Is It A Castle in the Air?

Assessing the Sino-US WTO Agreement:

From the Perspective of Telecommunications and Banking Liberalization

by

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Abstract

China, a nation inhabited by one fifth of the world's population and often referred to as "the sleeping giant", is undergoing significant transition. China, subject to domestic changes in its quest for a new balance between traditions, socialist notions and market economy, defines its new role in a changing world that drives towards the globalization of trade in goods and services faces.

This study examines the Chinese position regarding two aspects significant for both China's domestic process of transition and China's international role: telecommunications and banking services. The first chapter examines the general international framework of the GATS with respect to telecommunications and financial services. This includes, *inter alia*, a study of the legal framework, comprising in particular the WTO Financial Services Agreement and the Basic Telecommunications Agreement. Chapter Two provides an overview of the Chinese telecommunications and banking sectors. This Chapter focuses on the historical and cultural background influencing the process of domestic deregulation and internationalization of these sectors. Chapter Three features an assessment of the Sino-US WTO Agreement on the telecommunications and banking sectors. In the course of this study, a number of concerns and probable consequences can be identified for both sectors examined.

Will "the sleeping giant" move on towards complete market liberalization, or is that prospect merely a castle in the air? This study explores how the China's legal framework governing these two key sectors might unfold.

Extrait

La Chine, une nation représentant le cinquième de la population du monde, souvent considérée comme « le géant dormant », est en phase de transition. La Chine vit présentement une transformation interne alors qu'elle cherche un nouvel équilibre entre ses traditions, les notions socialistes et l'économie de marché. Elle se définit, aussi, un nouveau rôle dans le contexte de la globalisation du commerce et des services.

Cette thèse explore le cadre juridique de deux secteurs clefs pour la Chine: les télécommunications et le secteur bancaire. Le premier chapitre examine l'accord-cadre général des lois internationales du GATS concernant les télécommunications et les services bancaires. Cet examen inclut, entre autres, une considération des loi-cadres, qui se retrouvent particulièrement à l'Accord sur les services financiers de l'Organisation mondiale du commerce et à l'Accord de base en télécommunications. Le chapitre deux donne un aperçu des secteurs des télécommunications et des banques en Chine. Ce chapitre met en lumière les événements historiques et les aspects de la culture chinoise qui ont influencé le processus interne de la libéralisation et de l'internationalisation de ces secteurs. Le chapitre trois rend compte de l'accord entre la Chine et les États-Unis relativement aux conditions d'accession de la Chine à l'Organisation mondiale du commerce, en plaçant un accent sur les secteurs des télécommunications et des services bancaires. Cette étude permet d'identifier des préoccupations réelles reliées à l'entrée de la Chine dans l'Organisation mondiale du commerce, tout en soulignant les effets possible d'une telle démarche sur les secteurs étudiés.

Le « géant dormant » s'éveillera-t-il vraiment aux règles de la libéralisation des marchés ou cette idée ne restera-t-elle rien de plus que le rêve d'un château en Espagne? Cette étude analyse comment le droit chinois dans ces secteurs pourrait se développer.

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Abbreviation

Agricultural Bank of China	ABC
Bank of China	BOC
Bank of Communications	BOCom
Basic Telecommunications Agreement	BTA
Construction Bank of China	CBC
Code Division Multiple Access	CDMA
Financial Services Agreement	FSA
General Agreement on Tariffs and Trade	GATT
General Agreement on Trade in Services	GATS
Gross Domestic Product	GDP
Global System for Mobile Communications	GSM
Industrial and Commercial Bank of China	ICBC
Ministry of Electronic Industries	MEI
Ministry of Finance	MOF
Ministry of Foreign Trade and Economic Co-Operation	MOFTEC
Ministry of Information Industry	MII
Ministry of Posts and Telecommunications	MPT
Most Favored Nations	MFN
People's Bank of China	PBOC
People's Construction Bank of China	PCBC
Regulations of the People's Republic of China Governing Financial Institutions with Foreign Capital	RFIFC
Renminbi	RMB
State Administration of Radio, Film and Television	SARFT
State-Owned Enterprises	SOEs
Value Added Services	VAS
Very Small Aperture Terminals	VSATs
World Trade Organization	WTO

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Introduction

Once upon a time, there was a man of wealth who wanted to build a grand and lofty castle. One day he saw a magnificent three-story castle next to his village. He sent for the architect who built that castle, asking him to build the third floor for him exactly the same as that of the one in the next village. But, he wanted only the top. "This is not possible." said the architect, "How could a castle go up without a base? And without the first and second floors, where comes the third?" The wealthy man was upset and said, "I tell you, I am not going to use the first and second floors. You must just build the top one for me."

--A Castle in the Air[1]

Today, China is the ninth largest trading country in the world.[2] However, it is not yet a member of the World Trade Organization (WTO), the only international

[1] This is a story named "A Castle in the Air" in *The Hundred Words Sutra in Analogies*, which was an album found in the Qi Dynasty during the period of Southern & Northern Dynasties (AD 402-589).

[2] In 1998, China's trade was US$ 323.9 billion. Since 1993, it has attracted the largest amount of foreign investment of any country in the world, second to the United States of America. By the end of March 1999, China had US$146.63 billion in foreign exchange reserves, next to Japan. See M. O'Neill, "Towards Capitalist China" *South China Morning Post Internet Edition* (15 April 1999) online: <http://www.scmp.com> (date accessed: 15 April 1999).

organization that governs international trade in goods and in services.[3] For almost half a century, the international trading system has been developed primarily based on the market economy, which involves competition and liberalization. China, presently, is in a state of transition towards a market-oriented economy. Some economic sectors, however, still remain closed and regulated due to China's chronic exercise of a centrally planned economy. The so-called "strategic sectors" such as telecommunications and financial services[4], for instance, are especially subject to heavy regulation. In the talks with the WTO members concerning China's WTO accession, China has been hesitant to commit the full opening up of these two markets, while some WTO members are eagerly seeking the market access to China's telecommunications and banking markets. Hence, the liberalization of and market access to both China's telecommunications and banking sectors have caught a great deal of attention during China's WTO talks.

China has pursued a membership in the world trade club -- the WTO and its predecessor GATT -- for more than a decade.[5] On November 15, 1999, China reached an

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3 Founded in 1994, the WTO is the first ever international trade organization dealing with the global rules of trade between WTO members. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. Before the establishment of the WTO, the General Agreement on Tariffs and Trade (GATT) had served as a provisional framework governing international trade in goods among party countries since 1940s. Now the GATT has been included as one part of the WTO framework, governing international trade in goods. The WTO framework also extends the international trading system to the services sector, which is under the General Agreement on Trade in Services (GATS). For more details on the introduction to the GATT and the WTO, see A.O. Krueger, "Introduction" in A.O. Krueger, ed., *The WTO as an International Organization* (Chicago: University of Chicago Press, 1998) at 1. See also J.H. Jackson, W.J. Davey and A.O. Sykes, *Legal Problems of International Economic Relations: Case, Materials and Text*, 3rd ed. (St. Paul, Minn.: West, 1995) at 289.

4 China's financial services sector is dominated by the banking industry. Therefore, the study focuses on China's banking sector while accessing China's commitment to the liberalization of financial services.

5 China was one of the 23 founding Contracting Parties to the GATT, when it was brought into existence by the Final Act of the United Nations Conference on Trade and Employment on October 30, 1947. For details see GATT Status of Legal Instruments, 3rd rev. (Geneva: GATT Secretariat, 1970).

China formally applied for the resumption of its Contracting Party status in the GATT in July 1986. See GATT, Committee on Trade and Development, *Report Presented to and Adopted by the Contracting Parities on 10 July 1986*, GATT Doc. L/6017. (1986).

For more details on the history of China's relation to the GATT/WTO and the resumption of China's seat in the GATT, see W.G. Cai, "China's Membership in the GATT/WTO: Historical and Legal Issues" in W.G. Cai, M.G. Smith and X.Q. Xu, eds., *China and the World Trade Organization: Requirements, Realities, and Resolution* (Ottawa: Centre for Trade Policy and Law, 1996) 10 at 16-17. Also online: <http://www.utoronto.ca/cis/china.html> (date accessed: 9 July 1999).

agreement with the United States on terms of its WTO entry.[6] In the Sino-US WTO agreement, China took great steps forward towards the liberalization of its telecommunications and banking sectors. It probably was one of the most remarkable break through in the China WTO accession negotiations. Both sectors have been subject to government regulations and restrictions in China for decades. The telecommunications sector has remained tightly closed up to the present despite the fact China adopted an open-door policy already in late 1970s. China's existing regulations clearly rule out foreign involvement in managing and operating China's telecommunications. As compared to the telecommunications sector, the banking sector, dominant in China's financial services sector, has opened up to foreign investors considerably more widely. Since the first foreign bank was allowed to set up a representative office in 1979, there have been approximately 200 foreign financial institutions operating in China.[7] They are currently subject to limitations in both business and geographic scope. Under the Sino-US WTO agreement, China committed to phase out these limitations upon a concluded timetable. This represents a substantial step that has been taken by the Chinese government in liberalizing its telecommunications and banking sectors.

As the Sino-US WTO agreement served as a cornerstone for ongoing talks between China and other interested WTO members,[8] this study is intended to assess the Sino-US WTO agreement on the liberalization of China's telecommunications and banking sectors. Central to the assessment is the question of whether China's commitments to telecommunications and banking liberalization are a "castle in the air", raising a complex set of issues, including: (1) the justifications for China to keep

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6 USTR, "U.S., China Sign Historic Trade Agreement" (15 November 1999) online: <http://www.ustr.gov> (date accessed: 15 November 1999). China also concluded the WTO accession agreement with the European Union on May 19, 2000. See REUTERS in Beijing, "Beijing Revels in WTO Achievement" *South China Morning Post Internet Edition* (20 May 2000) online: <http://www.scmp.com> (date accessed: 20 May 2000).

7 By the end of February 1999, the number of foreign financial institutions operating in China stood at 191. Their assets totaled USD 36 billion. CEInet, "2 US Banks Given Branch Approval" (1 April 1999) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 1 April 1999).

8 As European Union Trade Commissioner Pascal Lamy put it, the Sino-US WTO agreement had represented 80 per cent of what the EU wanted. The recently concluded EU-China negotiations had added another 16-17 per cent and further improved the Sino-US accord. See "EU Trade Commissioner Pascal Lamy informs EU Member States on China WTO deal" (22 May 2000) online: <http://europa.eu.int/comm/trade/bilateral/china/wto.htm> (date accessed: 22 May 2000).

telecommunications and banking sectors closed and subject to high levels of government regulations; (2) the incentives for China to liberalize and open up the telecommunications and banking sectors; (3) the potential of the Chinese government losing managerial control over Chinese telecommunications and banking infrastructures, due to high level of foreign percentage of equity participation in Chinese service provider; and (4) the risk of bankruptcy of Chinese state-owned banks; and (5) other post-accession challenges including the implementation of China's WTO concessions.

Scope of the Study

The study is aimed at assessing the Sino-US WTO agreement, focusing on the liberalization of telecommunications and banking sectors. It involves both China's telecommunications and banking sectors for a number of reasons.

First, telecommunications and banking services are covered by the multilateral General Agreement on Trade in Services (GATS) under the WTO framework. While pursuing a membership in the WTO, China is required to make appropriate commitments to the GATS.[9] The GATS promotes liberalization of trade in services, including telecommunications and financial services. In the context of China, banking services

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[9] The GATS was included in the world trading system as a result of the Uruguay Round of trade negotiations in April 1994. It is a set of multilateral, legally enforceable rules governing international trade in services. The GATS is an integral part of WTO agreements that provide legal ground-rules for the world trading system. No country can opt out of the GATS when applying for WTO membership. For a detailed history of the emergence of the GATS, see W.J. Drake and K. Nicolaidis, *Ideas, Interest, and Institutionalization: "Trade in Service" and the Uruguay Round"* International Organization 46, no. 1 (Winter): 37-86. For the full texts of the GATS, online WTO web site: <http://www.wto.org/english/docs _e/legal_e/26-gats.pdf> (date accessed: 12 July 2000).

The WTO agreements include: the GATT for dealing with trade in goods, the GATS for trade in services, Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) dealing with relevant aspects of intellectual property, and agreement on dispute settlement and trade policy reviews. See the Final Act Embodying the Result of the Uruguay Round of Multilateral Trade Negotiations, Marrakesh, Morocco, April 15, 1994 (Geneva: GATT Secretariat, 1994) online WTO: <http//www.wto.org/wto/legal/ finalact.htm> (date accessed 12 January 1999).

dominate in the financial services sector.[10] The focus is therefore given to the liberalization of China's banking industry in this study.

Second, the telecommunications and banking sectors are seen as strategic sectors in Chinese economy. They both hold a strategic position in the building of a dynamic and flexible national economy. Telecommunications cuts across and integrates social and economic activities by transmitting information at a speedy pace. In the so-called Information Age, trade in information is germane to capital, commerce, technology transfer, and national security.[11] As a fundamental means of transmitting information, telecommunications is central to the national and international flows of capital and commerce. In addition, it is crucial to a nation's national security. With respect to the banking sector, a sound banking system creates a more effective corporate governance[12] structure that creates behavioral changes in the enterprises.[13] It improves the efficiency of investments and, in turn, contributes to the growth of the overall economy. Thus, the government intends to keep both the telecommunications and banking sectors under control. While receiving supports and subsidies from the government, they are at the same time subject to strict restrictions and regulations. Given that China is urged to open

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10 Two decades ago, there were only two types of transactions that were operated by China's financial institutions -- deposit and credit. Insurance was only for foreign transactions. Although many new financial institutions, including banking and non-banking ones have emerged since the late 1970s, China's four state-owned banks, the mainstay of China's financial system, still account for more than 90 per cent of banking assets and more than 70 per cent of financial assets. See F.C. Peng in Shanghai, "New Panels Will Keep Tabs on Managers of Big Four" *South China Morning Post Internet Edition* (22 February 2000) online: <http://www.scmp.com> (date accessed: 22 February 2000); see also R. Stride and G. Gaeta, "Sector Must Tread A Rocky Path to Reform" *South China Morning Post Internet Edition* (14 May 1998) online: <http://www.scmp.com> (date accessed: 20 May 1999).

11 M. Jussawalla and C.W. Cheah, "International Trade and Information: Some Welfare Implications" in M. Jussawalla and H. Ebenfield, eds., *Communication and Information Economics* (Amsterdam: Elsevier, 1984) at 51-72.

Trade in information is also related to capital in that money is merely an information product. See R. O'Brien, *Global Financial Integration: The End of Geography* (London, Pinter, 1992) at 7.

12 "Corporate governance" refers to the functions of financial institutions in allocating resources. Financial institutions perform two roles in allocating resources: (1) they first select managers and projects among competing sectors and competing firms that have the highest expected returns; (2) after funds have been allocated the selected managers and projects, they ensure that the funds are used in the way promised by the borrower, and that the borrower, in responding to new contingencies, takes into account the interests of the providers of capital. The economic literature has referred to these two roles of financial institutions as "screening" and "monitoring." See D. Eu, "Financial Reforms and Corporate Governance in China" (1996) 34 Colum. J. Transnat'l L. 469 at 473, online: WL (TP-ALL).

13 *Ibid.*

up both the telecommunications and banking markets upon its entry into the WTO, it is believed that domestic firms in both sectors will be facing the fiercest challenge.

Third, the two sectors are closely linked together. Telecommunications is a fundamental means of transmitting information, while money, the essential object with which banks deal, is merely an information product.[14] As banking is an information-intensive services sector, banks are heavy users of telecommunications. Development and innovation in telecommunications changed the way the banking industry operates.[15] Money can be moved faster than ever before. The choice of financial services, instruments and institutions has widened. Furthermore, telecommunications is a key means of moving banking services across national borders. The innovation of the Internet has enabled banking services to be accessible at all corners of the world, providing telecommunications infrastructures are available. On the other hand, telecommunications is a capital-intensive industry. Investment in telecommunications is so great that it needs to be accomplished through various means of financial services. Linking the world via the Internet and facilitating the allocation of global financial resources, telecommunications and banking services are major contributors to the global liberalization of the world economy.

Structure of the Study

To provide a general understanding of the WTO/GATS framework, the study starts with an introduction to the GATS, focusing on specific rules that govern international trading in telecommunications and financial services. This is done for three reasons. First, the GATS is an integral part of the WTO system, dealing with international trade in services. It is binding on all WTO members. Furthermore, no country can opt out of it while seeking a membership in the WTO. Hence, China shall make commitments to the GATS in its pursuit of the WTO membership. Second, the

[14] R. O'Brien, see *supra* note 11.

[15] See also W. Dobson and P. Jacquet, *Financial Services Liberalization in the WTO* (Washington, D.C.: Institute for International Economics, 1998) at 107, 109, 112.

purpose of the study is to assess China's WTO commitments from the perspectives of the telecommunications and banking sectors. Both sectors are not only governed by the WTO/GATS general principles and disciplines, but also subject to the WTO Basic Telecommunications Agreement (BTA) and Financial Services Agreement (FSA) respectively. The two WTO agreements were concluded under the GATS, and are a part of the GATS framework. Third, the GATS, the BTA and the FSA are a kind of international constitution. They present the most desired measures for fair trade and smooth market access. It is the zenith that the WTO/GATS urges all countries to reach. Comparing the world liberalization to the *castle* in the story, the multilateral frameworks are at the top floor of the castle. The introduction to the GATS framework is therefore to provide a useful context for the survey of China's telecommunications and banking sectors and for the assessment of the Sino-US WTO agreement.

Chapter Two surveys the process and the current level of liberalization in both the Chinese banking and telecommunications industries, focusing on the following issues: (1) historical backgrounds that put a straightjacket on reforms in both sectors; (2) the levels of liberalization that have been achieved; (3) the current structures of both sectors; and (4) the comparison of both sectors.

Having been given the outline of China's telecommunications and banking industries, the reader's attention is drawn to the Sino-US WTO agreement regarding both sectors in Chapter Three. The study first gives an outline of China's WTO concessions to telecommunications and banking services. It then examines in details how realistic the Sino-US accord is with regards to the telecommunications and banking industries.

The study draws several conclusions. Today, China's telecommunications and banking sectors are undergoing institutional restructuring and a systematic transition towards liberalization. In the meantime, China has made substantial liberalization commitments for both sectors in the China WTO accession negotiations. They push China into a more aggressive transition into uncharted territory. Domestic firms and markets will inevitably face competitive pressures. While market opening contributes to the improvement of economic efficiency, continuing domestic deregulation reforms in both sectors is important to ensure economic stability and growth. Whether China asks for or China is being asked to build *a castle in the air*, the challenge facing China will be how to facilitate and monitor the transition over the next six years following the WTO accession.

Chapter One

Telecommunications, Financial Services and the GATS

Global Scenario

Few landscapes in the world have changed as dramatically in the past couples of decades as have the landscapes of both the telecommunications and financial services sectors. The use of telecommunications is shifting away from voice service and toward data communications. With the aid of satellites and other wireless technologies, telecommunications is available not only to people in places with communications infrastructure, but also to people in the most remote corners of the Earth. These changes led to the liberalization of telecommunications domestically and internationally, which has been operated or owned by public or private monopolies for a century.

Rapid innovation in telecommunications technologies has also changed the financial services sector. The moving of money -- the primary operation of financial services -- can be done, domestically and across borders, at ever-faster rates and in ever-greater volumes. As new financial services have dramatically proliferated, additional competitors such as asset management companies and credit card suppliers now challenge the traditional service providers and accelerate the rate of change. The growing trend toward competition in both telecommunications and financial services has spread out across the global economy. Countries around the world are undertaking liberalization of telecommunications and financial services both domestically and globally.

Strategic Sectors

It is not unfamiliar to the WTO members that both telecommunications and financial services sectors are deemed strategic to their economies. Telecommunications is the modern nervure system of countries.[16] In the so-called Information Age, the power to control the flow of and to manipulate information has become increasingly vital to both economic prosperity and military power status.[17] Transmitting information to and from all corners of the globe, given that an infrastructure is available, the civilian and military features of telecommunications are indivisible. Almost all branches of economies today are fundamentally dependent on telecommunications. It shapes the opportunities for national economic development.[18]

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[16] H.N. Janisch and R.J. Schultz, *Exploiting the Information Revolution: Telecommunications Issues and Options for Canada* (Montreal: Public Affairs Department, Royal Bank of Canada, 1989) at 33.

[17] For an excellent study on the relevant issues, see generally D.R Headrick, *The Invisible Weapon: Telecommunications and International Politics 1851-1945* (New York: Oxford University Press, 1991) particularly at 272-4.

[18] For a literature review on the role of telecommunications in economic development, see P. Lee, "Telecommunication and Development", in P. Lee, ed., *Telecommunications and Development in China* (Cresskill, N.J.: Hampton Press, 1997) at 3-20. See also B.A. Petrazzini, *Global Telecom Talks: A Trillion Dollar Deal* (Washington, D.C.: Institute for International Economics, 1996) at 42-5 [hereinafter Petrazzini 1996]. See also B.A. Petrazzini, *The Political Economy of Telecommunications Reform in Developing Countries: Privatization and Liberalization in Comparative Perspective* (Westport, CT Praeger, 1995) at 1-3 [hereinafter Petrazzini 1995].

