILY CHINA NEWS, Oct. 19, 2000.

83. *See id.*