On the other hand, a country's telecommunications infrastructure is also seen as a significant element of its ability to handle situations of national emergency. Telecommunications is the linkage of the so-called "3 C's": command, control and communication. Only through an effective and sophisticated telecommunications network can commands be passed on to their addressees to be performed quickly and in the manner required. The control of the 3 C's, therefore, can be realized and ensured. It applies to military aspects (defense against foreign attacks, war, revolution) as well as to states of emergency arising from major accidents (e.g. aircraft crashes in crowded areas or in remote and not easily accessible locations) or natural disasters (e.g. reaction to hurricane warnings, evacuation of inhabited areas in the course of earthquakes, flooding, or volcano eruptions).[19] All of these aspects are not new, as even in the year 500 BC Sun Tzu described the significance of telecommunications on the battlefield (then performed by smoke and flag signals).[20] New, however, are the means of telecommunications, the speed of transmission and amount of information transmitted. Within the last century, the technical development, proceeding at a breathtaking pace, has featured incredible improvements.[21]

Financial services are provided to allocate resources by reconciling different needs of savers and investors and to facilitate payments between economic units.[22] The financial services sector makes possible most of economic transactions in an economy. Given the role of the financial services sector as "screening and monitoring" in allocating resources,[23] the financial services sector also contributes to the efficiency of investment.

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19 See A. Kadletz and R.F. Hedrick, "The 27th Annual Pacific Northwest Aviation Law Seminar: Washington, 22-24 October 1999" (2000) 49 Z.L.W. 94 at 94.

20 See R.D. Sawyer, trans., *Sun-Tzu: The Art of War: with introductions and commentary* (New York: Barnes & Noble, 1994) at 198. See also J.H. Huang, trans., *Sun-Tzu: The Art of War -- The New Translation, Research and Reinterpretation* (New York, Quill William Morrow, 1993) at 72.

21 For a more detailed discussion, see Chapter Three, below.

22 Investors are primarily business enterprises who borrow to be able to purchase and employ more tangible capital goods to facilitate their production of goods and services than would otherwise be possible. Savers are primarily households who set aside some of their money for future use. Providers of financial services are basically an intermediary in that they, in a straightforward and simplified illustration, take the money from savers and lend to investors. See R.C. Bryant, *International Financial Intermediation* (Washington, D.C.: Brookings Institution, 1987) at 6.

23 See D. Eu, *supra* note 12.

In this regard, it is essential to the economic development of a country.[24] In addition, it is crucial to the stability of the economy. The failure of a bank,[25] for example, can have a significant impact on the rest of the economy.[26] It may also spill over into the political realm. Furthermore, any changes in the financial sector would have an immediate impact on the ability of governments to pursue policy inasmuch as finance is probably the only specialized sector to achieve autonomy.[27]

Both the telecommunications and financial services sectors are deemed as strategic to a nation's economy. They are subject to government intervention through regulation and other measures. In fact, proper regulation and supervision contribute to the development and efficiency of both the financial services and telecommunications industries. It is especially true of developing countries according to the "late-development paradigm". Appropriate state intervention promotes and secures the development of strategic national economic sectors in those comparatively late developed countries, such as China, which are willing to develop in the world economy already dominated by advanced and developed countries.[28]

The GATS Framework

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24 For a literature review on the role of financial services sector in economic development, see W. Dobson and P. Jacquet, *supra* note 15 at 24-9.

25 A bank is failed if it is liquidated to meet its obligations to creditors. For the definition of "bank failure", see G.J. Benston et al., *Perspectives on Safe & Sound Banking: Past, Present, and Future* (Cambridge, Massachusetts: MIT Press, 1986) at 91-3.

26 In general, a country's banking system is the heart of its financial system. Holding the lion's share of the assets of financial intermediaries, banks are a major player in financial services sector, especially in most developing countries. It is also the case in some industrial countries such as Japan and Germany. See W. Dobson and P. Jacquet, *supra* note 15 at 109. See also D. Eu, *supra* note 12 at 472.

If depositors lose confidence in one bank, it can affect their confidence in other banks. It may spread to the entire banking system and lead to bank runs. The consequences may be felt throughout the economy. See W. Dobson and P. Jacquet, *ibid.* For discussion on the consequence of bank failure, see G.J. Benston, *ibid.* at 37-42 & 65.

27 R.B. Packer, *Financial Liberalization and the Reconstruction of State-Market Relations* (New York: Garland, 1998) at 4.

28 The "late-development theory" insists on state intervention. See P. Bowles & G. White, *The Political Economy of China's Financial Reforms: Finance in Late Development* (Boulder: Westview Press, 1993) at 5.

At global level, the existing multilateral GATS framework provides rules that ensure fair competition and promote liberalization in both the telecommunications and financial services sectors. Under the GATS framework, the WTO has reached multilateral liberalization agreements on both telecommunications and financial services. The WTO members that account for more than 95 per cent of the world's telecommunications traffic[29] and of the world's financial services market shares,[30] have signed respectively the WTO Basic Telecommunications Agreement (BTA) and Financial Services Agreement (FSA).

The GATS is the first-ever set of rules governing international trade in all kinds of services. It regulates any internationally traded service in any sector except those provided in the exercise of governmental authority.[31] Despite the fact that GATS does not provide a definition for the term of "services", it categorizes international trade in services upon the mode of supply of the services.

A. Category of International Trade in Services

According to Article I.2 in the GATS, international trade in services is categorized in the following four modes[32] of supply of a service[33]:

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[29] D.L. Dougan, "Globalizing Telecommunications Services: Angel in the Concept, Devil in the Details" in W.B. Garrison, Jr., C.P. Foss and C. Charles, eds., *The WTO Telecom Agreement: Engineering the Global Information Highway* (Washington D.C.: Center for Strategic & International Studies, 1997) 5 at 6. For a background on the BTA, See J.D. Aronson, "Telecommunications Agreement Tops Expectations" in G.C. Hufbauer and E. Wada, eds., *Unfinished Business: Telecommunications after the Uruguay Round* (Washington, D.C.: Institute for International Economics, 1997) at 15-26 ; See also W.J. Drake & E.M. Noam, "Assessing the WTO Agreement on Basic Telecommunications" in G.C. Hufbauer and E. Wada, eds., *Unfinished Business: Telecommunications after the Uruguay Round* (Washington, D.C.: Institute for International Economics, 1997) at 27-61.

[30] The FSA covers more than 95 per cent of world trade in banking, insurance, securities and financial information. "Successful Conclusion Of The WTO's Financial Services Negotiations" *WTO Press/86* (15 December 1997); See also W. Dobson & P. Jacquet, *supra* note 15 at 89.

[31] GATS Article I 3 (b): "services" includes any service in any sector except services supplied in the exercise of governmental authority, *supra* note 9 at 286.

[32] GATS Article I 2, *supra* note 9 at 285-6 See also J.H. Jackson, W.J. Davey and A.O. Sykes, *supra* note 3 at 922.

[33] GATS Article XXVIII (b) "supply of a service" includes the production, distribution, marketing, sale and delivery of a service, *supra* note 9 at 302.

a. Cross-border Supply of Services

Services are received by consumers in the territory of a WTO member from suppliers in the territory of another WTO member. There is no physical movement of the supplier or consumer through cross-border supply. For example, one of the international telecommunications services -- call-back services[34] -- are usually provided by American telecommunications providers to users in other countries without presenting themselves in those countries. By using their call-back services without going to where the American telecommunications providers are located, for instance, a user in Argentina, can make long-distance calls to anywhere in the world at US rates.[35]

b. Consumption Abroad

Consumers who are nationals of a WTO member use or receive services in the territory of another WTO member where the service suppliers are located. For example, a Japanese tourist opens an account with an American bank in New York City during his trip to the United States.

c. Commercial Presence[36]

Services are supplied in the territory of a WTO member by (legal) entities that have established a presence there but originate in the territory of another WTO member. For example, the Royal Bank of Canada sets up a branch in China according to relevant Chinese laws.

d. Movement of Natural Persons

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[34] Call-back service is an international telecommunications service that bypasses the local telephone provider. After a user calls the call-back service and identifies himself, the computer breaks the connection and calls the user back at a predetermined telephone number with a low-cost foreign dial tone. B.A. Petrazzini 1996, *supra* note 18 at 21-3, 92. See also C.H. Kennedy and M.V. Pastro, *An Introduction to International Telecommunications Law* (Boston: Artech House, 1996) at 133-4.

[35] See B.A. Petrazzini 1996, *ibid.*, see also C.H. Kennedy and M.V. Pastro, *ibid.*

[36] Defined in GATS Article XXVIII (d), *supra* note 9 at 302.

Services are supplied in the territory of a WTO member by persons employed by service suppliers or natural persons as service suppliers who are nationals of another WTO member. For example, a German engineer travels to China to provide annual maintenance to a Chinese factory that bought equipment from his company in Germany.

Any services that are provided by a WTO member country through any of the above-mentioned four modes of supply are bound by the GATS. However, a WTO member is allowed to choose the kinds of services that are bound under the GATS, given that it has filed schedules of commitments on market access and national treatment.

B. Specific Schedules of Commitments

The specific schedules of commitments are the outcome of negotiations on liberalization of trade in services between WTO members on a country-by-country basis, and comprise of an integral part of the GATS. In the schedules, individual WTO members specify: (1) the sectors to be opened (market access), (2) the extent of market access to be given in those sectors,[37] and (3) any limitations on national treatment[38]. The specific schedules of commitments serve as *de facto* guaranteed conditions for foreign exporters and importers of services and investors in services sectors doing business in hosting WTO member countries. The schedules can be modified, whereas the withdrawal

[37] However, the WTO members are not allowed to impose the following limitations on market access that is granted to other WTO members in their schedules. GATS Article XVI exhaustively classifies measures of market access limitations that are prohibited:

(1) limitations on the number of service suppliers;
(2) limitations on the total value of service transactions or assets;
(3) limitations on the total number of service operations or on the total quantity of service output;
(4) limitations on the total number of natural persons that may be employed in a service sector or which a service supplier may employ;
(5) restrictions or requirements on the types of legal entity or joint venture permitted; and
(6) limitations on the participation of foreign capital.

[38] For instance, whether some rights granted to local companies will not be granted to foreign companies. But the GATS does not provide specific classifications of national treatment limitations.

of a country's commitments would lead to compensation for affected countries.[39]

a. Market Access

Market access is a WTO member's commitment to open its markets to services suppliers from other WTO members. WTO members can decide the extent to which, and the service sectors in which they grant market access, with respect to the four modes of service supply, in their specific schedules of commitments.

b. National Treatment

National treatment is a principle of non-discrimination under the GATS. Once a WTO member allows a foreign services supplier to do business in its territory, the foreign services supplier shall be subject to conditions no more onerous than the conditions imposed on its national services suppliers.[40] However, host countries are not barred to grant more favored treatment to foreign services suppliers than domestic services suppliers. Under the GATS, it is not compulsory for a WTO member to apply this principle unless it has granted market access to a foreign services supplier. In other words, the national treatment is not binding to WTO members unless commitments to market access have been made by them. However, the WTO members are allowed to impose limits on binding national treatment in their specific schedules.

c. Additional Commitments

The GATS allows the WTO members to undertake additional commitments with regard to services measures not covered by market access and national treatment, including commitments on qualifications, standards and licensing.[41]

39 GATS Article XXI, *supra* note 9 at 299.
40 GATS Article XVII, *supra* note 9 298.
41 GATS Article XVIII, *ibid.*

C. Most Favored Nations (MFN)

Most favored nation (MFN) is another non-discrimination principle under the GATS. It requires that services suppliers from any WTO member be given no less favorable access than is allowed to other WTO members. That is, favor one, favor all. If a WTO member allows services suppliers from another WTO member to do business in one sector, equal opportunities in the same sector should be given to services providers from all other WTO members. It applies to all services sectors, including those sectors in which no commitments to market access have been made by the WTO member. Besides, the principle of most favored nation applies to all measures[42] affecting trade in services.

Nevertheless, WTO members are allowed to make exemptions to the MFN obligation. The MFN exemption must only be made before the entry into force of the agreement. In principle, the exemption can not last more than ten years.[43] Without a MFN exemption, a WTO member must treat the services or services suppliers from each WTO member as favorably as it treats those from any other country, including both WTO members and non-WTO members. On the other hand, even if a WTO member files a MFN exemption, it may be applicable only to unscheduled services or to grant special preferences over and above the market access restrictions indicated in its schedule.

D. Transparency

Article III of the GATS requires all WTO members to ensure the public

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42 GATS Article XXVIII:
(a) "measure" means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form;
(c) "measures by Members affecting trade in services" include measures in respect of:
(i) the purchase, payment or use of a service;
(ii) the access to and use of, in connection with the supply of a service, services which are required by those Members to be offered to the public generally;
(iii) the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member.

43 GATS Article II, *supra* note 9 at 286. See also GATS Annex on Article II Exemptions, online: <http://www.wto.org/english/docs_e/legal_e/26-gats.pdf> at 305, (date accessed: 12 July 2000).

availability of information with respect to all relevant laws, regulations, administrative guidelines, and international agreements relating to trade in services. Further, they have to notify the WTO of any changes in regulations that apply to the services covered by their specific commitments.

Within two years of the entry into force of the agreement, WTO members have to set up inquiry points within their bureaucracies for information dissemination. Foreign companies and governments can then use these inquiry points to obtain information about regulations in any services sector. However, individual developing countries may ask for appropriate flexibility regarding the time limit due to practical difficulties.

E. Progressive Liberalization

In pursuing increased market access and national treatment, the GATS states that the process of liberalization shall take place with due respect for national policy objectives and the level of development of individual WTO members, both overall and in individual sectors. There shall be appropriate flexibility for developing countries for opening fewer sectors, liberalizing fewer types of transactions, and progressively extending market access in line with their development situation.[44]

F. Summary

While the MFN and National Treatment are essential to ensure that international trade in services is conducted fairly and freely, the provisions of transparency secure a predictable trading environment among the WTO members. Furthermore, market access is the cornerstone necessary for the concept of liberalization to prevail. Above all, the process of liberalization can be determined by individual countries in consideration of

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[44] GATS Article XIX 2, *supra* note 9 at 298.

their national policy objectives and the level of development.

Telecommunications and Financial Services under the GATS

As services in general, both telecommunications and financial services are regulated by the general rules and principles under the GATS. However, there are different issues with respect to each of them that need to be addressed specifically. Telecommunications is provided quite differently from the manner in which financial services are provided. Unlike users of telecommunications services that consume services, customers of financial services bear more risk. Depositors, for instance, help to provide the resources that financial institutions use to distribute. If depositors lose confidence in one bank, it can affect their confidence in other banks and result in a run on banks. The entire banking system can therefore be put in jeopardy.[45] Therefore, a bank's failure can be destructive to the economic growth of an economy as the consequences may be felt throughout the economy. The stability of a financial system is certainly of paramount importance to an economy. Hence, it is crucial to maintain customers' confidence in the financial system.

Unlike the financial services sector, interconnectivity is essential to the operation of telecommunications. Telecommunications is a network of networks. It is provided by providers through various network systems. To allow the users of one provider to communicate with users of another provider and/or to access services provided by another provider, it is essential to ensure the technical compatibility of different communications systems and the access of one system to another.

Due to the significant differences in the two sectors, both were negotiated separately under the GATS framework. Annexes on financial services and on telecommunications were added to the GATS in order to deal with special sectoral issues.

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45 See G.J. Benston et al., *supra* note 25, at 42 & 65.

Upon the conclusion of the FSA and the BTA, these annexes were included as parts of the two agreements accordingly.

A. WTO Financial Services Agreement (FSA)

The WTO Agreement on Financial Services was reached on 12 December 1997 and entered into force on 1 March 1999. The agreement brings trade in financial services under the GATS' multilateral rules, aimed at the elimination or relaxation of restrictions on, *inter alia*, commercial presence of foreign financial services suppliers, and the reduction of current limitations on services suppliers. It covers three major sectors of financial services -- banking, securities and insurance.[46]

a. Ensuring the Stability of the Financial System

The FSA is designed to promote trade liberalization in the financial services sector. The primary function of the financial services sector is, under the financial system, to allocate resources and facilitate finance in the economy. A financial system of a country is essentially the central nerve of its finance infrastructure. Given that finance is a direct means of achieving autonomy, any change in the financial system would have an immediate impact on both economic and political aspects of an economy.[47] Maintaining the stability of the financial system is of paramount importance to an economy while it undergoes liberalization in its financial services sector.

Among others, the prudential measures have been well acknowledged as a feasible means of maintaining the stability of a financial system.[48] Setting standards for prudent

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[46] Activities covered by the GATS in financial services include two broad categories of services: insurance and insurance-related services, and banking and other financial services. See the GATS Annex on Financial Services 5 *Definitions* (a), *supra* note 9 at 309.

[47] R.B. Packer, *supra* note 27.

[48] There are two different approaches with respect to this goal. First is the restriction of market forces, which represents obstacles to free competition in financial services. Second is prudential regulation, which involves the supervision of balance-sheet ratios and of norms aimed at a proper diversification of risk exposure. OECD, *Banks Under Stress* (Paris: OECD, 1992) at 32-34.

management of financial institutions, prudent regulation does not directly interfere with the price mechanism, nor prohibit the rendering of financial services. Therefore, it has generally been strengthened and adapted to meet the trend of liberalization in the financial services sector.[49]

The GATS/FSA allows the application of prudential measures taken by the WTO members so as to protect investors and to ensure the integrity and stability of their domestic financial systems.[50] It also permits the use of temporary non-discriminatory restrictions on balance-of-payments and transfers in the event of serious balance-of-payments and external financial difficulties.[51] Moreover, the management of monetary and exchange rate policy falls outside the scope of the GATS.[52] Indeed, countries are not required in any way to compromise their ability to pursue sound macroeconomic and regulatory policies.

b. Liberalization of Capital Account Transactions

The FSA does not focus on the question of how far and how fast a government liberalizes capital account transactions. Rather it intends to liberalize the financial services sector. While a WTO member commits to liberalize its financial services sector,

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49 See OECD, *ibid.*

50 The GATS Annex on Financial Services 2 *Domestic Regulation* (a), *supra* note 9 at 308:

> "Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement."

See also W. Dobson & P. Jacquet, *supra* note 15 at 34.

51 GATS Article XII, *supra* note 9 at 293.

52 The GATS Annex on Financial Services 1 *Scope and Definition* (b), *supra* note 9 at 308:

> "For the purposes of subparagraph 3(b) of Article I of the Agreement, "services supplied in the exercise of governmental authority" means the following:
>
> (i) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies;
>
> (ii) activities forming part of a statutory system of social security or public retirement plans; and
>
> (iii) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government."

it is required to allow international transfers and payments for transactions relating to their specific commitments. Some of these transactions may involve capital account transactions.[53] Nevertheless, the GATS/FSA aims at seeking improvements in the terms and conditions of market access and non-discriminatory treatment for foreign suppliers of financial services. In addition, the GATS/FSA gives due regard to individual countries' level of economic and sectoral development. No country is forced to liberalize its capital account transactions immediately upon entry to the WTO.

B. WTO Basic Telecommunications Agreement (BTA)

The WTO Agreement on Basic Telecommunications was reached on 15 February 1997 and entered into force on 5 February 1998.[54] Basically, the agreement, under the auspices of the GATS, provides rules for liberalization in domestic telecommunications markets, including market access, foreign investment, and pro-competition regulatory principles.

Under the BTA, the WTO members grant market access to their local, long-distance, and international call services through any means of network technology, either on a facilities basis or through resale of established network capacity.[55] These services can be supplied cross-border and through commercial presence. Under the agreement, the WTO members allow each other to own and operate independent telecommunications network infrastructures while establishing legal entities within their respective territories. In fact, the BTA extends to regulate foreign investment in the telecommunications sector.

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53 See W. Dobson & P. Jacquet, *supra* note 15 at 34.

54 For a comprehensive summary, see P. Larouche and M. Bronckers, "Telecommunications Services and the WTO" (1997) 10 *J. World Trade L.*. See also WTO working paper S/C/W/74, Telecommunication Services: Background Note by the Secretariat, 8 December 1998. See also J.D. Aronson, and W.J. Drake & E.M. Noam, *supra* note 29.

55 WTO S/GBT/W/2/Rev.1, *Notes for Scheduling Basic Telecom Services Commitments - Revision* (16 January 1997) online WTO: <http://www.wto.org/wto/services/tel16.htm> (date accessed: 7 December 1998).

Through commercial presence, the WTO members ensure to each other the opportunity to acquire, establish, or hold stakes in telecommunications companies in the market.

The telecommunications industry across the world was naturally deemed to be under private or public monopoly control. The provider and operator of telecommunications in any country was either the regulator of its telecommunications industry, or had a close relation to the regulator. It was not until the 1980s that competition gradually stepped into the industry and the monopolies have been broken up one after another all over the globe. As regards the long history of monopoly over the telecommunications industry, it is necessary to secure a fair competition in the market. The GATS/BTA provides regulatory principles that make competition effective.[56]

a. Competition Safeguards

Despite the fact that many countries have broken up their telecommunications monopolies, their telecommunications to a large extent are operated by some dominant telecommunications providers. These dominant telecommunications providers are usually big and strong in terms of finance, size and technology. They can easily block competition from other new and smaller telecommunications providers in the market. Some dominant telecommunications providers apply cross-subsidization, others exploit information obtained from their competitors, and others fail to make available to competing providers on a timely basis technical information about essential facilities and other commercial information required to provide services. The WTO members are obliged to provide "appropriate measures" so as to prevent these anti-competitive practices.

b. Interconnection

[56] WTO, Negotiating Group on Basic Telecommunications, *Reference Paper on Regulatory Principles* (24 April 1996) [hereinafter "Reference Paper"]. Online WTO: <http://www.wto.org/wto/services/tel23.htm> (date accessed: 7 December 1998).

Telecommunications is essentially a network of networks. To allow the users of one provider to communicate with users of another provider and to access services provided by another provider, the WTO members are required to ensure interconnection rights at any technically feasible point in the network under the BTA. Interconnection must be provided on non-discriminatory terms, and in a timely fashion. Its rates are required to be cost-oriented, transparent, and unbundled.[57] Furthermore, the WTO members shall make the procedures for interconnection publicly available and transparent. An independent regulator with the power to resolve disputes is called for to settle disputes about interconnection within a reasonable period of time.

c. Universal Service

Telecommunications helps people around the world to contact one another, to access information instantly, and to communicate from remote areas. It is also fundamental for operators of all sorts of economic activities to conduct business. Hence, the obligation of universal service is essential to ensure the provision of telecommunications services to all households and small firms. The agreement does not rule out the WTO members' right to establish universal service obligations. However, they must be administered in a transparent, nondiscriminatory, and competitively neutral manner. The obligations should not be so burdensome as to constitute a barrier to competition.[58]

d. Licensing Criteria

Where licenses are required to operate a service, the country must make publicly available all licensing criteria and the time period required to reach a decision about an application for a license. The WTO members under the BTA are also committed to make

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[57] The term 'unbundled' means that the competitors that apply for interconnection shall not be charged for network components or facilities that they do not require. See Reference Paper 2.2 (b), *ibid.*

[58] Reference Paper 3, *ibid.*

the terms and conditions of individual licenses publicly available.

e. Independent Regulators

Previously, telecommunications monopolies were either the regulators of the telecommunications industry, or had a close relation to the regulators. It was easy for those telecommunications monopolies to block competition in the market. Telecommunications liberalization would be ineffective if the regulatory bodies had a close link to and great interest in the operation and provision of telecommunications. Under the agreement, the WTO members are required to set up regulatory bodies that are separate from, and not accountable to any telecommunications providers. The independent regulator over the telecommunications industry is expected to make decisions on an impartial basis, and to regulate the industry so as to prevent anti-competitive behaviors.

f. Resource Allocation

Telecommunications is provided through scarce resources such as spectrum frequencies etc., that need to be allocated. Other resources such as telephone numbers are also important in the operation of telecommunications. To secure a pro-competitive telecommunications market, procedures for the allocation of these resources should be "carried out in an objective, timely, transparent, and nondiscriminatory manner."[59]

g. Wide Access

Transmitting information and data, telecommunications facilitates the fulfillment of economic activities and serves as an infrastructure for the delivery of services in the Information Age. Under today's trend of globalization, many types of services can be accessed across national borders in the use of telecommunications. Telecommunications

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59 Reference Paper 3, *ibid.*

networks and services therefore constitute a crucial form of cross-border supply, one of four designated modes of supply for services under the GATS framework. Hence, the BTA requires WTO members ensure the access to, and use of, public telecommunications networks and services. The WTO members must make their public telecommunications networks accessible to foreign services suppliers for domestic and international services provisioning once they have agreed to liberalize the services in question.[60] It requires that access to and use of public networks and services be provided on a reasonable and non-discriminatory basis. All in all, the BTA requires that the WTO members apply no restrictions on access and use, and given that the public services responsibilities of the public telecommunications operations are safeguarded, the technical integrity of public networks is not endangered.

Conclusion

Telecommunications and financial services are currently being liberalized throughout the world. The GATS framework provides a set of comprehensive principles governing international trade in services in general, and telecommunications and financial services in particular. The multilateral agreements on telecommunications and financial services under the GATS framework represent the level and range of liberalizing process in both sectors. Moreover, they provide rules that ensure fair competition and promote further liberalization in both sectors. Nevertheless, the GATS framework gives due respect to national policy objectives and the level of development of individual countries undertaking liberalization in both sectors.

What are China's national policy objectives in telecommunications and financial services sectors? How well have China's telecommunications and financial services sectors developed? The next Chapter presents a survey of China's telecommunications and banking industries.

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60 See GATS Annex on Telecommunications 2. *Scope*, *supra* note 9 at 313.

Chapter Two

An Overview of Chinese Telecommunications and Banking Sectors

General Background

A. Centrally Planned Economy from 1949-1979

With the beginning of the regime of the Chinese Communist Party in 1949, China employed a centrally planned economy along Stalinist Soviet lines.[61] Market prices, which play a crucial role in signaling information and allocating resources in market

[61] The Soviet model of a centrally planned economy minimizes market exchange, the use of money, and private ownership of the means of production. The state is the allocator of resources and sponsor of accumulation. See P. Bowles & G. White, *supra* note 28, at 47.

China's economy was never completely planned from the center; even before the reforms it was substantially less planned than Soviet and East European economies. See B. Naughton, "Industrial Planning and Prospects in China" in E.K. Lawson, ed., *U.S.-China Trade: Problems and Prospects* (1988) 179 at 181.

economies, did not exist in the centrally planned Chinese economy. Rather, the state fixed all prices.[62] The prices therefore have no relation to relative scarcity of resources. In addition, national economic activities were generally organized through central commands and targets. The state allocated both financial and physical resources to the state-owned enterprises (SOEs) in order for them to meet the national plans.[63] The practice of central planning failed to gather appropriate information, thus constraining enterprises from bidding for scarce resources.[64] That, in turn, shriveled the state's ability to properly finance all sorts of industries in the economy. The ministries had to compete with each other for the limited state budget. The telecommunications industry, for example, was unable to substantially extend China's telecommunications network because of insufficient financial resources. The telephone penetration rate in China was still only 0.4 telephones per 100 inhabitants for the country as a whole in 1980.[65]

In the absence of market prices, the financial system in the centrally planned economy had an essentially passive role in allocating resources.[66] Bank credit was allocated to the SOEs in accordance with the state credit plan.[67] In practice, Chinese banks in no way took into account the performance and creditworthiness of the SOEs while granting loans to them. They did not function as an intermediary as do banks in Western industrialized countries that supervise the performance of enterprises and allocate funds in between savers and investors. Rather, they were expected to cover any

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62 In a centrally planned economy, prices are primarily used for accounting and control purposes. They are often dictated by the state for the simple reason that the inflexibility of prices is crucial toward those ends. D. Eu, see *supra* note 12, at 485-6.

63 See generally J.L. Wu, "China's Economic and Financial Reform" in O.K. Tam, ed., *Financial Reform in China* (London: Routledge, 1995) 83 at 83-4.

64 D. Eu, see *supra* note 12, at 485-6.

65 By the end of 1980s, ten years after the initiation of the economic reforms, nationwide telephone density was only about one per 100 person, far below the developing countries' average density of three telephones for every 100 people. See P. Lee, "Telecommunication and Development", *supra* note 18 at 16, 193. In 1995, there were still only 2.37 mainlines per 100 persons. M. Mueller and Z.X. Tan, *China in The Information Age: Telecommunications and The Dilemmas of Reform* (Westport, CT: Praeger, 1997) at 29.

66 D. Eu, *supra* note 12 at 486.

67 The credit plans was formulated by the State Planning Commission, the People's Bank of China (PBOC) and various ministries. It was implemented through a set of credit quotas for each bank and direct bank financing of enterprises. Banks were required to issue loans through the government's credit plan. The credit plan determined credit allocations for all enterprises, through which the government directed banks towards the achievement of the central investment plan targets. The credit plan was mandatory on the state-owned banks. See W. Dobson & P. Jacquet, *supra* note 15 at 165.

losses that were necessary to balance the SOEs' accounts.[68] Bank credits were automatically granted to designated SOEs. Through the practice of policy lending under the centrally planned system, the SOEs had little incentive to operate on an efficient and productive basis. Furthermore, those loss-making SOEs were not allowed to go bankrupt.[69] The state, with its already scarce financial resources, had to finance and support not only productive but also money-losing SOEs. The economy as a whole remained backwards at that time.

B. Reforming Age - from 1979 onward

In order to improve the effectiveness and productiveness of the economy, China embarked on economic reforms and adopted an open-door policy in the late 1970s.[70] The economic reform programme was put forth to change the economy from administrative methods of regulation and control towards economic mechanisms. It involved the decentralization of the centrally planned system and the introduction of market mechanisms.

In the reforming era, greater operational autonomy was given to both lower administrative levels within the state machine and economic actors of all kinds, from large SOEs to individuals. Private-owned enterprises have increasingly emerged and tapped into most economic sectors.[71] The centrally planned economy was gradually deregulated. Market competition was steadily brought into many aspects of China's economic activities. Notwithstanding, the ownership remained substantially in the state's hands. Without exception, both telecommunications and banking sectors have, more or

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68 See P. Bowles & G. White, *supra* note 28, at 61.

69 "If the enterprises was unable to repay the loans, it would not be allowed to go bankrupt." P. Bowles & G. White, *supra* note 28 at 62.

70 For an historical introduction to China's economic reform and the open door policy, see C.R. Dipchand, Y.C. Zhang and M.J. Ma, *The Chinese Financial System* (Westport: Greenwood, 1994) at 15-6. For a summary on Chinese economy in 1980-1990, see C.R. Dipchand, Y.C. Zhang and M.J. Ma, "Appendix", at 209-20.

71 In 1998, most of the privately owned enterprises were still in the service trade. CEInet, Industrial Profiles & Market Research -- General, "Outlook of China's Private Sector" online: <http://ce.cei.gov.cn/ ecit.htm> (date accessed: 16 June 1999).

less, walked along a similar institutional transition path, albeit at different paces and through different strategies.[72]

C. Characteristics of Chinese Reform Model

A glimpse of China's economic reforms in the past two decades reveals two major characteristics of the Chinese reform model. First, China's economic reforms have not followed a rigid, comprehensive blueprint. The only possible but informal guideline may be found in one of Deng Xiaoping's favorite slogans - "Navigating an unknown river while searching rocks".[73] In other words, there did not exist an outline of the overall economic reforms from the outset. This includes two important aspects. First, as China is a comparatively late developer in the world economy, it has a good chance to learn the lessons from the early and advanced market economies.[74] It is particularly the case while China is seeking market solutions to its under-developed economy in the transition towards a more market-oriented infrastructure. The People's Bank of China (PBOC), as an example, is being transformed into China's central bank much in the manner of the Federal Reserve Bank in the United States.[75]

Another aspect to this is that China's economic reforms have been characterized by pragmatism and gradualism.[76] Reforms first started in the agricultural sector where resistance was the weakest and then spread to those sectors where the reform measures were more complex. Each projected reform started only after extensive experimentation. Special economic zones, for example, were set up as a trial of the open-door policy. In the beginning, foreign investors were only allowed to operate in the special economic

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[72] See Part II of this Chapter, below, for more discussion on this topic.

[73] Translated by the author. In Chinese Pin Yin, "Mo ze shi tou guo he."

[74] As observed by Amsden, those economies succeeding in industrialization in the twentieth century have done so by learning. See P. Bowles & G. White, *supra* note 28, at 34. China, as a late developer in the world economy, especially in the telecommunications and banking sectors, can well learn from those who have already experienced deregulation and liberalization of both sectors.

[75] S.X. Xu, "PBOC Holds Key to Averting Crisis" *South China Morning Post Internet Edition* (14 May 1998) online: <http://www.scmp.com> (date accessed: 20 May 1999).

[76] H. Mehran and M. Quintyn, "Financial Sector Reforms in China"(March 1996) online: Finance & Development <http://www.worldbank.org/fandd/english/0396/articles/040396.htm> (date accessed: 24 June 1999)

zones, in which different regulations and policies applied. Once the practice of the special economic zones was proven successful, more and more cities and areas were opened up to extensive foreign investment one after another. It is not surprising that China applies the same approach in granting market access to foreign financial institutions and foreign telecommunications providers.

The lack of a reform blueprint has a further implication. While seeking market solutions to the under-developed economy, China has a good chance to learn the lessons from the early developed and advanced market economies. For instance, China's banking system has little experience of real banking as it served as the government's cashier under the centrally planned system.[77] With China under transition towards a market economy, it has adopted the concepts of commercial banking from, and created a central bank in line with, Western countries.[78]

Second, China intends to seek a unique Chinese road that combines authoritarianism, nationalism, and market solutions.[79] China's Constitution, amended in 1993, clearly states that China practices a "socialist market economy".[80] It advocates that more weight should be given to market forces, with the government limiting its role to setting and implementing broad macroeconomic policies.[81] In addition, the 1999 Amendment to China's Constitution clarified the role of private business as "an important

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77 See part II of this Chapter, below, for more on this topic.

78 See S.X. Xu, "PBOC Holds Key to Averting Crisis", *supra* note 75. See also P. Chan and M. O'Neill, "Asia Woes Spur Beijing to Act" *South China Morning Post Internet Edition* (14 May 1998) online: <http//www.scmp.com> (date accessed: 20 May 1999). See also X.W. Wang, "Reforms Pave Way for Radical Change at Beijing Cashier" *South China Morning Post Internet Edition* (14 May 1998) online: <http//www.scmp.com> (date accessed: 20 May 1999).

79 D. Burstein & A. Keijzer, *Big Dragon: China's Future: What Is Means For Business, The Economy, And The Global Order* (New York: Simon & Schuster, 1998) at 352.

80 1993 Chinese Constitution Article 15: "The state practices socialist market economy." "Constitution of the People's Republic of China" online: Chinalaw Web <http://www.qis.net/chinalaw/> (date accessed: 10 December 2000)

81 At the 14th Party Congress held in October 1992, the Congress called for a "socialist market economy". The Chinese Premier Jiang Zemin interpreted the term "socialist market economy" as the following:

> "By establishing the structure of a socialist market economy we mean to let market forces, under the macroeconomic control of the state, serve as a basic means of regulating the flow of resources, to subject economic activity to the law of value and to make it responsive to changing relations between supply and demand."

C.R. Dipchand, Y.C. Zhang, and M.J. Ma, *supra* note 70 at 194.

part of the socialist market economy".[82] However, the government relies predominantly on remittances from the SOEs for its revenues. When resources are in short supply, the SOEs always have the first priority in their allocation. Moreover, private businesses are in a different category for bank loans and securities listings where tougher standards of approval are applied. There is also the policy of no-entry for private business into certain industrial sectors where it is held that only state companies will strive to serve the needs and the interests of the state.[83] In general, the SOEs still play a leading role in the economy.[84] Their development is ensured by the state through state subsidies. The SOEs are thus subject to state control and regulation.

According to the theory of late development, state involvement in China's economy is desirable for the country to address multiple national and sectoral priorities. It is especially true when China, apparently a late developer in the telecommunications and banking sectors, intends to develop in an international context that has already been dominated by earlier and advanced industrialized countries.[85] The implication in the banking sector is that the central government is required to retain sufficient power over the central bank so as to ensure a financial system capable of implementing strategic development objectives. In this respect, certain types of direct government intervention might be carried out in China's financial system. In the telecommunications industry, it implies that the government intends to strongly support the development of domestic enterprises so that they are able to catch up with and/or compete with their counterparts in

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82 In 1994, the state-owned enterprises accounted for approximately 34% of China's output, the rest was shared by the collective-owned enterprises, individuals and the "other" enterprises. See Pacific Rim, "People's Republic of China -- Country Overview" in A. Tambunan, ed. *Pacific Rim Country Overviews*, online: <http://pacificrim.bx.com> (date accessed 7 June 1999). See also CEInet, Industrial Profiles & Market Research -- General, *supra* note 71.

83 These areas usually include energy and raw materials, heavy industries, transport, and communications.

84 1993 Chinese Constitution Article 7: "The state-owned economy, i.e. the socialist economy with ownership by the people as a whole, is the leading force in the national economy. The state will ensure the consolidation and development to the state-owned economy." Chinalaw Web, *supra* note 80.

85 According to the theory of late-development, the 'late developer' should adopt policies that promote and secure the development of strategic national economic sectors. Only when its national economic interest is appropriately addressed, is the late developer able to develop in an international context already dominated by earlier and advanced economies. In so doing, the relationship between state and economy is considerably coordinated. Thus, the degree of state involvement in the economy will be high. P. Bowles & G. White, *supra* note 28.

the international market.

China's Banking Industry

A. The Banking Industry in Transition

a. Force for Financial Reforms

Prior to 1979, China employed a monobank system.[86] The PBOC was the only bank in China.[87] It was responsible for the issue and control of currency, the implementation of monetary policy and other functions of a central bank. It also operated a commercial banking business, including taking of deposits and lending. The PBOC held not only accounts of all enterprises, government units and cooperatives, but also savings of individuals.[88] Furthermore, the PBOC, as a financial agent complementary to the centrally planned economy, was responsible for monitoring the implementation of the state plan.[89] It employed monetary and credit policy through the form of a credit plan.[90] It was one of its primary concerns to ensure that loans be made to priority state sectors. The PBOC is responsible for overseeing the distribution of bank credit to the SOEs with the assistance of two of its departments -- the Bank of China (BOC) and the Agricultural

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86 See J.L. Wu, *supra* note 63 at 85.

87 Prior to 1949, there were some financial institutions and financial markets in China. After the Chinese Communist Party adopted the centrally planned economy, the PBOC was designated as a monobank. Old financial institutions were either confiscated or nationalized, and were merged with the PBOC. Financial markets were closed and financial instruments were prohibited. For a historical review of China's financial sector before 1979, see C.R. Dipchand, Y.C. Zhang and M.J. Ma, *supra* note 70 at 1-18. See also J.L. Wu, *ibid.*

88 During that time, the government was the main saver and investor. On the eve of the reforms in 1978, household savings accounted for only 3 per cent whereas the state budget accounted for 46 per cent of total national savings. See J.C.H Chai, *China: Transition to a Market Economy* (Clarendon: Oxford, 1997) at 118. See also J.L. Wu, *ibid.*

89 See generally C. Holz, *The Role of Central Banking in China's Economic Reforms* (Ithaca, N.Y.: East Asia Program, Cornell University, 1992) at 38-52.

90 See *supra* note 67.

Bank of China (ABC) -- and the People's Construction Bank of China (PCBC).[91] In so doing, the PBOC should, in theory, have a strong position in enhancing the efficient operation of the SOEs.[92] However, practice has provided evidence to the contrary. Since the credit plan was an aggregation of sectoral and local financing needs done from the bottom up, an expansionary bias was inherent in the system. The SOEs were entitled to borrow from the state banks as required for fulfillment of the target without being restrained by interest rates and credit ceilings. Moreover, plans enabled loss-making SOEs to receive banking loans anyway. Banks rarely took into account the performance of the designed SOEs while granting bank credit in accordance with the state credit plan. This impaired the PBOC's ability to manage monetary developments.[93] In addition, the loss-making SOEs were not allowed to go bankrupt if they were unable to repay the loans.[94] The exercise of policy lending has therefore allowed many loss-making SOEs to remain in business. In practice, it failed to promote economic efficiency. Rather, it encouraged inefficient use of borrowed capital by SOEs.[95] It also induced further shortages of financial resources in the entire economy.

As economic reforms proceeded, various forms of decentralization, deregulation and the restoration of the market mechanism in all economic sectors transformed and created new socioeconomic institutions. Bank credit started to play a new and significantly expanded role as a source of finance in all spheres of economic activities.[96] China's old banking system had been merely a complement to the centrally planned economy. The newly reforming socioeconomic environment called for such a banking system that is able to create an effective corporate governance structure.[97] Besides, the

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91 Under the monobank system, the BOC and the ABC were then two departments under the auspice of the PBOC, while the PCBC was an agent of the Capital Construction Finance Department of the Ministry of Finance (MOF).

For a detailed introduction to of the BOC, ABC and PCBC, see C.R. Dipchand, Y.C. Zhang and M.J. Ma, *supra* note 70 at 56-68.

92 See P. Bowles & G. White, *supra* note 28 at 55-68.

93 See H. Mehran and M. Quintyn, *supra* note 76.

94 See *supra* note 69.

95 See P. Bowles & G. White, *supra* note 28 at 62.

96 After the economic reforms were introduced, household savings deposits dramatically increased. From 1978-1988, they increased by an average rate of 30.5 per cent per annum. Household saving deposits formed the main source of bank funds in the state banking system. See J.L. Wu, *supra* note 63 at 84.

97 See *supra* note 12.

open door policy drew foreign investment and boosted international trade. It required greater compatibility between Chinese and international financial practices. Hence, the financial reforms have been set out as a prominent part of China's overall programme of economic reform since 1979.

Table 1: The Centralized Financial System and the Ministry of Finance[98]

State Council[99]	
Ministry of Finance (MOF)	People's Bank of China (PBOC)
People's Construction Bank of China (PCBC) Bank of Communications (BOCom before 1958)	Bank of China (BOC) Agriculture Bank of China (ABC) Bank of Communications (BOCom after 1958) People's Insurance Company of China and other insurance companies

b. Deregulation of China's Banking System

The main drive of China's financial reforms has been towards a diversified and competitive financial system. It intends to move China's banking system away from one that is administratively controlled towards one that is more commercialized and market-oriented. In doing so, greater autonomy was necessitated for banks, to operate as truly independent units on a profit and loss basis.

i. Two-tier Banking System

Against this background, the monobank system was broken up into a two-tier banking system, which consists of commercial banks and a central bank. The ABC was the first to be given independence, taking over all the deposit and lending business in rural areas from the PBOC.[100] Then, the BOC was separated from the PBOC, focusing on

98 C.R. Dipchand, Y.C. Zhang, and M.J. Ma, *supra* note 70 at 6.

99 State Council is China's cabinet level organization of the executive branch of the government.

100 The Agricultural Bank of China was founded in the early 1950s. It had previously existed as an independent bank during 1951, from March 1953 to April 1957 and from October 1963 to November 1965. When it was dissolved and merged in the meantime, its operations were embodied within the Rural Bank Management Bureau of the PBOC. For details about the ABC, see CHINAEXPO, "Introduction of China's Financial System" online: <http://www.chinaexpo.com/service/index.html> (date accessed: 17 June 1999). See also C.R. Dipchand, Y.C. Zhang and M.J. Ma, *supra* note 70 at 8, 20, 65-8.

foreign currency business. The PCBC also became an independent bank, managing investment in fixed assets and providing medium- and long-term financing for capital construction. The Industrial and Commercial Bank of China (ICBC) was created to take over all commercial banking business from the PBOC in 1984.[101] Henceforth, the four banks conducted the commercial banking business in China within their well-defined business scopes.

Consequently, the PBOC was freed from commercial banking functions. It gradually took on the responsibilities of a central bank exclusively. It was to be responsible for managing the government's finance, macro-financial control of the economy and supervising the loan activities of the four existing banks. When the Law of the People's Republic of China on Commercial Banks (Commercial Bank Law) and the Law of the People's Republic of China on the People's Bank of China (Central Bank Law) came into force in 1995, the two-tier banking system was finally established in China. Accordingly, the PBOC is now the central bank, and the four state-owned banks are solely state-owned commercial banks.[102]

ii. Commercializing State Banks

The state-owned commercial banks consist of the ABC, the BOC, the ICBC, and the PCBC. They are subordinate directly to the State Council and supervised by the central bank PBOC.[103] The four state banks are allowed to open branches across the country. Having a vast network of branches in each province, they are able to take the bulk of deposits throughout the country. Accounting for 70 per cent of the assets of all banks and non-bank financial institutions in China,[104] the four state banks are the mainstays in China's banking industry.

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101 The ICBC is the largest commercial bank in China. It lends loans to the state-owned commercial and industrial enterprises.

102 Article 2 of the Central Bank Law, and Articles 18 and 41 of the Commercial Bank Law. See Appendices A and B.

103 Article 10 of the Central Bank Law. See Appendix A.

104 *People's Bank of China Annual Report 1992.* They accounted for 70 per cent of the assets in 1997. See R. Stride and G. Gaeta, *supra* note 10. They account for more than 90 per cent of banking assets. See also F.C. Peng in Shanghai, *supra* note 10.

Yet, the state banks had been continuously required to make policy lending to the SOEs for decades.[105] Bank credits were granted automatically to designated SOEs in accordance with the credit plan. While no SOEs were allowed to go bankrupt, some loss-making SOEs had been continuously financed by the state banks. The exercise of policy lending has therefore generated a tremendous amount of non-performing loans undertaken by the state banks.[106] It is one of the most pressing obstacles that has hindered the commercializing transition of the state banks. Due to the close relation of the resolution of non-performing loans to the rationalization of the SOEs, the big four can hardly be further commercialized without compatible reforms in the state sector.

iii. Towards A Competitive Banking System

Along with changes in the structure of the banking system came a rapid emergence of new banks and other types of financial institutions. In addition to the four state banks, China has two other groups of commercial banks. One group is the national banks. They are the Bank of Communications (BOCom),[107] which is the fifth largest bank in China, the CITIC Industrial Bank, whose shareholder is the China International Trust and Investment Company Group. Everbright Bank and Huaxia Bank are two smaller national banks, associated with industrial groups. And a third, Minsheng Bank, is a private shareholding bank. With the approval of the central bank, national banks can

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[105] The Commercial Bank Law also legitimates the responsibility of SOBs for policy lending. See Article 41 of the Commercial Bank Law in Appendix A. It was not until 1998 that policy lending was removed from the four state banks. Other commercial banks are not obliged to initiate policy lending under the Commercial Bank, though they should issue loans in accordance with the need of the national economy and social development and under the guidance of the State industrial policies. See Article 34 of the Commercial Bank Law. They were released from the responsibility for policy lending in 1998.

[106] In 1996, the SOEs consumed almost three-quarters of industrial investment but accounted for only a third of industrial output. They account for 65 per cent of national capital formation. See W. Dobson & P. Jacquet, *supra* note 15 at 164 and 175. For further discussion on the issue of non-performing loans, see below.

[107] The Bank of Communications is now the fifth largest bank in China, next to the four state banks. It was first set up in 1908. In the old China, it was one of the currency-issuing banks. After the liberation in 1949, it was restructured by the PBOC. It functioned as a public-private operated bank until 1958, when its business was taken over by the PBOC and the BOC. Its Hong Kong office remained under the supervision of the BOC. The BOCom was reestablished as a national commercial bank in 1987. For an introduction to the BOCom, see C.R. Dipchand, Y.C. Zhang and M.J. Ma, *supra* note 70 at 73-82.

open branches across the country. Yet, none of them has set up a branch network as extensive as have the state banks.[108] Another group is the regional banks, including, to name but a few, Guangdong Development Bank, Shenzhen Development Bank, China Merchants Bank, and Shanghai Pudong Development Bank. They are subject to geographic restrictions with respect to branching.[109] Unlike the national banks supervised directly by the central bank, the regional banks are supervised by the local branches of the PBOC.

Both national and regional banks are founded mostly as joint stock banks with various shareholders from the state to individuals. The shares of the Bank of Communications (BOCom)[110] are mostly owned by the central bank on behalf of the central government, and by local governments. Everbright Bank of China is the first bank in China that is partially owned by a foreign financial institution.[111] Mingsheng Bank is China's first bank wholly-owned by private shareholders, whose shareholders are drawn from the All-China Federation of Industry and Commerce.[112]

Unlike the four state banks, the two groups of banks are not required to extend loans on the state credit plan. Rather, according to the terms of the Commercial Bank Law, they make their lending decisions primarily on economic criteria.[113] Although influence from lead industrial groups and government investors may be exerted on them,

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108 Barely any of them have more than 25 branches so far. By comparison, the four state-owned banks have around 50,000 outlets. See R. Stride and G. Gaeta, *supra* note 10.

109 However, some regional banks, like the Merchants Bank and Shanghai Pudong Development Bank, operate almost on a national scale. See N. R. Lardy, *China's Unfinished Economic Revolution* (Washington, D.C.: Brookings Institution, 1998) at 70-1.

110 The Bank of Communications is now the fifth largest bank in China, next to the four state banks. It was first set up in 1908. In the old China, it was one of the currency-issuing banks. After the liberation in 1949, it was restructured by the PBOC. It functioned as a public-private operated bank until 1958, when its business was taken over by the PBOC and the BOC. Its Hong Kong office remained under the supervision of the BOC. The BOCom was reestablished as a national commercial bank in 1987. For an introduction to the BOCom, see C.R. Dipchand, Y.C. Zhang and M.J. Ma, *supra* note 70 at 73-82.

111 Everbright Bank was owned by the China Everbright (Group) Co. when it was established in 1992. In 1995, it was approved by the PBOC to convert to a joint stock bank. Everbright is the first Chinese bank having a foreign financial institution as one of its shareholders. The Asian Development Bank holds about 3.3 per cent minority ownership of Everbright. See N. R. Lardy, *supra* note 109 at 67.

112 See N.R. Lardy, *ibid.* at 69.

113 Chapter IV of the Commercial Bank Law -- Basic Rules Governing Loans and Other Businesses, see Appendix A.

the national and regional commercial banks provide services on a more market-oriented and customer-focused basis. With little burden of policy lending and non-performing loans, they are apparently in a stronger financial situation than the four state banks.[114]

However, these banks are mostly of small capital and of limited branch networks. They usually operate in chosen geographic regions and/or focus on specific industries. Together, they account for only one quarter of the market share in assets.[115] Their influence on the current banking system is insignificant.

c. Foreign Participation

In spite of the concerns that China's fragile banking system and fledgling financial markets might be subject to severe challenges from the introduction of foreign financial institutions, it was believed that opening China's financial services market would not only help bring in more foreign investors, but also contribute to the development of China's financial system. Thus, the introduction of foreign banks and other financial institutions was put on agenda as one of the major components in China's long-term reform and open-door policy.

In 1980, the first two foreign banks -- the First National Bank of Chicago and the Bank of Tokyo -- were authorized to open representative offices[116] in Beijing. Four years later, Chinese government granted foreign financial institutions the chance to set up branches and to establish joint venture banks with Chinese partners in selected cities. As of today, there are approximately 200 foreign financial institutions operating in the form of branches, joint ventures and subsidiaries in 23 Chinese cities and Hainan province.[117]

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114 "In 1996, the top six new commercial banks had grown about 28 per cent in both loans and deposits, while state-owned banks achieved only about 21 per cent growth...In terms of loans, figures are probably higher, in deposits, probably lower: new commercial banks alone account for about 15-20 per cent of loans but only 8-10 per cent of deposits." R. Stride and G. Gaeta, *supra* note 10.

115 See R. Stride and G. Gaeta, *ibid.*

116 Representative office of a foreign financial institution in China is not able to conduct business that aims at generating profit. For more discussion, see Section C. Regulations concerning Foreign Financial Institutions in China in this Chapter, below.

117 See CEInet, *supra* note 7.

Furthermore, a number of selected foreign financial institutions has been able to operate domestic currency business in China.[118] Currently, foreign financial institutions in China can only operate in limited geographic areas. These foreign financial institutions are allowed to operate most banking businesses involving foreign currencies. Yet, their clientele is restricted to non-resident individuals, overseas non-bank clients and joint ventures. Despite the fact that foreign financial institutions in China are subject to restrictions on business scope, location and clientele, they are vying for a share of the pie in China's banking industry. Arriving with managerial technology and expertise in international trade settlements, the foreign financial institutions have played an important role in China's economic construction, particularly in the advancement of China's financial sector.

d. Further Commercializing the State Banks -- Efforts to Abandon Policy Lending

From their inception, the four state banks were responsible for policy lending. Their bank credits were granted automatically to the state-owned enterprises in accordance with the targets in the national economic plan. Prior to 1996, 70 per cent of bank loans were channeled to the state sector, which produced only approximately 34 per cent of total industrial output.[119] As a result, the state banks bear a huge amount of non-performing loans.[120]

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118 Shanghai and Shenzhen are the only two Chinese cities where foreign banks are allowed to conduct renminbi business. Shanghai was opened for renminbi business in late 1996 and Shenzhen in 1998. China has also broadened the scope of renminbi business that foreign banks can conduct. Initially, they were allowed to grant renminbi loans only to foreign-funded firms. Now they can also participate in syndicated lending to Chinese enterprises. See *ibid.*

119 "China: A Funny-Looking Tiger" *Economist* (17 August 1996) at 18.

120 There is no clear information on the amount of non-performing loans in China. The PBOC estimated that bad loans were 2.9 per cent of the assets in the banking system at the end of 1999. If non-performing and delinquent loans are added, official figures are about 20 per cent. Some foreign estimates top out at 70 per cent. The consensus of foreign estimates remains at about 40 per cent. See G. Chang, "Big Four Banks Bleeding But Far From Deathbeds" *South China Morning Post Internet Edition* (9 September 1999) online: <http://www.scmp.com> (date accessed: 9 September 1999.

According to Moody's Investors Service, the mainland's banks could have an estimated 30 per cent of total loans. See Bloomberg, "Rule Change Poised To Produce Bad-Loan Surge" *South China Morning Post Internet Edition* (26 August 1999)

A conservative estimation by Standard & Poor's revealed that non-performing loans in China's banking system amounted to USD 200 billion at the end of 1997. See P. Chan and M. O'Neill, *supra* note 78.

Various steps have been taken to release the state banks from policy lending and to relieve them of at least part of their burden of bad loans. In 1994, the Import and Export Bank of China, the State Development Bank of China and the Agricultural Development Bank of China were created as policy banks to free the four state banks from policy lending.[121] Furthermore, the credit plan was abandoned and the mandatory responsibility of the state banks for policy lending was completely abolished in 1998. As recently as 1999, the four state banks set up their own asset-management companies, which were financed by the Ministry of Finance, to take over a portion of the bad debts of the banks.[122] The government has also made efforts towards re-capitalizing the four state banks. In 1998, the government issued a special treasury-bond issue of 270 billion yuan to boost the capital adequacy ratio of the four state banks.[123]

In defiance of all the efforts made by the Chinese government, the four state banks still face serious problems resulting from the past exercise of policy lending. It implies that, in addition to the abolition of policy lending and re-capitalization of the big four, further institutional measures and changes are desired in order to pave the way for the commercialization of the big four and the improvement of the Chinese financial system.

B. Regulatory Framework

According to the Central Bank Law, the PBOC is the central bank in China. It is a body at the ministerial level on par with the Ministry of Finance (MOF), under the leadership of the State Council. Owned by the state, the PBOC is authorized to formulate and implement the government's monetary policies and to draw up interest rate policies.

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121 Currently, the three policy banks have a loan portfolio roughly equivalent to 6 per cent of the big four banks. See R. Stride and G. Gaeta, *supra* note 10.

122 They are China Cinda of the China Construction Bank, China Oriental of the Bank of China, Great Wall of the Agricultural Bank of China and Hua Rong of the Industrial and Commercial Bank of China. See M. O'Neill, "Third Key State-Owned Bank Starts Unit for Bad Loans" *South China Morning Post Internet Edition* (19 October 1999) online: <http://www.scmp.com> (date accessed: 19 October 1999).

123 See P. Chan and M. O'Neill, *supra* note 78. It is far less than the figure estimated the investment bank Goldman Sachs, which is about USD 272 billion. See X.W. Wang, "Goldman Puts Loan Clean-Up Bill at US$272b" *South China Morning Post Internet Edition* (24 September 1999) online: <http://www.scmp.com> (date accessed: 24 September 1999).

It also exercises supervision and control over the financial services sector.[124] China's commercial banks are supervised and regulated by the central bank -- the PBOC. The establishment, branching, merger, dissolution and the business scope of financial institutions, including the four state banks, all other commercial banks, non-banking financial institutions, and foreign financial institutions etc., are subject to the approval of the PBOC.[125]

Table 2: Structure of China's Current Financial System

<table>
<tr><td colspan="3">Central Bank</td><td>People's Bank of China (PBOC)</td></tr>
<tr><td rowspan="3">Commercial Banks</td><td colspan="2">State Commercial Banks</td><td>Agricultural Bank of China (ABC)
Bank of China (BOC)
Construction Bank of China (CBC)
Industrial and Commercial Bank of China (ICBC)</td></tr>
<tr><td rowspan="2">Other Commercial Banks</td><td>National Banks</td><td>CITIC Industrial Bank
Everbright Bank
China Investment Bank
Bank of Communications (BOCom)
Huaxia Bank
Others</td></tr>
<tr><td>Regional Banks</td><td>Merchant Bank
Shanghai Pudong Development Bank
Guangdong Development Bank
Shenzhen Development Bank
Fujian Xingye Bank
Others</td></tr>
<tr><td colspan="3">Policy Banks</td><td>China Agricultural Development Bank
State Development Bank
Import and Export Credit Bank</td></tr>
<tr><td colspan="3">Credit Co-operative Banks</td><td>Urban Credit Co-operative Banks
Rural Credit Co-operative Banks</td></tr>
</table>

124 Articles 2 and 4 of the Central Bank Law, see Appendix B.

125 Chapter V of the Central Bank Law. It is also stipulated in details in Article 11and Article 24 under the Commercial Bank Law. See Appendices A and B.

Although there is no explicit wording concerning foreign financial institutions in the Central Bank Law, branches of foreign banks, Sino-foreign joint venture banks and solely foreign-invested banks are subject to the Commercial Bank Law. Article 88 of the Commercial Bank Law states:

> "This law applies to the foreign-funded commercial banks, Sino-foreign joint venture commercial banks and the branches of foreign commercial banks in China, and if there are special laws and administrative regulations governing them, they should follow such special laws and regulations."

In addition, Article 4 of the Regulations of the People's Republic of China Governing Financial Institutions with Foreign Capital(Promulgated on February 25, 1994) states:

> "The People's Bank of China is the sole regulatory authority responsible for the regulation and supervision of the financial institutions with foreign capital; the branches of the People's Bank of China exercise routine regulation and supervision of the financial institutions with foreign capital in their jurisdiction."

Therefore, they need the approval of the PBOC in the terms of their establishment, branching and business scope.

Non-Banking Financial Institutions	Insurance Companies	State-owned	People's Insurance Company of China (PICC) China Reinsurance Company (CRC) Ping An Insurance Company of China China Pacific Insurance Company Ltd. China's Life Insurance Co., Ltd.
		Non State-owned	PICC Property Company of China Hua Tai Property Insurance Company Ltd.[126] New China Life Insurance Company Ltd. Tai Kang Life Insurance Company Ltd. Tian An Insurance Company Ltd. of China Da Zhong Insurance Company Ltd. of China Sinosafe General Insurance Company Ltd. Yong An Property Insurance Company Ltd. Xin Jiang Agriculture and Construction Insurance Company of China
		Foreign-involved[127]	Branches[128], Joint Ventures[129], Representative Offices[130]
	Securities Firms		Shanghai Stock and Shenzhen Stock Exchanges
	Assets Management Firms		China Cinda of the China Construction Bank China Oriental of the Bank of China Great Wall of the Agricultural Bank of China Hua Rong of the Industrial and Commercial Bank of China
Foreign Financial Institutions			Representative Offices Chinese-Foreign Joint-Venture Banks Foreign Bank Branches Solely Foreign-Invested Banks (Subsidiary Banks)

The PBOC is responsible for implementing domestic monetary policy. Its principal functions are to (i) formulate and implement monetary policies in accordance

126 The Huatai Insurance Co., Ltd, the first Chinese shareholding property insurer, opened a branch in Shanghai on November 19, 1999. Huatai Insurance's shareholders include more than 63 large state-owned enterprises, and that its premium income last year reached 180 million yuan. The insurer's total assets are now valued at over 1.6 billion yuan. Please see CEInet, "Huatai Insurance Opens Branch in Shanghai" (20 November 1998) online <http://ce.cei.gov.cn/echn.htm> (date accessed: 26 June 1999).

127 Currently, foreign financial institutions are not able to establish solely foreign-invested insurance companies. This type of form exits only in principle. Interesting to note that, the number of foreign capital and joint venture insurance companies in China has exceeded the number of Chinese ones. However, Chinese insurers still hold a lion's share of the premium income. Of the 124.73 billion RMB yuan premium income on the Chinese market in 1998, foreign capital insurers grabbed only six percent. CEInet, "It Is Inevitable To Open Insurance Market" online: <http://ce.cei.gov.cn/echn.htm> (date accessed 23 June 199).

128 Branches of foreign insurance companies provide commercial insurance service. So far, they are only allowed to manage property insurance service. There are, to name but a few, American International Assurance Company Ltd., Shanghai Branch and Guangzhou Branch, AIU Insurance Company, Shanghai Branch, the Tokyo Marine and Fire Insurance Co., Ltd., Shanghai Branch, Winterthur Swiss Insurance (Asia) Company, Shanghai Branch, Royal & Sun Alliance Insurance Company, Shanghai Branch, The Minan Insurance Company (H.K.) Ltd., Shenzhen Branch, The Minan Insurance Company (H.K.) Ltd., Hai Kou Branch, Zhong Hong Life Insurance Company Ltd.

129 Joint ventures are allowed to manage life insurance service. They include Pacific and Aetna Life Insurance Company Ltd., Shanghai, Allianz-Dazhong Life Insurance Company Ltd., Pudong, Shanghai, AXA Minmetals Assurance Co. Ltd., Shanghai, Health Alliance Insurance Group and People's Insurance (Life) Company of China.

130 Sedgwick Insurance and Risk Management Consultants (China) Ltd., Employers Reinsurance Corporation (ERC), US based, Yasuda Fire & Marine Insurance Co. Ltd., Japanese, Chongqing representative office, Commercial Union Assurance Co. Ltd., Chengdu Office.

with the law, (ii) issue renminbi (RMB) and control its circulation, (iii) approve, supervise and administer financial institutions in accordance with regulations, (iv) supervise and control the financial market in accordance with regulations, (v) promulgate ordinances and rules concerning financial administration and business, (vi) hold, administer and manage the state foreign exchange reserve and bullion reserve, (vii) act as fiscal agent for the State, (viii) maintain the normal operation of payment, clearing and settlement systems, (ix) be responsible for statistics, investigation, analysis and forecasting for the financial industry, (x) engage in relevant international financial activities in the capacity of the central bank of China, and (xi) other functions assigned by the State Council.[131]

The Central Bank Law forbids any government authorities at any level, any local governments, social organizations or individuals from interfering in the PBOC's lawful and independent implementation of monetary policy, fulfilling its responsibilities, or its business operations. However, many of the PBOC provincial branches had for decades been under the dual administration of both the PBOC headquarters in Beijing and their relevant local provincial or municipal governments. The interference of local administrative bodies has remained in reality although the law entered into force in 1995. In order to reduce the interference of local government, the Chinese government recently restructured the branching system of the central bank. The 31 previous provincial PBOC branches were merged into 9 first class PBOC branches. Each of them covers more than one province, autonomous region and/or municipality. The branch restructuring was designed to strengthen the supervisory power of the central bank and to ensure its independence. It was expected that the central bank would be able to more closely and efficiently oversee the operations of commercial banks through its trans-province, cross-autonomous region and trans-municipality branches.[132]

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131 Article 4 of the Central Bank Law, see Appendix B.

132 On November15, 1998, the PBOC set up 9 division PBOC banks across China, taking the place of all formal provincial banks and so on. Each of them is responsible for at least two provinces, independent municipalities and autonomous regions, and ensuring the independence of the regulatory system. This structure is more or less like the US Federal Reserve's structure. See China News, "Central Bank Reform" (5 January 1999) online: <http://www.chinanews.com> (date accessed: 5 January 1999).

C. Regulations concerning Foreign Financial Institutions in China

The Central Bank Law stipulates that the PBOC is the regulator and supervisor of all financial institutions in China[133]. The Commercial Bank Law explicitly states that the law applies to the foreign-funded commercial banks, Sino-foreign joint venture commercial banks and the branches of foreign commercial banks in China. However, if there are special laws and administrative regulations concerning these financial institutions with foreign elements, these laws and administrative regulations supercede the Commercial Bank Law.[134] The existing regulations specifically concerning foreign financial institutions is the Regulations of the People's Republic of China Governing Financial Institutions with Foreign Capital (RFIFC) in 1994. They set forth rules allowing for the establishment of foreign financial institutions in China

According to the RFIFC, foreign financial institutions are allowed to operate in China in the following forms: (1) branch of a foreign bank (hereinafter referred to as foreign bank branch); (2) subsidiary bank or finance company incorporated by foreign capital with their head offices in China (hereinafter referred to as solely foreign-invested financial institutions); and (3) equity joint-venture bank or finance company in between foreign financial institutions and Chinese financial institutions.[135]

The establishment of a representative office is the prerequisite for a foreign financial institution to operate in China through any of the three forms. Representative offices of foreign financial institutions are banned from doing business aimed at generating profits. They can only act as consultants, do liaison work and conduct market

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133 Chapter V of the Central Bank Law, see Appendix B.

Financial institutions in China, under the Commercial Bank Law, consist of the four State commercial banks, national and regional commercial banks, and non-banking financial institutions including insurance companies, financial trust and investment companies (TICs), securities companies, finance companies, financial leasing companies, newly organized commercial bank consolidating local credit cooperatives, foreign financial institutions (including jointly owned Chinese foreign banks and subsidiaries of foreign banks) and representative offices established by foreign financial institutions in China.

134 Article 88 of the Commercial Bank Law, see Appendix A.

135 Article 2 of the RFIFC, see Appendix C.

investigations. Representative offices are not allowed to operate any commercial business such as deposit-taking, lending etc.[136]

In order to establish a foreign bank branch and a solely foreign-invested foreign financial institution, the applying foreign financial institution must have maintained a representative office in China for at least 2 years.[137] However, the requirement for setting up an equity joint-venture financial institution is much looser in this regard. The equity joint-venture financial institution can be established provided only that the applying foreign financial institution has a representative office in China.[138]

Foreign financial institutions doing business in China are, according to the RFIFC, subject to restrictions regarding business scope, location and clientele. The locations where foreign financial institutions are able to operate in China are determined by the State Council.[139] To date, they have spread out to 23 cities and Hainan province.[140] Foreign financial institutions in China are able to operate most banking businesses involving foreign currencies.[141] However, their clientele is restricted to non-resident individuals, overseas non-bank clients and joint ventures. In general, foreign financial institutions are not allowed to carry out domestic currency business.[142] Only selected foreign banks in Shanghai, Shenzhen and a several southern and coastal provinces are

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136 The representative offices are subject to the Administration of the Establishment of Resident Representative Offices in China by Financial Institutions with Foreign Investment Procedure (1991 Representative Office Procedures). It expressly prohibits the conduct of profitable commercial banking operations by representative offices of foreign financial institutions. However, many representative offices engaged in such activities as discounting trade bills for importers and exporters and confirming letters of credit etc. in China in the late 1980s. See S.H. Mac Cormac, "Foreign Banking in China: Opportunities for U.S. Investors in the 1990s" (1993) 7 J. Chinese L. 225 at 237, online: WL (TP-ALL).

137 Articles 6 and 7 of the RFIFC, see Appendix C.

138 Article 8 of the RFIFC, see Appendix C.

139 Article 2 of the RFIFC, see Appendix C.

140 See CEInet, *supra* note 7.

141 See the table below: "Establishment: Foreign Financial Institutions in China vs. China's Commercial Banks".

142 See "China Takes New Step in Opening Financial Sector" (27 January 1999) online Embassy of the PRC in the USA: <http://www.china-embassy.org/Cgi-Bin/Press.pl?financeopen> (date accessed: 27 January 1999).

authorized to conduct RMB business.[143] In addition, China's national currency is not convertible. It has, to a large extent, undermined the competition in the domestic currency market.[144]

D. Conclusion

The Chinese banking system has undergone substantial development since the initiation of economic reforms. While efforts have been made to strengthen the supervisory power of the central bank and to commercialize the state banks, a two-tier banking system has been gradually shaped in a true sense. A range of new commercial banks outside the four state banks has been brought onto the banking scene. Furthermore, the banking industry has consistently opened-up to foreign participants.

Although many reforms have been carried out in the banking sector, the Chinese government has not yet developed effective market-based policy instruments. While China has in place national bank laws, measures such as interest rate control, restrictions on business scope and on the establishment of financial institutions etc., keep banks heavily regulated. They have not gained necessary autonomy over their financial activities. Due to chronic practice of policy lending, state banks lack experience in real commercial banking. Moreover, the mammoth burden of non-performing loans undertaken by the state banks poses a major challenge to transforming them into true

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[143] Shanghai and Shenzhen are the first two Chinese cities where foreign banks are allowed to conduct renminbi business. Local-currency banking business was opened to a select group of Shanghai-based foreign banks in January 1996, and to Shenzhen-based foreign banks in August 1998. See Colin Galloway, "Sector Door Remains on Tight Latch" *South China Morning Post Internet Edition* (13 August 1998) online: <http://www.scmp.com> (date accessed: 17 May 1999).

Later in 1999, China opened more localities to foreign banks to conduct local currency business. They include China's Jiangsu, Zhejiang, Guangdong and Hunan provinces, and the Guangxi Zhuang Autonomous Region. See CEInet, " Foreign Banks Allowed to Deal in Yuan in More Chinese Localities" (6 August 1999) online: <http://ce.cei.gov.cn> (date accessed: 6 August 1999).

China has also broadened the scope of renminbi business that foreign banks can conduct. Initially, they were allowed to grant renminbi loans only to foreign-funded firms. Now they can also participate in syndicated lending to Chinese enterprises. See CEInet, *supra* note 7.

[144] "Mainland Widens Foreigners' Access" *South China Morning Post Internet Edition* (15 May 1999) online: <http://www.scmp.com> (date accessed: 15 May 1999).

commercial banks. Given that China intends to integrate with the world economy, further substantial reforms are required to build up a stable and sound banking system.

Table 3: Establishment: Foreign Financial Institutions in China vs. China's Commercial Banks

Solely Foreign-Invested Bank	Foreign Bank Branch	Equity Joint-Venture Bank	Chinese Commercial Bank
(1) the applicant is a financial institution;		(1) each partner to the joint-venture is a financial institution;	The Establishment of commercial banks in China is subject to the "Company Law of the People's Republic of China".
(2) the applicant has maintained a representative office in China for two years or longer;	(1) the applicant has maintained a representative institution in China for two years or longer;	(2) the foreign partner has a representative institution in China;	
(3) the total assets of the applicant at the end of the year prior to its application are not be below US $ 10 billion;	(2) the total assets of the applicant at the end of the year prior to the application shall not be below US $ 20 billion;	(3) the total assets of the foreign partner at the end of the year prior to the application are not be below US $ 10 billion;	
(4) there is a sound system for financial regulation and supervision in the home country or region of the applicant.	(3) there is a sound system for financial regulation and supervision in the home country or region of the applicant.	(4) there is a sound system for financial regulation and supervision in the home country or region of the applicant.	
The minimum registered capital: equivalent to RMB 300 million yuan; the paid-up capital shall not be below 50 per cent of the registered capital	Its head office shall allocate a working capital: equivalent to no less than RMB 100 million yuan without any repayment or recompense	The minimum registered capital: equivalent to RMB 300 million yuan; the paid-up capital shall not be below 50 per cent of the registered capital	The minimum registered capital for setting up a commercial bank is RMB 1 billion yuan. The minimum registered capital for setting up an urban cooperative commercial bank is RMB 100 million yuan, and the minimum registered capital for setting up a rural cooperative commercial bank is RMB 50 million yuan. The registered capital should be the actually paid capital.

Table 4: Business Scope: Foreign Financial Institutions in China vs. China's Commercial Banks

Solely Foreign-Invested Financial Institutions Foreign Bank Branch	Joint Venture Financial Institutions	China's Commercial Banks
Subject to the supervision and regulation of PBOC.		Subject to the supervision and administration of the PBOC in accordance with laws.[145]
The State Council determines the locations that are open to foreign financial institutions		The establishment of commercial banks should go through the process of examination and approval by the People's Bank of China.
(1) foreign currency deposit-taking;	(1) foreign currency deposit of USD 100,000 in minimum for each deposit with a maturity of three months or longer;	(1) Absorb public deposits;
(2) foreign currency lending;	(2) foreign currency lending;	(2) Issue short-term, medium-term and long-term loans;
(3) foreign currency bill-discounting;	(3) foreign currency bill-discounting;	(3) Arrange settlement of both domestic and overseas accounts;
(4) approved foreign exchange investment;	(4) approved foreign exchange investment;	(4) Handle the discount of negotiable instruments;
(5) foreign exchange remittance;		(5) Issue financial bonds;
(6) foreign exchange guarantee;	(5) foreign exchange guarantee;	(6) Issue, cash and sell government bonds as agents;
(7) import and export settlement;		(7) Buy and sell government bonds as agents;
(8) foreign currency dealing and brokerage;	(6) foreign currency dealing and brokerage;	(8) Do inter-bank lending and borrowing;
(9) exchange of foreign currencies and bills denominated in foreign currency;	(8) foreign exchange trust business;	(9) Buy and sell per se or as agents foreign exchanges;
(10) foreign currency credit card payment;		(10) Provide letter of credit (L/C) service and guarantee;
(11) custody and safe-deposit box service;		(11) Handle receipts and payments and insurance businesses as agents;
(12) credit verification and consultation;	(7) credit verification and consultation;	(12) Provide safe boxes;
(13) approved business activities in domestic currency and other foreign currencies.	(9) approved business activities in domestic currency and other foreign currencies.	(13) Undertake other businesses approved by the People's Bank of China.
The foreign currency deposit-taking refers to the following deposits denominated in foreign currencies:		Business scopes of the banks are to be defined in the articles of association of the banks and reported to the People's Bank of China for approval.
(1) inter-bank deposits both in China and abroad;		
(2) deposits taken from the non-bank clients located outside China;		
(3) deposits taken from foreigners in China;		
(4) deposits taken from overseas Chinese and compatriots from Hong Kong, Macao, and Taiwan;		
(5) deposits taken from enterprises with foreign investment in China;		
(6) re-deposits as occurred as a result of lending by financial institutions with foreign capital to non-enterprises with foreign investment;		
(7) other approved foreign exchange deposits		

145 Article 10 of the Commercial Bank Law, see Appendix A.

Telecommunications in China

A. A Snapshot of Chinese Telecommunications

Chinese telecommunications has been dramatically developed since the economic reform unfolded and the open door policy was adopted in the late 1970s. Presently, China has a total capacity of more than 145 million telephone lines, raising its rank of national fixed telephone networks from 17th in 1985 to 2nd in 1998 in the world.[146] In 1999, China added some 15 million telephone new lines -- the equivalent of an U.S. Baby Bell.[147] It has also laid some 250,000 kilometers of long-distance optical cables throughout the country. The number of telephone subscribers has nudged 130 million, including 98.8 million fixed phone subscribers and 33.8 million mobile subscribers.[148] Today, there are more residential telephone lines than business lines.[149] Chinese teledensity[150] is presently 7.88 per cent.[151] However, it increased around three folds in 5 years.[152]

The country has 70 satellite communications networks, 5,321 communications earth stations, and 10,000 one-way satellite stations.[153] The capacity of its mobile switching system has added up to 57 million lines. Emerging in 1984 with the operation of the first paging network in Shanghai, the Chinese paging market has become the largest in the world. The number of pager users surpassed 62 million by the end of 1998.

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146 MII, "China's Telecommunications in 50 Years", August 1999, in Chinese, online MII: <http://www.mii.gov.cn/dx50/dx00.htm> (date accessed: 2 September 1999).

147 MII, *Ibid.*

148 See CEInet, "China's Postal and Telecom Services Expand Steadily" (1 July 1999) online: <http://ce.cei.gov.cn> (date accessed: 1 July 1999). Data from the MII Statistics online: <http://www.mii.gov.cn> (date accessed: 3 July 1999).

149 MII Statistics shows that 61.20 per cent of new telephone subscribers were households in 1997. MII online: http://www.mii.gov.cn> (date accessed: 3 July 1999).

150 Teledensity is the ITU's term for the number of main telephone lines per 100 inhabitants.

151 Data from MII Statistics online: <http://www.mii.gov.cn> (4 January 2000).

152 See *supra* note 65 and accompanying text.

153 CEInet, "China Developing Radio-Technology" (30 June 1999) online: <http://ce.cei.gov.cn/efor.htm> (date accessed: 30 June 1999).

Internet services have rapidly developed in China in recent years. The number of Internet subscribers hit seven million at the end of 1999, more than tripling in 12 months.[154]

B. The Telecommunications Industry in Transition

As China embarked on economic reforms and adopted an open-door policy in the late 1970s, the Chinese market has been gradually exposed to the world economy. Demands for a modern telecommunications infrastructure and good international and domestic communications increased rapidly.[155] In addition, modernization, the central theme of Chinese economic reforms, has ushered the promotion of Chinese high-technology industries. Telecommunications as infrastructure is an essential requirement for the effective deployment of information systems and the wider application of computer networks. Having acknowledged the significant role of telecommunications in national growth,[156] the Chinese government placed telecommunications at the top of China's industrial agenda.[157]

a. Deregulating Financing Responsibility

Under the centrally planned system, the central government's budget was the only financing resource for all industries. The MPT had to compete with all other national ministries for a portion of the national budget that was handed down through the credit plan.[158] This substantially limited the amount of money available for telecommunications

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154 Data from the MII Statistics online: <http://www.mii.gov.cn> (date accessed: 3 January 2000). See also "Beijing to Open Sector Earlier Than Promised" *South China Morning Post Internet Edition* (6 January 2000) online: <http://www.scmp.com> (date accessed: 6 January 2000).

155 For instance, many new Western-style hotels were established to encourage the tourist trade in the beginning of 1980s. In such hotels, each room required a telephone line and access to overseas dialing facilities. That was something that China's then exiting telephone system -- with less then two telephone lines per 100 inhabitants -- was completely incapable of handling. On the other hand, Chinese export-oriented enterprises that became active as the open-door policy was adopted in late 1970s, required highly sophisticated telecommunications network facilities and services to communicate with the rest of the world. See also J. Ure, ed., *Telecommunications in Asia: Policy, Planning and Development* (Hong Kong: Hong Kong University Press, 1995) at 12.

156 *Supra* note 18.

157 See also J. Ure, *supra* note 155 at 21.

158 See General Background A in this Chapter, above.

investment. The telecommunications infrastructure could not be adequately extended and the telecommunications industry could not be well developed, as there was insufficient investment.

As reform proceeded, the MPT transferred responsibility for financing network development to the local post and telecommunications bureaus. In addition, they were allowed to retain 90 per cent of their profits. The government also permitted the local and regional post and telecommunications bureaus to keep all of their foreign exchange earnings to be utilized in the development of the local exchanges. Furthermore, the local and regional post and telecommunications bureaus gained more flexibility to raise their charges for domestic and long-distance calls, as well as charges for the installation of telephone or lines. These preferential policies to a large extent spurred the development and expansion of Chinese telecommunications industry.

b. Liberalizing Telecommunications Services

In addition to the financing decentralization, the government liberalized some telecommunications sectors. Enterprises or economic units outside of the auspices of the MPT were allowed to invest and operate in some telecommunications sectors.[159] Nevertheless, foreign direct investment and management have remained prohibited in any number of telecommunications services.

c. Efforts to Deregulate the Telecommunications Services Sector

Chinese telecommunications services, as in almost all other countries in the world two decades ago, were operated, managed and regulated by the former Ministry of Posts

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[159] The liberalized telecommunications sectors include radio paging, non-public cellular mobile telephone (450 MHz and 800 MHz), VSATs (Very Small Aperture Terminal, a satellite-based technology used primarily for data transmission), telephone and computer messaging services, email, EDI, and videotex. While engaging in network direct investment and services operation in these sectors, the firms are subject to receive licenses or a declaration. State Council Order (1993) 55. See China Telecommunications Construction, October 1993, at 6-7.

and Telecommunications (MPT).[160] As a regulator in China's telecommunications industry, the MPT also engaged in the operation and provision of telecommunications services through its telecommunications bureaus at the provincial and municipal levels.

In 1994, the Chinese government decided to restructure the MPT into a separate regulatory body, serving as a regulator and supervisor over China's telecommunications industry. China Telecom was then set up to operate all basic telecommunications business and provide telecommunications services in China. China Telecom was an independent state enterprise but under the auspices of the MPT.

Meanwhile, another two telecommunications providers -- China Unicom and Ji Tong -- were promoted to enter into China's telecommunications market. China Unicom was created as a competitor for China Telecom, and Ji Tong was created to compete in value added services. Both were initiated by the Ministry of Electronics Industry (MEI).[161] A competitive telecommunications market was to be shaped in China. However, China Telecom controlled more than 95 per cent of the market. In addition, the

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160 In 1998, the Ministry of Information Industry (MII) was established under the principle of separating administrative and enterprise management functions and breaking the monopoly, replacing the former Ministry of Posts and Telephone, which ran China Telecom, and the Ministry of Electronics Industry, which ran China Unicom.

161 China Unicom was authorized to build and operate both fixed line and radio based local and trunk telecommunications networks. The following is quoted from the website of China Unicom: <http://www.chinaunicom.net/chucview.htm> (date accessed: 7 June 1999).

The main scope of business of China Unicom as approved by the State Council in a written reply:

> To upgrade and perfect the existing private telecommunication networks of the Ministry of Railways and the Ministry of Electric Power to provide long-distance telephone services to society while first meeting the demands of both ministries; and to provide local telephone services in areas where public telephone networks cannot reach or there is a shortage of such services.
>
> To provide radio telecommunication services, including mobile telecommunication services.
>
> To provide value-added telecommunication services;
>
> To provide engineering services for all kinds of telecommunication systems;
>
> To provide other services related with the main business activities.

Ji Tong was primarily authorized to engage in VAS (value added services -- telecommunications services provided through private or public networks with computer-based information feature or performance) in the areas of information services, mobile telephone services and so forth. For details on the creation of Ji Tong and China Unicom, see M. Mueller and Z.X. Tan, *supra* note 65 at 49-53. See also C.O. Long, *Telecommunications Law and Practice*, 2nd ed. (London: Sweet & Maxwell, 1995) at 363-4.

separation of enterprise entities from regulatory body was not effectively put in practice. With its close relation to the regulator, China Telecom succeeded in blocking competition from new entrants in the market.

On the other hand, the competition between China Telecom, China Unicom and Ji Tong led to a sharp rivalry between the MPT and MEI.[162] To better regulate the telecommunications networks in China and balance the conflicts between different Ministries that operated telecommunications, China set up the Ministry of Information Industry (MII) in 1998.[163] The MPT that ran China Telecom was merged with the MEI that ran China Unicom, and the Radio-Film-Television ministry. China Telecom, China Unicom and all other telecommunications providers came under the regulation and supervision of the MII.

d. Efforts to a More Competitive Telecommunications Market

To end the dominance of China Telecom in the domestic telecommunications market, the Chinese government decided to split the heavy player into four companies, focusing on paging service, mobile telecommunications, ground network and data business, and satellite telecommunications respectively. Despite the fact that the four companies are all state-owned, it is evidence that China's government is vividly shaping an intensively competitive market on basic telecommunications services. In addition, the decision to break up China Telecom demonstrated MII's independence from China Telecom.

Furthermore, it has been MII's policy to encourage new entrants into the telecommunications market. China Netcom Corp (CNC), for example, has recently been approved to establish an Internet-based basic telecommunications network. It was funded

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162 See generally M. Mueller and Z.X. Tan, *supra* note 65 at 46-53.

163 For more details on MII, see "D. Regulatory Framework" in this Chapter, below.

by the Ministry of Railways,[164] the State Administration of Radio, Films and Television (SARFT), the Chinese Academy of Social Sciences and the Shanghai municipal government. Integrating the existing wide-band optical fiber network operated by the SARFT and the Ministry of Railways, the CNC provides network access and carrier-to-carrier services for China's Internet service providers and large companies.[165] The establishment of the CNC is hoping to restructure China's telecommunications market and further challenge the existing big players.

In the meantime, the Chinese government intends to strengthen the competitive role of China Unicom in the domestic telecommunications market. China Unicom was approved to extend its business scope to conduct a local-call trial in Tianjin, Sichuan and Chongqing.[166] The company has also been licensed for international long-distance telecommunications service. China Unicom has been licensed to operate the GSM[167] that used to be dominated by China Telecom.[168] It has also gained the right to construct and operate the CDMA[169] network in China.[170] The two mobile networks extensively enhanced China Unicom's role in the mobile market. Furthermore, the paging company

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164 The Ministry of Railway itself has a complete nationwide network that consists of 120,000 kilometers of telecommunications lines, 66,000 long-distance lines and 4,593 kilometers of digital microwave lines. The railway's network is second only to China Telecom's. However, it has a capacity of only 1.5 million lines, 1 per cent of China Telecom's capacity. So far, it has provided channels for China Unicom's GSM cellular phone system and other services for China Ji Tong. See X.W. Wang, "Telecommunications: Three New Challengers for China Telecom" *South China Morning Post Internet Edition* (27 May 1999) online: <http://www.scmp.com> (date accessed: 27 May 1999).

165 SCMP, "Mainland Sets Launch of Third Telecoms Giant" *South China Morning Post Internet Edition* (20 September 1999) online: <http://www.scmp.com> (date accessed: 20 September 1999). CEInet, "Another Telecom Basic-Service Giant Emerges" (April 30 1999), and "China Set for Third Major Telecom Company" (21 April 1999) online: <http://ce.cei.gov.cn/> (date accessed: 20 May 1999).

166 See China Unicom's Website: "The Profile of The Company" online: <http://www.chinaunicom.net> (date accessed: 7 June 1999).

167 GSM stands for Global System for Mobile Communications. Originally it was called Group Speciale Mobile. It is a European digital cellular standard. see B.A. Petrazzini 1996, *supra* note 18 at 95.

168 That is expected to bring China Unicom 12 per cent of the mobile market by the end of this year. See CEInet, "China Unicom Approved to Operate GSM Service Nationwide" (3 November 1998) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 20 May 1999).

169 CDMA stands for Code Division Multiple Access, which is an American digital cellular standard.

170 The CDMA network is expected to reach the capacity of 10 million subscribers covering 250 cities by the end of 2000. At present, the capacity of China Unicom's mobile switching systems reached 5.42 million lines that has settled in 99 cities and with an accumulated number of network users exceeding 1.6 million. See CEInet, "China Unicom Licensed to Build, Operate CDMA Network" (16 June 1999) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 16 June 1999).

that separated from China Telecom was integrated into China Unicom.[171] It brought 13 billion yuan worth of assets and some 40 million subscribers into China Unicom, multiplying China Unicom's existing subscribers by a factor of eight.[172] China Unicom has apparently become the biggest paging service provider in China's domestic market. In addition, China Unicom has recently started providing Internet services and has become the fifth Internet provider in China.[173] This suggests that the Chinese government has been trying to intensify the competition in domestic telecommunications market while strengthening domestic telecommunications providers.

Another, perhaps surprising, but increasingly active player in the market is the People's Liberation Army (PLA), which has been using excess capacity on its own fixed telecommunications network together with spectrum allocated for military purposes to offer services. Like China Unicom, the PLA has been exploring joint venture arrangements with foreign firms in its effort to establish a national CDMA mobile network.[174]

C. Competition without Privatization? -- A Survey of China's Paging Market

[171] The Guoxin Paging Co., Ltd. was established on the basis of tens of paging service providers affiliated to the former MPT. It was a part of China Telecom services before the split of China Telecom at the end of 1998. It was the largest paging service operator in China, with 39.55 million subscribers and holding three-fifths of the domestic market. With 13 billion yuan in total assets and 7 billion yuan in net assets, the company raked in more than 8.36 billion yuan in main operating turnover and 1.45 billion yuan in profits last year. Its turnover in the first quarter of 1999 reached 2.25 billion yuan, tripling the turnover of China Unicom in the same period. After the split of China Telecom, Guoxin Paging was merged in China Unicom. CEInet, "China Unicom Expanding Quickly" (31 May 1999) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 31 May 1999).

[172] *Ibid.*

[173] The other four IP are, CSTNET, ChinaNet, CERNET and ChinaGBN. China Unicom will be under the name of UNINET. It is expected to cover 100 cities before the end of 1999 and most of China's local networks by 2,000. But dial-up service has not yet been on its agenda. See CEInet, "China Unicom to Provide Internet Service" (16 June 1999) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 16 June 1999).

[174] See R. Janda, "Benchmarking a Chinese Offer on Telecommunications: Context and Comparisons" IJCLP (1999) 2 Web-Doc 6-2-1999 online: <http://www.digital-law.net/IJCLP/2_1999/ijclp_webdoc_6_2_1999.html> (date accessed: 27 May 2000).

The liberalization of the telecommunications sector in general refers to privatizing and deregulating the telecommunications monopoly, separating the regulator from market players. As China pursues a socialist market economy, market forces are put to use while the SOEs remain as dominant players in the market. On that account, China cannot simply commit to the privatization of telecommunications sector.[175] Xu Yan argues that privatization is not the only solution to the market liberalization.[176] Xu points out that the objectives of government are to promote the development of the telecommunications sector and protect the interests of the public, which can be done by introducing competition among state-owned firms.

This is true that the public has gained many benefits from the introduction of competition as reforms were carried out in China's telecommunications industry.[177] With the increasing competition in the telecommunications market, the cost of telecommunications services has dropped significantly. Installation fee of a telephone line in Beijing has been reduced to 1,000 yuan from 5,000 yuan previously. Charges for international calls have been cut to half of the former prices. The monthly fee for Internet access has been cut by one fifth.[178] It is also true that the telecommunications sector has experienced staggering development, though the government's preferential policies and subsidiaries have played a decisive role. However, as Xu mentioned, it can be *partly* reached by introducing competition.

The ready example is the paging market.[179] China has liberalized and exposed its paging market to domestic competition for years. When the paging services started being provided in China in the mid-1980s, it was seen as a means of making fast profit. At that time, state departments and local and provincial governments had earned greater operational autonomy. They were urged to be responsible for their own financing

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175 See generally M. Mueller and Z.X. Tan, *supra* note 65 at 114-122.

176 Y. Xu, D.C. Pitt and N. Levine, "Competition without Privatization: the Chinese Path" in S. Macdonald and G. Madden, eds., *Telecommunications and Socio-Economic Development* (Amsterdam: Elsevier, 1998) at 375.

177 See also M. Mueller and Z.X. Tan, *supra* note 65 at 59-60.

178 CEInet, "Ministry Unveils Fee Adjustments" (1 March 1999) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 2 May 1999).

179 See generally M. Mueller and Z.X. Tan, *supra* note 65 at 72-3.

resources and profits. Many of them then engaged in the paging market in order to meet their own financial needs. They either set up their own paging companies, or sponsored other paging companies. Today, there are more than 2,000 paging companies in the market throughout the country. Some major paging companies are licensed to operate paging services across provinces, other medium to small paging companies operate within their relevant provinces or an approved location. The paging market has since been extensively developed. Paging companies competed for customers through reducing service charges and offering other services promotions. The intensely competitive market has contributed to the popularization of paging services. However, the paging market failed to operate efficiently. Thousands of medium to small paging companies in the market only have approximately 5,000 pager users each. They together account for only 5 per cent of the market share.[180] As a matter of fact, most of them have suffered heavy losses and have stopped operating. However, their special sponsors from the governmental department tried all manner of means to keep them in the market.[181] As each of these paging companies has dozens of paging services providers that themselves possess designed frequency resources, the mere fact that they remain in the market caused waste of frequencies. Meanwhile, the frequencies of many major paging companies are overused. It severely undermines the efficiency of the industry.

It is competition that drives the market growth and brings benefits to customers. However, a competitive market does not automatically bring efficiency to the industry where the principles of market forces are not put into use. That is, firms that are not productive should go bankrupt. Otherwise, it exhausts not only scarce resources such as frequencies, but also financial resources. In the end, they are financed through banks or other financial institutions, given the government intervention in China's banking and financial system. As discussed above, the mere fact that money-losing SOEs remain in business undermines the financial strength of the state banks. It challenges the commercializing and liberalizing process of the banking industry. In the context of the

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[180] After the merger of Guoxin Paging, China Unicom controls two thirds of the paging market. 20 per cent of the market is shared by another 20 major paging companies. See CEInet, "China Unicom Expanding Quickly", *supra* note 171.

[181] CEInet, China IT Market: Report on China's IT sector: Telecommunications, "China's Pager Production & Paging Service Market" online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 3 June 1999).

telecommunications industry, it creates chaos in the market. Competition without privatization can be a solution to liberalization, but market mechanisms must be applied.

D. Regulatory Framework

a. Regulatory Body

China's telecommunications industry falls under the regulation and supervision of the Ministry of Information Industry (MII). Established in 1998, the MII was expected to function as a separate regulator over the information industry, including telecommunications. It merged both the former MPT and the MEI. It also took over the functions for information and network management of the Ministry of Radio, Film and Television, China Aerospace Industry Corp and China Aviation Industry Corp. The main functions of the MII with respect to part of the telecommunications sector are:

> 1. *Drawing up laws on telecommunications* and administrative rules and *supervising their enforcement*;
> 2. *Supervising the telecommunications services market* according to the law, examining and approving telecommunications services licenses, supervising service quality, *ensuring fair competition* and general service, and safeguarding the interests of the state and customers; *drawing up regulations on the interconnection and settlement* of various telecommunications networks and *supervising their implementation*;
> 3. *Working out policies of charging telecommunications services and fee standards for telecommunications services, and supervise their implementation*. (Emphasis added)[182]

b. Lack of National Law of Telecommunications

The Chinese telecommunications market is currently governed by a number of laws relating to telecommunications. However, there is no comprehensive national law of

182 MII Website, online: <http://www.MII.gov.cn> (date accessed: 27 June 1999).

telecommunications, though the MII had been considering a ninth draft bill.[183] Rather, telecommunications regulations in China are follow-up rules in each emerging area, such as paging and the Internet. The principal law that regulates China's telecommunications industry is not a law at all. It is merely an opinion of 1993 -- the Opinion of the Ministry of Posts and Telecommunications Markets.[184] The current absence of a national telecommunications law has left telecommunications policy directly in the hands of officials. It has given rise to a complex patchwork approaches to services, standards and prices at the level of provincial telecommunications administrations, which in principle come under the authority of the Ministry in Beijing but in practice have acted with considerable independence.

c. Regulations Concerning Foreign Involvement in China's Telecommunications Industry

The basic principle in China's telecommunications industry with respect to foreign investment is in the 1993 MPT Opinion. Article V of the Opinion says:

> Foreign enterprises shall not conduct or participate in telecommunication operations within the territory of China. For all the public communications networks, wire or radio communications of the specific networks, the operation of participation in such business by all kinds of foreign institutions, enterprises, individuals and wholly foreign owned enterprises, Sino-foreign joint ventures and Sino-foreign cooperative enterprises established within our country are not allowed. Any means of introducing foreign equity investment in the operation is not allowed either.[185]

Foreign companies are allowed to provide value-added services over a network operated by a Chinese company. However, they are prohibited from offering international value-added services. Foreign participation in the operation of China's telecommunications services is, in general, strictly prohibited in China. It is clearly stated

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183 N. Ingelbrecht, "'Super Ministry' Harms Foreign Hopes in China", *Communications Week International* (20 April 1998).

184 It was approved by the State Council, China's cabinet level organization of the executive branch of government, on August 3, 1993.

185 State Council document, 1993 Regulation 55, *State Council approves MPT proposal regarding further strengthening regulation of the telecommunications markets.*

in the Guide for foreign investment in China that no foreign enterprises or foreign individuals are allowed to manage or participate in the operation of basic telecommunications services in China.[186] In 1997, China Unicom employed the so-called mechanism of China-China-foreign joint ventures to raise funds. That is, a foreign investor first established a joint venture with a local partner, and then, in the name of this joint venture, the foreign partner of the joint venture itself funded China Unicom at a pre-determined rate of return negotiated by the foreign partner of the joint venture and China Unicom. In fact, this practice allowed the indirect involvement of foreign investors in China's telecommunications sector. This practice apparently violates Article V of the 1993 MPT Opinion, which is in force at the present time. Therefore, the F-C-C practice by the China Unicom was soon ruled out by the MII.[187]

However, foreign investment in telecommunications will eventually be opened up as China seeks entry into the WTO. The questions are when and how to open up its telecommunications market. Moreover, the process requires a set of proper rules in place governing the telecommunications market, in which competition shall be secured and market forces shall apply.

E. Potential Problems in the Domestic Telecommunications Market

When Chinese government split China Telecom into four specialized telecommunications providers, it intended to promote China Unicom's role as a comprehensive basic telecommunications provider. The Ministry of Railway, the SARFT and others who possess networks have also been encouraged to enter into the basic telecommunications market. On the one hand, it can be understandable when taking into

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186 MOFTEC, "Catalogue for the Guidance of Foreign Investment Industries" (20 June 1995) online: <http://www.moftec.gov.cn/moftec/official/html/laws_and_regulations/investment25.html> (date accessed: 16 June 1999).

187 CEInet, "China Unicom Investigation Favorable to Investors: MII" (5 February 1999), see also "China Unicom Under Investigation" (29 December 1998) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 9 January 2000).

In EU-China WTO talk in May 2000, the EU also obtained a settlement of outstanding claims by Siemens Deutsche-Telekom, France Telecom, and Telecom Italia regarded their aborted joint venture with China Unicom.

account China's national policy objectives with respect to telecommunications industry. One policy is that the state-owned telecommunications providers shall be strengthened to facilitate the development of the national telecommunications infrastructure. It fits well China's current situation as a socialist market economy and a late developer in the international market.

On the other hand, the four specialized telecommunications providers separated from China Telecom will possibly become dominant providers in their respective areas. Together with its Hong Kong-listed arm -- China Telecom (HK),[188] China Telecom currently operates at least 90 per cent of cellular and fixed-line networks across the country. It dominates China's fixed telephony market.[189] The separation was expected to break the monopoly role of China Telecom in China's telecommunications market and to create a fairly competitive market by reducing the cross-subsidization. However, there exists a contradiction in the telecommunications market. The four specialized telecommunications providers separated from China Telecom are restricted to their respective business scopes. They are banned from operating across telecommunications service sectors. Meanwhile, the remaining and emerging big telecommunications providers, such as China Unicom etc., keep on operating comprehensive telecommunications services after the split of China Telecom. It raises the question of whether the competition in the telecommunications market is fair.

While China's telecommunications is in transition, there remain many issues to be solved. Before or during the introduction of foreign basic telecommunications in China's market, China should further carry out domestic reforms in its telecommunications industry. A set of rules that ensure a pro-competitive telecommunications market and management mechanisms that promotes industrial efficiency should be developed in time.

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188 China Telecom (Hong Kong) was created under the former MPT in 1997, to explore investment opportunities in Hong Kong for the cellular market on the mainland. See R. Janda, *supra* note 174. See also Andrew Chetham, "CTHK Set to Continue March into Provinces" *South China Morning Post Internet Edition* (11 June 1998) online: <http://www.scmp.com> (date accessed: 28 January 1999).

189 Only recently was China Unicom authorized to start a trial of fixed telephony business in three cities -- Tianjin, Shenzhen and Chongqing. See CEInet, "China Unicom Expanding Quickly", *supra* note 171.

Otherwise, the foreign entrants will not only challenge China's domestic telecommunications providers, but also impose pressures on the institutional system of China's telecommunications industry.

G. Conclusion

As the Chinese government realized the link between telecommunications sector and the development of economy, it set the development of its telecommunications infrastructure as a national goal and provided a series of assisting policies to boost the telecommunications sector. China's telecommunications industry has since experienced rapid expansion. While the telecommunications equipment market has been widely opened up to foreign investment, the telecommunications services market is exclusively insulated from any means of foreign involvement. However, competition has been introduced into the domestic telecommunications markets, including paging, Internet, mobile services, and soon local telephony. While most of the big players in the domestic telecommunications market are state-owned, fair competition might be in doubt if the principles of market forces do not apply. Furthermore, China has not yet developed the necessary management skills that secure an orderly telecommunications market. Hence, China must further carry out institutional transition and develop market mechanisms in its telecommunications industry.

Despite the staggering growth of China's basic telecommunications sector, it still lags far behind the telecommunications sectors in industrialized countries, in terms of finance, technology and services. Neither China Telecom nor China Unicom is able to compete against AT&T, British Telecom and like companies who are eagerly looking forward to entering China's market. As is always said, market access will bring benefits in the long run. The issue facing China is how not to be harmed in the short term while the market opens up. It requires that China carefully arrange the transition to telecommunications liberalization and balance its national objectives and the global trends in the telecommunications sector.

Last but not least, a national telecommunications law is necessary to enhance the current regulator, the MII's supervision power, and to secure a pro-competitive market in the future.

Comparison of the Chinese Telecommunications and Banking Industries

A. National Policy Objectives

Due to historical reasons, the telecommunications and banking sectors were given a backseat during the period of China's centrally planned economy.[190] It was not until China embarked on the economic reforms and adopted an open-door policy in the late 1970s that the Chinese government realized the significant roles of the telecommunications and banking sectors played in national economic growth. The telecommunications and banking industries have since been seen as strategic sectors by Chinese government.

The objectives of government policies and regulations on telecommunications and banking sectors are not the same. To an extent, this is not surprising since the problems that can arise in the two sectors are different. In the telecommunications industry, concern has been raised primarily over monopoly control over essential facilities that impose high costs and poor services on users of telecommunications. In the banking sector, however, there is great concern about the stability of the banking system. This is because the failure of a bank will induce the loss of customers' confidence in other banks, which will in turn affect the overall economy.[191]

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190 For the details on telecommunications, see Z. He "A History of Telecommunications in China: Development and Policy Implications" in P. Lee, ed. *Telecommunications and Development in China* (Cresskill, N.J.: Hampton Press, 1997) at 66-74. On banking, see Chapter Two, above.

191 See *supra* note 26 and accompanying text.

However, the two sectors might share a number of policy objectives:

1. The infrastructure should be developed to facilitate overall economic growth;
2. The extensive system should provide services to the entire populace;
3. State-owned firms should be dominant in China;
4. Both industries should be Chinese controlled;
5. Domestic providers and/or production should be expanded.[192]

Accordingly, it is not surprising that China is hesitant to commit to foreign ownership in the two sectors. Besides, the government has to design policies to promote the development of domestic telecommunications and banking systems, the strength of domestic firms and to improve the efficiency of the two markets.

B. Moves to Deregulation

Government has always played a critical role in determining the environment in which banks and telecommunications providers develop. The staggering development of the telecommunication industry has, to a large extent, contributed to government preferential policies.[193] In order to improve the efficiency of the industry, the government has engaged in creating a competitive telecommunications market. It split the dominant provider -- China Telecom -- into four specialized telecommunications providers. Meanwhile, the government has tried all means to strengthen the competitiveness of China Unicom and other state-owned network operators in the market. Meanwhile, the MII was established as a separate regulator to oversee fair competition in the domestic telecommunications market.

Likewise, the government has carried out reforms to strengthen the domestic banking system. The PBOC was designated as the central bank. The managerial and supervisory power of the PBOC has subsequently been enhanced through institutional

192 With respect to telecommunications, see J. Ure, *supra* note 155 at 2.
193 See Telecommunications in China B. a. in Chapter Two, above.

restructuring. The four state banks have been authorized to undertake institutional transition towards full-fledged commercial entities. To facilitate the commercializing transition of the four state banks, policy banks were set up to reduce their responsibility for policy lending to fulfill the national financing plan. Furthermore, the government has encouraged the establishment of new financial institutions to improve the efficiency of the banking industry.

C. Insufficient Competition

Competition is one contributor to the improvement of market efficiency. Efficient telecommunications and financial/banking markets in an economy are, in turn, important contributors to economic growth and stability. The introduction of competition in both industries has played a significant role in improving their efficiency. However, competition from domestic counterparts is not sufficient enough to affect the dominant player in both the telecommunications and banking markets.

The four state-owned banks, as a whole, account for 70 per cent of market share in assets. They have a vast network of branches, which allows them to hold the bulk of deposits throughout the country. The ICBC, for example, controls almost all banking in the cities. None of the newly emerging banks is able to compete with it. Gaining approximately one per cent of the market share per year in both loans and deposits on the four state banks,[194] the newly emerging banks cannot fundamentally alter the inefficient banking system.

In the telecommunications industry, the introduction of competition has contributed to the cut of charges for mobile and other services. The growth and competitiveness of China Unicom and the other new entrants, however, has always been undermined by China Telecom, who has a close relation with the former MPT.[195]

194 R. Stride & G. Gaeta, *supra* note 10.

195 See X.W. Wang, "Telecommunications: Three New Challengers for China Telecom", *supra* note 164.

Though China Telecom was split into four units focusing on paging service, mobile telecommunications, ground network and data business, and satellite telecommunications respectively, the four state-owned specialized companies have indeed all become dominant players in their respective telecommunications services markets. None of the existing telecommunications firms can compete against them in terms of size and market assets.[196] Although the MII was later established to replace the MPT, the reappearance of former MPT Minister Wu Jichuen as Minister of the MII indicates that the old wine might now be in a new bottle.

Customers require diversified services provided in good quality and at reasonable prices, which will only be possible in a competitive market. Yet, it is obvious that the competition from domestic newcomers is not sufficient enough to meet customer's needs.

D. Inadequate Regulatory Framework

Traditionally, China has been conservative in adopting untested legal norms and standards. It took fifteen years until China finally adopted national banking laws in 1995. There has been nine draft bills of a national telecommunications law since1980.[197] In spite of the rapidly developing telecommunications market, the country has not yet developed a legal and regulatory infrastructure that keeps pace with the development of local and international telecommunications markets. Over the last two decades, there have been discernable trends towards liberalization and deregulation of certain aspects of China's telecommunications industry. The absence of a national law has been brought to great attention. It not only affects the efficiency of the industry, but also gives pause to some potential foreign participants.

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196 Before the split of China Telecom, it was more than 60 times the size of its biggest rival, China Unicom. It controlled more than 95 per cent of the market. See Associated Press in Beijing, "Telecoms split aims to boost competition" *South China Morning Post Internet Edition* (21 April 2000) online: <http://www.scmp.com> (date accessed: 21 April 2000). See also X.W. Wang, "Telecommunications: Three New Challengers for China Telecom", *ibid.*

197 N. Ingelbrecht, see *supra* note 183.

While China has in place the Commercial Bank Law, the Central Bank Law, as well as regulation on foreign financial institutions operating in China, there remains ambiguity in some provisions of these laws and regulations that require further clarification. National bank laws, for instance, stipulate the supervisory and regulatory role of the PBOC over financial institutions in China. However, the language is more or less like "in accordance with relevant regulations"[198]. The detail remains unclear given that it is hard to get access to the so-called "relevant regulations". The non-transparency issue regarding Chinese laws and regulations has always been a target of criticism in practice. In addition, their application remains questionable. Article 42 of the Commercial Bank Law explicitly states that borrowers of loans should repay the principal and interest of the loans on time.[199] If this provision were duly applied, there would not have accumulated so much non-performing debt. In brief, China's regulatory framework in both industries is inadequate.

E. Other Problems

In addition to the above-mentioned issues in both industries, the lack of technologies and management skills stands to impede the development of both industries. After decades of extending loans on policy basis, the banks have not gained sufficient experience in real commercial banking. The central bank has limited regulatory and supervisory capacity. It is not in a strong position to lead and manage the transition to an efficient and stable banking system. The current banking system is inefficient at allocating financial resources for the whole economy, including the telecommunications industry. China's telecommunications industry, on the other hand, is chronically short of funds. China has limited internal finances to provide a desperately needed update to its telecommunications infrastructure. Without an efficient, diversified, and open banking system, there is little chance for the telecommunications industry to raise funds domestically and internationally.

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198 Article 10 of the Commercial Bank Law and Article 31 of the Central Bank Law, see Appendices A & B.

199 See Appendix A.

F. Conclusion

Given that one of China's national policy objectives for both the telecommunications and banking industries is to improve their efficiency so as to ensure the development of both domestic industries, it is desirable that foreign entrants and investment should be introduced in both markets. Foreign participants will serve as an alternative for the Chinese government to improve efficiency in both industries. Foreign investment will certainly bestow adequate funding to fuel the development of China's telecommunications industry. Furthermore, foreign entrants will bring substantial benefits such as access to new products and services, technical transfer and a force for modernization. In terms of technology, management, and products, those foreign financial institutions and telecommunications firms that long to enter both Chinese markets are more advanced than China's domestic firms. They are also both bigger and stronger in terms of size and financial resources. Upon their entry, competition against Chinese dominators in both industries will become stiffer. It is commonly acknowledged that increased competition benefits users directly. The users will have a wider choice of products, better quality, and lower cost of services.[200] Increased competition will also create incentives for domestic players to increase managerial efficiency, improve services, and make better use of advanced technology. The improved efficiency in the domestic banking system will, in turn, encourage the inward flow of capital. Therefore, it will attract more foreign capital into the domestic telecommunications industry. A well-constructed telecommunications infrastructure, on the other hand, will contribute to the

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[200] As domestic firms become more market-oriented and efficient, the users will have a wider choice of products, better quality and less cost of services. In financial services sector, users will gain higher rates of return since there are more opportunities to diversify risk in a competitive market. For details on benefits of financial services users, see WTO, *Opening Markets in Financial Services and the Role of the GATS*, Special Studies, Geneva. See also W. Dobson and P. Jacquet, *supra* note 15 at 15-24. For details on benefits of telecommunications users, see B.A. Petrazzini 1996, *supra* note 18 at 32-42.

development of the banking industry.

Moreover, China's commitments to the GATS framework will assist the improvement of the legal infrastructure in both sectors. It is thus desirable that the Chinese government introduce competition from foreign entrants so as to spur further development of efficient domestic industries. Upon the conclusion of China's WTO accession negotiations with the USA, the EU, and other interested WTO member countries, China has committed to open the country's telecommunications and banking markets to telecommunications providers and banking firms from WTO member countries that have reached agreements with China. The remaining question is whether it is feasible under current circumstances in both the telecommunications and banking industries. The next Chapter intends to analyze China's commitment to both sectors in the Sino-US WTO agreement.

Chapter Three

Assessing the Sino-US WTO Agreement:

Telecommunications and Banking Sectors

China has engaged in negotiating its WTO/GATT accession with the United States of America (USA) for more than a decade. During his visit to the United States in April 1999, Chinese Premier Zhu Rongji presented China's deepest concession on the WTO accession to the USA. Although the US side was in general "extremely pleased"[201] by China's April proposal during the bilateral negotiations in the United States, with respect to telecommunications and financial services, significant issues of contention remained in discussion between the two sides[202]. China-US bilateral WTO accession

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201 W.W.L. Lam in Washington, "WTO quest nears finish" *South China Morning Post Internet Edition* (10 April 1999) online: <http://www.scmp.com> (date accessed: 10 April 1999).

202 In April talks, China, for the first time ever, made commitments to open up its telecommunications sector. In the financial sector, China made considerable commitment to opening the market. However, both the securities and banking sectors remained under discussion, without drawing any conclusion. See "Market Access and Protocol Commitments" online USTR: <http://www.ustr.gov/> (date accessed: 21 May 1999).

negotiation therefore stalled. Half a year later, on November 15, 1999, China and the USA finally completed their bilateral talks on China's accession to the WTO -- they agreed upon a WTO agreement for China. Accordingly, China has made commitments to phase out most restrictions in a broad range of service sectors, including telecommunications and banking, insurance and securities. China will also participate in the WTO Financial Services and Basic Telecommunications Agreements.[203]

As discussed in the previous Chapter, both telecommunications and banking markets are currently subject to heavy regulation and restrictions. China's telecommunications sector remained tightly closed during the past two decades of economic reform and opening. The existing regulations clearly rule out foreign involvement in managing and operating telecommunications in China. Compared to telecommunications, the banking sector has opened to foreign investors considerably more widely in recent years. Since the first foreign bank was allowed to set up a representative office in Beijing in 1979, there have been approximately 200 foreign financial institutions operating in China in the form of branches, joint ventures and subsidiaries. However, their legal form of establishment is subject to certain prerequisites, namely the establishment of representative offices. In addition, they are currently subject to limitations as to business scope and clientele, and also to geographic restrictions. Presently, only a few foreign banks are allowed to do local currency business and only in selected localities. They are not permitted to conduct local currency business with Chinese clients. Furthermore, foreign banks can only be permitted to establish in approved localities in China.

203 The United States-China Business Council, a principal organization of US companies engaged in trade and investment in the People's Republic of China, has revealed the full text of the US-China WTO Market Access Agreement on its Web site. See Section II: Services Commitments -- pages 183-302 and 204-226, online US-China Business Council Web site: <http://www.uschina.org/> (date accessed: 15 May 2000).

See also "Summary of U.S.-China Bilateral WTO Agreement" (2 February 2000), online the United States-China Business Council: <http://www.uschina.org/public/wto/ustr/generalfacts.html> (date accessed: 15 May 2000). [hereinafter Summary]

Sino-US WTO Agreement concerning the Telecommunications and Banking Sectors

On November 15, 1999, China and the USA agreed upon a WTO market access agreement for China's accession to the WTO. Accordingly, China has made commitments to phase out most restrictions on the banking and telecommunications sectors. China also agreed to participate in the WTO Financial Services and Basic Telecommunications Agreements. The China Trade Relations Working Group of the White House of the United States of American provided facts sheets on China's commitments to market access in both sectors:

Table 5: Overview of China's Commitments[204]

Market Access Issue/Product	Current Conditions	Post-Accession Conditions
Telecommunications	Closed to foreign investment	•**Regulatory Principles**: Implementation of the Reference Paper on Regulatory Principles (including cost-based pricing, interconnection rights, and the establishment of an independent regulatory authority.) Technology-neutral scheduling. •**Geographic Scope**: All geographic restrictions for paging and value-added services phased out within 2 years of accession; mobile/cellular within 3 years (note: U.S. bilateral was 5 years); and domestic wireline services within 6 years. Beijing, Shanghai, and Guangzhou, will open immediately on accession in all telecommunications services. •**Investment**: 49% foreign ownership in mobile services within 3 years of accession (note: U.S. bilateral was 5 years); 49% in international and domestic land and sea (not mobile) services within 6 years; 49% in most other services upon accession; 50% in value-added services within 2 years.
Banking	Local-currency business with Chinese clients is prohibited. Narrow geographic restrictions on where foreign banks may operate. Foreign financial institutions require approval–granted on	Gain full market access within 5 years of accession. •Be able to conduct local-currency transactions with Chinese enterprises 2 years after accession. •Be able to conduct local-currency business with Chinese individuals from 5 years after accession. •Non-banks be able to conduct motor vehicle finance upon

[204] The White House Office of Public Liaison, online: <http://www.uschina.org/public/wto/uscbc/wto bilat.html> (date accessed: 15May 2000). See Appendix D for a comparison of China's April offer with the ultimate commitments.

	a discretionary, case-by-case basis–for new representative offices and branches.	accession without restrictions (note: U.S. bilateral had been auto finance). •Foreign banks will have the same rights (national treatment) as Chinese banks within designated geographic areas. •Geographic and customer restrictions will be removed 5 years after accession.
Insurance	Foreign companies may operate only in Guangzhou and Shanghai. Restrictive licensing practices have limited the number of foreign insurers in China's market to less than 20, and restricted each company to a narrow range of operations. Foreign companies must join with government-approved Chinese partners, and are unable to sell group or pension policies.	•**Geographic scope**: Foreign property and casualty firms permitted to insure large-scale risks nationwide immediately upon accession, and all geographic limitations eliminated in 3 years. •**Product Scope**: China will expand the scope of activities for foreign insurers to include group, health, and pension lines of insurance, which represent about 85% of total premiums, phased in over 3 years (note: U.S. bilateral was 5 years). Brokerage services are also covered (Note: added in Europe bilateral) •**Prudential Criteria**: China has agreed to reward licenses solely on the basis of prudential criteria, with no economic needs test or quantitative limits on the number of licenses issued. •**Investment**: *Life Insurance*- 50% foreign ownership in life insurance joint ventures. Life insurers will be able to choose their own joint-venture partners with management control permitted (note: last element added in Europe bilateral). *Non-life*- Upon accession, China will allow the establishment of branches, or 51% ownership in joint ventures, and will permit the formation of wholly foreign-owned subsidiaries in 2 years. *Reinsurance*- Completely open to foreign providers upon accession. *Brokerage*-50% foreign ownership upon accession, majority in 3 years, completely open in 5 years (note: added in Europe bilateral).
Securities	Closed to foreign investment. Underwriting by foreign banks of domestic securities and foreign-currency denominated securities is prohibited.	•Foreign financial institutions will be allowed a 33% stake in fund management enterprises upon accession. The stake will rise to 49% after 3 years. •Foreign underwriters will also be allowed to invest up to 33% in joint ventures. •Joint ventures in which US firms have minority stakes will be allowed to underwrite domestic securities issues as well as underwrite and trade in foreign-currency denominated securities (debt and equity); and will be allowed to engage in fund management on the same terms as Chinese firms.

A. Telecommunications[205]

a. Value-added and Paging Services

Foreign service suppliers will be able to provide the following services through joint venture enterprises: electronic mail, voice mail, online information and database retrieval, electronic data interchange, enhanced/value-added facsimile services (including store and forward, store and retrieve), code and protocol conversion, online information and data processing (including transaction processing), and paging services.

Foreign service suppliers may hold 30 per cent foreign equity share upon accession, 49 per cent after one year, and 50 per cent after two years.[206]

Beijing, Shanghai, and Guangzhou[207] will be open to foreign value-added services and paging services providers upon accession. Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan and Wuhan will be accessible after one year, and nationwide after two years.

b. Mobile Voice and Data Services

Foreign service suppliers will be able to provide all analogue/digital cellular services and personal communications services.

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205 The following descriptions are based on the Fact Sheets provided by the China Trade Relations Working Group on Telecommunications (15 February 2000) online: <http://www.chinapntr.gov/industry%20fact%20sheets> (date accessed: 15 May 2000) together with the text of the U.S.-China bilateral, available at www.uschina.org and the overview of results of the Sino-EU bilateral provided by the available on the European Union's official Web site: <http://www.europa.eu.in/comm/trade/bilateral/china/res.pdf> (date accessed: 15 May 2000).

206 It is interesting to note that neither the United States nor the EU were able to negotiate with China that the 50 per cent equity level included permission of operation and management control. For more discussion on this issue, see "c. National Defense" in next section of this Chapter below.

207 China's key telecommunications services corridor in Beijing, Shanghai and Guangzhou represents approximately 75 per cent of all domestic traffic. See "Beijing to Open Sector Earlier Than Promised", *supra* note 154.

Foreign mobile voice and date services providers may hold a 25 per cent foreign equity share one year after accession, 35 per cent after three years, and 49 per cent after five years.[208]

They may provide services in and between Beijing, Shanghai, and Guangzhou one year after accession, [209] to Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan and Wuhan after three years, and nationwide after five years[210].

c. Domestic and International Services

Foreign service suppliers will be able to provide domestic and international voice, packet-switched data transmission services, circuit-switched data transmission services, and facsimile services through joint venture enterprises. International closed user groups voice and data services are also included.[211]

Foreign service suppliers may hold a 25 per cent foreign equity share three years after accession, 35 per cent after five years, and 49 per cent after six years.

Foreign service suppliers may provide services in Beijing, Shanghai, and Guangzhou after three years, in Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan and Wuhan after five years, and nationwide after six years.

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208 In the EU-China WTO accession agreement concluded on May 19, 2000, the timetable for the opening of the mobile telephony market has been accelerated by 2 years. Foreign investment will be allowed at 25 per cent on accession, 35 per cent after 1 year and 49 per cent after 3 years. For mobile and fixed services, traffic between cities as well as within them, will be open. See "Highlights of the EU-China Agreement on WTO" online: <http://europa.eu.int/comm/trade/bilateral/china/high.htm> (date accessed: 28 May 2000).

209 The EU was able to negotiate immediate access to the Beijing, Shanghai and Guangzhou inter-city markets, *ibid.*

210 The EU was able to access to these cites after one year, and nationwide after two years, *ibid.*

211 In Sino-EU talks, China agreed to open up its leasing market in 3 years, allowing foreign firms to rent capacity from Chinese operators and resell it domestically and internationally (private leased circuits & closed user groups). See "Highlights of the EU-China Agreement on WTO", *ibid.*

d. Internet and Satellite Services

Internet and satellite services are included, but not explicitly scheduled, following the scheduling convention of most WTO members, including the United States.

Internet services are subsumed under value-added services. For satellite services, China has attached to its agreement a services schedule and signed the "Notes for Scheduling Basic Telecom Services"[212]. This means that unless explicitly excluded in China's sectoral column, any basic service may be provided through any means of technology (e.g., cable, wireless, satellites).

e. Access to International Services

All international telecommunications service suppliers shall be licensed for their operation in China. China's telecommunications authorities, which will act as an independent regulatory authority, are responsible for this practice. The decisions and procedures used by regulators shall be impartial with respect to all market participants.

f. Other Commitments

China has agreed to undertake all the obligations contained in the WTO Reference Paper on pro-competitive regulatory principles[213]. Accordingly, China will apply non-discriminatory interconnection at any technical feasible point subject to transparent arrangements and dispute settlement through an independent domestic body. Furthermore any licensing requirements must be transparent and the regulator body must be independent. China also made commitments in accordance with the Notes for Scheduling Basic Telecom Services and Market Access Limitations on Spectrum

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212 *Supra* note 55.
213 *Supra* note 56.

Availability[214].[215]

B. Banking Services[216]

a. Financial Services Licenses

As a general matter, criteria for authorization to deal in China's financial services sector are solely prudential and contain no economic needs test or quantitative limits. This is specified both in Part A of the Financial Services Schedule (Insurance) and in Part B (Banking and Other Financial Services).

b. Banking and Finance Company Licenses

Any existing non-prudential measures restricting ownership and juridical form shall be eliminated within five years. By then, foreign financial institutions may choose their legal form of establishment in accordance with certain asset thresholds. Foreign financial institutions having more than USD 10 billion in assets will be allowed to establish bank or finance company subsidiaries or a Chinese-foreign joint bank or joint finance company. Foreign financial institutions with more than USD 20 billion in assets will be allowed to establish foreign bank branches. Foreign financial institutions that have had business operations in China for at least three years and have been profit-making for the previous two years will be allowed to conduct local currency business. However, foreign ownership in banking sector is not accepted.

c. Banking Services

214 WTO, S/GBT/W/3 (3 February 1997) online WTO: <http://www.wto.org/wto/services/tel17.htm> (date accessed: 23 May 1999).

215 See Fact Sheets provided by the China Trade Relations Working Group on Telecommunications (15 February 2000) online: <http://www.chinapntr.gov/industry%20fact%20sheets/telecommunications.htm> (date accessed: 28 May 2000).

216 See Fact Sheets provided by the China Trade Relations Working Group on Banking (15 February 2000) online: <http://www.chinapntr.gov/industry%20fact%20sheets/banking%20and%20securities.htm> (date accessed: 15 May 2000).

Banking services are broadly defined to include deposit-taking, lending, financial leasing, payment services, guarantees and commitments. However, financial leasing will be allowed for foreign-owned banks only when allowed for domestic banks, which is currently not the case.[217] Cross-border supply of services is unbound except for (1) provision and transfer of financial information and financial data processing and (2) advisory, intermediation and other auxiliary financial services. China will expand the scope and geographic opportunities for foreign banks to conduct local currency business.

- Product Scope: Upon accession, foreign financial institutions are allowed to perform all types of foreign currency business to all types of client. Local currency business with foreign clients will be permitted upon accession, with Chinese enterprises two years after accession, and with Chinese individuals five years after accession.

- Geographic Scope: Upon accession, there are no geographic restrictions upon foreign currency business. Local currency banking will be permitted in Shanghai, Shenzhen, Tianjin and Dalian upon accession, Guangzhou, Qingdao, Nanjing and Wuhan one year after accession, Jinan, Fuzhou, Chengdu and Chongqing two years after accession, Kunming, Beijing, Xiamen and Zhuhai[218] three years after accession, Shantou, Ningbo, Shenyang and Xian four years after accession, and nationwide five years after accession.

C. Summary

China has agreed to permit direct investment in the operation of telecommunications services. The percentage of foreign ownership varies from 25 to 50 per cent for different telecommunications services according to the agreed-upon timetable. China will participate in the WTO Basic Telecommunications Agreement and

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217 *Ibid.*

218 The city of Zhuhai holds several EU banks. The EU succeeded in negotiating an acceleration of that timetable.

implement the pro-competitive regulatory principles embodied in the BTA, including cost-based pricing, interconnection rights and independent regulatory authority. China has also agreed to the technology-neutral scheduling, which means foreign suppliers can use any technology they choose to provide telecommunications. Furthermore, China will gradually phase out geographic restrictions for paging and value-added services, mobile/cellular services, data services, and domestic and international wireline services. China's key telecommunications services corridor in Beijing, Shanghai and Guangzhou will open to all basic telecommunications services immediately on the accession of the WTO.[219]

In the banking sector, China will expand the scope and geographic opportunities for foreign banks to conduct local currency business. With respect to foreign currency business, there will be no geographic restrictions on accession. China has agreed to condition issuance of licenses only on prudential grounds. China will allow internal branching and to provide national treatment for all newly permitted activities. Foreign banks will then be granted national treatment, meaning that they will have the same rights as Chinese banks, within designated geographic areas. All restrictions on geography and customers will be diminished five years after accession. Foreign banks will also be able to choose the legal form of their establishment five years after accession.

The Sino-US agreement apparently represents the most dramatic step toward the liberalization that has been undertaken by the Chinese government. If indeed China is accepted as a WTO member, the Sino-US agreement appears to be binding and applies to other WTO members.[220] Will China's telecommunications and banking industries be able to sustain the competition from foreign entrants? The following section analyzes what challenges that rise from the Sino-US agreement will be facing China from.

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219 See "Summary of the Sino-US WTO Agreement:" (forwarding Hong Kong Da Gong Bao's news release on the summary of the Sino-US Agreement on 16 November 1999) (in Chinese) online CWW: <http://cww.com>. See also "Beijing to Open Sector Earlier Than Promised", *supra* note 154.

220 The Sino-EU agreement took one step further the liberalization in both Chinese telecommunications and banking sectors. See *supra* note 8.

Is It Feasible?

A. Common Concerns about both Telecommunications and Banking Liberalization

a. Losing Personnel

Losing personnel is one of the issues that the domestic firms are concerned about with the entry of foreign competitors. As commonly observed, the potential foreign entrants that are from industrialized countries generally offer better payment and better working condition to attract local personnel. According to Dobson and Jacquet, some countries' experience has confirmed otherwise. As the president of a leading Indonesian insurance firm commented:

> It is common knowledge that the foreign banks operating in Indonesia are the source of banking expertise. They have trained a great many Indonesian men who later have become managers of national private banks. The number is so great that almost every national private bank has one of its manager originating from foreign banks...It is noteworthy that the foreign banks who are operating in Indonesia have played a major role in improving the know-how and expertise of our Indonesian bankers.[221]

The same logic also applies to the telecommunications industry. Foreign entry may, in the short term, pull native personnel out of domestic firms. In the long run, however, it can substantially contribute to the development of a skilled local labor force in the relevant domestic industries. It indicates that protection against foreign entry is not the best way to address such concerns.

b. The Disparity of Economic Development

221 W. Dobson and P. Jacquet, *supra* note 15 at 29.

There have been concerns about the potential of an excessive concentration of sectoral powers in the considerably more developed areas if foreign participants are allowed to freely expand their operations. Due to historical and natural factors as well as the recent state development policy, there already exists a great disparity of economic development among regions in China. Especially during China's reforming period, the government put the priority on the development of coastal cities and the eastern region. Provinces and municipalities in the eastern part of the country have since developed their economy much faster than those in the western and middle part of the country.[222] Cities and the SEZs that have been designated by the Chinese government to be opened up to foreign investors are all located in the eastern part of the country. It is clear that the wider the region opened to foreign investors, the more chance it has to access new technology and foreign capital, and thus the faster it grows. With the poor regions continuing to be kept closed, the regional disparity will apparently be further augmented.

China's current policy restricts foreign investors in certain areas and cities that are relatively more advanced and developed. The geographic restriction on foreign entry may well create excessive concentration of sectoral powers in the more developed areas. The sooner geographic restrictions on foreign entry are removed, the more possibilities the western and middle regions will have to access foreign capital and high technologies, the better it will contribute to alleviating the regional disparity, and in turn, to the overall national economic growth.

c. Competitive Forces

There are concerns about giving competitive forces free play. However, foreign competition consists of only one part of the competitive forces in the domestic market. There is competition from emerging domestic firms, both state-owned and private. There

[222] According to Chinese government report for the first half of 1999, the nine provinces and municipalities in the eastern region grew the fastest, with growth of gross domestic product (GDP) exceeding 9 per cent in average, while the nine provinces and autonomous regions had a GDP growth rate under 7.6 per cent. Data from CEInet, "Uneven economic development" (15 July 1999) online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 15 July 1999).

is also increasing competition among existing firms as new technologies and new services are being developed and adopted by them.

In addition, the competition from foreign entrants creates incentives for domestic firms to increase managerial efficiency and improve services. This has been evidenced by the recent operation of AT&T in China. As soon as AT&T started operating in China, it brought to light the significant gaps between foreign and domestic telecommunications providers. For example, the average time it takes Chinese telecommunications providers to install a new telephone line is approximately 20 days, compared with only 3-7 days for foreign telecommunications providers. In order to compete against the AT&T, Beijing Telecom, by way of illustration, made a move to cut the amount of time to install or move telephone lines. This shows how competition from foreign entrants contributes to the improvement of services and management of local firms.

Furthermore, an increase in competition will also benefit users directly. In addition to the improvement of services, it leads to the drop of service charges. The users will have a wider choice of products, better quality and lower cost of services.

Accordingly, protection against foreign competition is not the way to address concerns about increasing competition in the market. Indeed, what challenges the government is the quality and design of domestic reforms and how well the government manages the transition toward liberalization and deregulation.

B. Concerns about Telecommunications Liberalization

a. Development of National Telecommunications Networks

Telecommunications services in China were first set up by foreign companies in the late 19th century. They operated and owned China's telegraph, telephony business and other telecommunications services. These foreign companies tried to restrict the development of China's own networks by demanding exclusive rights in the operation of telecommunications in China.[223] Concerned about China's sovereignty over and the development of China's own telecommunications networks, Chinese governments, including the Qing Court and the Nationalists, have been reluctant with respect to foreign ownership and operation of telecommunications.

However, history produced its own particular circumstances. When telecommunications services were first introduced into China in the late 19th century, China possessed no capability of building up a telecommunications network due to the absence of necessary technologies and expertise. To the present, China has set up its own national public communication network on a considerable scale. Its telecommunications industry is presently equipped with various advanced technologies. It provides a variety of telecommunication services including fixed-line telephony, mobile telephony, satellite communications etc. An official report in 1997 described the situation of China's telecommunications infrastructure:

> By the end of July 1997, the length of long distance fiber-optic lines in China had added up to 150,000 km. The total length of fiber-optic lines had reached 820,000 km plus those county-to-county, inner-county and inner-city ones. After the Lanzhou-Xining-Lasa fiber-optic line is completed in 1998, the national backbone network will reach all the centrally governed metropolises, provincial capitals, 300 prefecture cities and 1068 counties. The amount of telephone switch gained a net increase of 79 million in 1992-1996 and more than 20 million annually in the past three years.

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223 The Great Northern Telegraph Company (GNTC), a Danish company with major stockholders from Britain and Russia, laid submarine cable connected to Shanghai that started China's first international telecommunications in 1871. In June 1881, when China was about to build its own telegraph networks and needed imported equipment and expertise, the GNTC presented a proposal to the then government, which stated:

(a) the existing cable owned by the GNTC enjoyed exclusive rights to profits in China, and no other countries should set up marine cable in Chinese territory in 20 years;

(b) within the 20 years, China should not install any submarine or land cables in places where the GNTC already had one;

(c) when China built new cables, the GNTC should be given the contract if its bidding was lower than others; and

(d) the GNTC offered free services to first-class official telegrams for 20 years as compensation.

See Z. He, *supra* note 190 at 58.

> The national mobile phone network was put into operation in 1987. By the end of July 1997, the amount of subscribers had topped 10 million and national roaming is actualized. Automatic roaming has been realized between China's GSM network and 16 mobile phone networks in 12 countries and regions of France, Germany, Switzerland, etc.
>
> The data communication network has covered 258, 000 subscribers in cities above prefecture level and most of the counties. The public communication network, which is now an automatic switched network, has completed the transition from analog to digital technology. The proportion of digitalized long distance transmission has reached 98.5%, and 99.7% of the inter-office telephone switches are program controlled.[224]

Hence, historical wariness about the control of China's telecommunications industry by foreign telecommunications companies should no longer serve as a justification for blocking foreign entrants to the industry.

b. National Security

The link between national security and telecommunications has been used in China as one reason for restricting foreign ownership of telecommunications operators. This concern is shared by other WTO members.[225] The GATS, accordingly, provides a safeguard in Article XIV *bis* (in relevant part):

> Nothing in this Agreement shall be construed:
>
> (b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:
>
> (i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
>
> (ii) relating to fissionable and fusionable materials or the materials from which they are derived;
>
> (iii) taken in time of war or other emergency in international relations;

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224 CEInet, "7.1 Present situation of China's telecom sector and expectation for the 9th Five Year Plan period" in Industrial Profiles and Market Research, online: <http://ce.cei.gov.cn/echn.htm> (date accessed: 3 June 1999).

225 Similar concerns were invoked in Brazil during the period of military government, and in the United States as well. See R. Janda, *supra* note 174 at 24.

China has national security laws and criminal laws that empower it to maintain control over telecommunications for purposes of defending national security.[226] As argued by Janda, national security should not be an obstacle that hinders liberalization in China's telecommunications industry.[227] Besides, WTO members such as the United States apply the issuance of licenses to foreign investors to ensure national security.[228] When China opens up its telecommunications to foreign investors, it may well employ certain measures of approval as other WTO members do.[229] Such procedures should not be considered too onerous given that China will, in compliance with the BTA, make publicly available all licensing criteria and the time period required to reach a decision about an application for a license.

c. National Defense

Historically, the development of telecommunications was of strategic importance for national survival and defense against military threats. Even in ancient times, telecommunications was a significant factor in military operations. For example, as early as 2,500 years ago in ancient China, flags and smoke, the primitive means of communication across long distances, were used to transmit military signals.230 Today,

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226 R. Janda, *supra* note 174 at 25-6.

227 R. Janda, *ibid.*

228 In the Open Entry Order of November 1997 of the Federal Communications Commission, it says:

> "We conclude we should continue to find national security, law enforcement, foreign policy and trade policy concerns relevant to our decision to grant or deny Section 214 and 310(b) (4) applications from applicants from WTO Members."

Federal Communications Commission, Report and Order on Reconsideration, Rules and Policies on Foreign Participation in the U.S. Telecommunications Market IB Docket No. 97-142 and Market Entry and Regulation of Foreign-Affiliated Entities IB Docket No. 95-22, Released: November 26, 1997. R. Janda, *supra* note 174 at 24-5.

229 A news release in Chinese Web site CWW, "Zhuan Jia Cheng Qing Dui Zhong Mei Xie Yi Shi Da Wu Jie", online: <http://cww.com> (date accessed: 12 December 1999)

As there was not an official announcement about the details of the Sino-US WTO Agreement, and people were eager to learn about the details, Chinese media sources quoted from one to another mainly based on Barshefsky's press remarks. Zhang Han Lin, vice President of WTO Studies Associate, clarified some misunderstandings about the Sino-US WTO Agreement that had been revealed through those media sources. With regard to the issues about telecommunications, he pointed out that, even though China agreed on American ownership, Long Rong Tu did not agree on the American side's control over the voting stock of local telecommunications firms in which they would be partners. In addition, certain measures of approval on foreign direct investment in China's telecommunications services will be employed.

230 See *supra* note 20.

modern telecommunications not only facilitates long-distance communications during wartime, but also are indispensable to novel weapons, for information is a weapon and so is secrecy.231 In modern times, the navigation of aircraft, the control of destructive missiles and so forth are all realized through telecommunications. Telecommunications is as civilian as civil aviation in time of peace, but as military as air forces in wartime. As said the Brigadier General William Mitchell in 1921:

> We must remember that, as we develop our commercial power in the air, just so much more do we develop our means of national defense. [Footnote omitted][232]

This can apply to the development of telecommunications infrastructure in a country. Not only historically, but also at the present time, telecommunications is a means of national defense. It is of war-making potential as well. As a country's ability to transmit information across long distances, within borders, across borders, on the Earth and extra-terrestrially, telecommunications is civilian and military, potential as well as existing. It is indivisible. It is definitely of strategic importance to a country's security.[233]

Not surprisingly, China intends to keep control over its domestic telecommunications industry and national telecommunications infrastructure. As a result, China agreed, in the Sino-US WTO agreement, to allow only up to 50 per cent foreign ownership in telecommunications services.

C. Concerns about Banking Liberalization

a. Sovereignty over the Banking System

231 See M. Jussawalla and C.W. Cheah, *supra* note 11.

232 Cooper, J.C., *Explorations in Aerospace Law: Selected essays by John Cobb Cooper 1946-1966* (Montreal: McGill University Press, 1968) at 19.

233 See D.R. Headrick, *supra* note 17.

The banking system is the heart of a financing system. Finance is by no means the only specialized sector to achieve autonomy.[234] The control of financing measures has probably the most immediate impact on the ability of governments to pursue policy. Hence, there is a fear about the take-over of China's domestic banking market by foreign entrants.

Two issues present themselves in this area. First, the domestic banking system is still underdeveloped. Domestic banks are not strong enough, in terms of size, capital, and management, to compete with those big and worldwide foreign financial institutions that are entering China's banking market. China's banks need to undertake further institutional transition so as to obtain the ability to compete with foreign entrants. Thus the financial reform must continue to provide for the appropriate means. This involves e.g. strengthening the supervisory power of the Chinese Central Bank and the commercialization of China's banks.

The second issue is the potentially growing influence of foreign financial activities on the Chinese government. Studies find that different foreign banks pursue different strategies.[235] The primary motivation for internationalization of banks is to follow their clients.[236] Most foreign banks in a host country focus on serving corporations from the same home country. Besides, the business scope focus of foreign banks is to a large extent determined by domestic market conditions and domestic regulations. When foreign financial institutions intend to compete against local financial institutions, they are induced to develop products in the interests of local customers. This can bestow economy-wide benefits to the host country.[237]

Moreover, financial products are invariably part of their environment. Foreign financial products may not easily appeal to local consumer preferences.[238] It has been

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234 Robert B. Packer, *supra* note 27.

235 W. Dobson and P. Jacquet, *supra* note 15 at 44.

236 Darroch, J.L., *Strategic Management and Multinational Banking: the Case of the Canadian Banks*, Ph.D. dissertation, 1989.

237 W. Dobson and P. Jacquet, *supra* note 15 at 29.

238 R. O'Brien, *supra* note 11.

evidenced by the experience of Latin American countries that it is unlikely foreign banks will dominate the banking market in the host country. Foreign banks have been active for many years in Latin America. In most cases, they control over 50 per cent of the voting stock of local financial institutions in which they are partners. In addition, there have been numerous acquisitions of local institutions by a few large European and Canadian banks in the 1990s. Yet, according to Dobson and Jacquet, their effective control of assets averages around 11 per cent.[239]

Furthermore, foreign banks operating in a host country are subject to local regulations and supervision. It is recognized by WTO members that each member country has the right to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives.[240] If there are any anti-competitive practices by foreign competitors, they are subject to the penalties under the GATS framework.

Therefore, the entry of foreign banks and financial institutions can be managed. A Chinese WTO concession to the opening of the banking market does not preclude the supervision and regulation of foreign banks. It should not be forgotten that the government has always played a critical role in determining the environment in which both domestic banks and foreign entrants compete. The question is how to efficiently manage and supervise the domestic banking market, including the operation of foreign financial firms, so that the domestic banking system is strong enough to withstand potential risks. The immediate challenge facing the Chinese government, before and during the opening of the banking market, is to strengthen the supervision of financial institutions to develop management measures.

b. Stability of the Overall Economy

239 W. Dobson and P. Jacquet, *supra* note 15 at 46.
240 GATS, Preface, *supra* note 9 at 285

The primary function of the financial sector is to allocate funding resources and facilitate transactions between and amongst economic activities. The financial sector, especially the banking sector, is thus the nerve center of an economy. It is vital to maintain the solvency and financial soundness of banks, for the simple reason that bank failure has a spillover effect on the stability of the overall economy. This has been demonstrated by the US savings and loan crisis of the 1980s and its aftermath, by Japan's ongoing struggle to work out the banking crisis that began in the early 1990s, and by the recent Asian Crisis in 1997-1998 and the associated currency turmoil.

Indeed, the common problems in the financial sectors of several Asian economies that have encountered the recent currency crisis can be easily identified in China. Among these is policy directed lending. Even though the responsibility of China's state banks for policy lending was abandoned in 1998, they are suffering the burden of tremendous non-performing loans that were accumulated in the past. An estimate from Standard & Poor's (S&P) indicates that China's non-performing loans were about USD 200 billion in 1997. Only 19.1 per cent of non-performing loans were covered by a net worth of 317 billion yuan at the end of the second quarter of 1997.[241] The state banks in China are technically insolvent.

The solvency and financial soundness of banks are of vital importance to the stability of the banking/financial system. The four state banks, the mainstay of China's financial system, are truly too big to fail. It would lead to an immediate impact on the stability of China's financial system that, in turn, damages China's overall economic stability. It has raised the concern that foreign bank entry may drive these financially fragile state banks into bankruptcy.

However, recent study has indicated that the stability of a financial system can be

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[241] S.X. Xu, *supra* note 75. For more on China's non-performing loans, see also *supra* note 120 and accompanying text.

maintained through prudential measures under domestic regulations.[242] Such prudential measures are allowed under the GATS framework. The provision concerning domestic regulation is found in the annex to the GATS on financial services stipulates, which reads, in relevant part:

> (a) Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.[243]

Due to chronic use of the credit plan under centrally planned economy, China has not yet developed such measures that carry out macroeconomic control through indirect methods of regulation.[244] The challenge facing China is to develop a set of prudential measures that prevent systemic risks.[245] It will not only help overhaul China's entire banking system, but also contribute to a sound and efficient financial system. Given that a sound financial system can efficiently allocate capital, it promotes the growth of the overall economy.

On the other hand, the resolution of non-performing loans, to a large extent, depends on the reforms in the state sector, i.e. the rationalization of the SOEs. The SOEs absorbed about 75 per cent of all bank loans while generating only 1.9 per cent of the

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242 Historically, the restriction of market forces was also employed for this purpose. Such regulations include interest rate control, restrictions on business scope and on the establishment of financial institutions that represent obstacles to free competition in financial services. See OECD, *supra* note 48 at 31-35.

Although they have been removed on a broad front since 1980s in most industrialized countries, they are easily found nowadays in China. Interest rates in China are highly regulated. Where the specialization of bank has been diminished, banking, securities and insurance are strictly compartmentalized. It is needless to mention that China applies restrictions on establishment by both domestic institutions and foreign institutions.

243 GATS Annex on Financial Services, 2 (a), *supra* note 50.

244 See P. Bowles & G. White, *supra* note 28 at 86.

245 Prudential regulation does not directly interfere with the price mechanism, nor prohibits the rendering of financial services. It usually sets standards for prudent management of financial institutions. See OECD, *supra* note 48 at 31-35.

mainland's USD 76.5 billion in corporate profit in the first half of 1997.[246] As argued by Lardy, reforms in the state sector and banking sector are closely intertwined.[247] To transform the state banks into truly commercialized and market-oriented banks, they are required to issue loans based on a stringent creditworthiness assessment. Given that many existing SOEs are *de facto* unproductive, the exercise of market discipline by banks will merely put a great number of SOEs out of business. That, in turn, poses further financial pressure on the state banks as they are holding most of non-performing loans. One alternative for rationalizing the SOEs is to develop a financial market, which is a potentially fundamental factor in an economy's long-term growth and development.[248] The intricate situation facing the state banks is illustrated in a report:

> It is important to remember that Beijing is not implementing these (*banking*) reform measures in a sealed greenhouse but in a tough and contradictory environment, where banks require better asset management while the economy requires sustainable liquidity.[249]

The implication is that reforms in both the state sector and banking sector are highly interrelated and must be handled with great care so as not to affect the stability of the financial system and the overall economy. Domestic reform is crucial in the financial sector. China needs to cautiously manage the transition towards a truly commercialized banking system so as to create a sound financial system.

c. Free Capital Flow

Free capital flow can facilitate efficient allocation of savings at the international level.[250] However, some countries' experience illustrates that capital account liberalization has been associated with financial crises.[251] It is one of China's greatest concerns that opening up the domestic banking market upon the entry into the WTO will

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246 See P. Chan and M. O'Neill, *supra* note 78.
247 See N.R. Lardy, *supra* note 109 at 76-92.
248 See W. Dobson and P. Jacquet, *supra* note 15 at 2. However, this topic is beyond the scope of this study.
249 See P. Chan and M. O'Neill, *supra* note 78.
250 W. Dobson and P. Jacquet, *supra* note 15 at 4.
251 A handy example is the Asian Crisis of 1997. W. Dobson and P. Jacquet, *supra* note 15 at 48-51.

lead to a free capital flow that will turn into financial shocks such as a reversal of the capital flow.

First of all, the WTO/GATS framework focuses on market opening and foreign entry. It is distinct from capital account liberalization. The GATS/FSA creates no obligation on the opening of the capital account. It in fact leaves the timing and the extent of capital account opening to the discretion of each WTO member country. China is therefore not required to liberalize its capital account upon the entry into the WTO.

Second, capital controls substantially reduce users' freedom to choose financial services between domestic and foreign financial institutions. China's stock market, as an example, is divided into local-currency A-share markets and foreign-currency B-share markets for the simple reason of exchange controls – namely, that China's currency -- renminbi -- is not freely convertible. China's A-share markets and B-share markets are strictly separated. Domestic users are not able to buy stocks from the foreign-currency market. And neither can foreign investors access the domestic-currency market. On the other hand, capital controls discourage foreign entry. Even though China's domestic currency business is opened to some foreign financial institutions, they cannot substantially compete with domestic financial institutions due to the exchange controls. When foreign financial institutions enter and the domestic market is opened up to foreign capital, capital account liberalization will sooner or later become an issue that China must face.

Third, a sound and efficient financial system with adequate supervision and risk assessment is a contributor to capital account liberalization. China currently still has an immature financial system. It has not yet developed a prudent regulatory framework for domestic banks. These are potential causes of financial shocks given that the capital account is totally liberalized.[252] China should carefully arrange its liberalization transition. In the meantime, it also should seriously consider strengthening its financial

[252] The Asian Crisis of 1997 has demonstrated the consequences. Chilean experience is another example. See W.Dobson and P. Jacquet, *supra* note 15 at 48-51, 64, 155.

institutions that will intermediate this capital before opening the capital account.

After all, capital opening needs not march in lockstep with the market opening.[253] China has the discretion to decide when and to what extent to liberalize its capital account.

D. Conclusion

There are common concerns about giving competitive forces free play. Some are addressed by the GATS, such as national security and the maintenance of economic stability. Safeguard provisions on such concerns are provided under the GATS. However, as telecommunications is seen as integral to national defense, it is beyond a doubt that the Chinese government insists on the control of telecommunications.

Opening domestic telecommunications and banking markets will expose both industries to foreign competition for customers and skilled personnel. The loss of skilled personnel can only be a short-term impact, while, in the long-term, the entry of foreign participants will contribute to the development of a skilled local labor force in both industries. Unlike in the telecommunications industry, in the banking sector, customers, especially depositors, provide the resources that banks use to distribute. The loss of bank customers leads to the drop of bank funds that are primarily placed in deposit by households and firms, which, in part, endangers the stability of banking system. As discussed above, the stability of the banking system can be ensured through prudential regulations under the GATS. Given that China has not developed the necessary regulatory framework that is required to ensure a sound and stable banking system, it will be more difficult for China to manage market opening in the banking industry than in the telecommunications industry.

253 See W.Dobson and P. Jacquet, *supra* note 15 at 4.

Although China's telecommunications has been kept closed for decades, it has been ripe for market opening with respect to the current level of development and liberalization in the industry. The Sino-US WTO agreement appropriately addressed China's intention to keep control over national telecommunications infrastructure. Moreover, China's commitment to the regulatory principle under the BTA would not only help to establish a legal framework in China, but also open up more opportunities for foreign investors that have been trying by fits and starts to access the operation of China's telecommunications.

In the banking sector, however, more significant domestic reforms are required to be undertaken before or during the transitional process in order to ensure a sound banking system. It is especially important at a time when the government is seeking to attract more foreign trade and investment, and attempting to rescue thousands of feeble SOEs that are drowning in operational losses and heavy non-performing debts. Given that reforms in the banking sector are closely intertwined with those in the state sector, inadequate reforms in the latter would result in weak credibility of the SOEs, which carries on to the overall crisis. On the other hand, if financial supervision and financial institutions are not strengthened, and if weaknesses in the real economy undermine borrowers' creditworthiness, market opening and liberalization of financial services entail real economic and political risks. Consequently, the liberalization and commercialization of China's banking sector should be cautiously managed so that the stability in the banking system is not endangered.

Compared to telecommunications liberalization, liberalization in China's banking sector is apparently more complex. A longer transition period is required for the four state banks to undertake commercializing transition. It remains to be seen how well China realizes its commitments to liberalize its banking market upon entry to the WTO.

Conclusion

Telecommunications, financial services and electronic commerce will be recognized as the landmark contributions of the twentieth century towards globalization. Telecommunications shrinks information transmission times for senders and receivers to mere seconds, while only 2 generations earlier weeks or months were required.[254] With the innovations in telecommunications technologies, the moving of money -- the primary operation of financial services -- can be done, domestically and across borders, at ever-faster rates and in ever-greater volumes. Electronic commerce has forged trade globalization in its true sense, with the availability of Internet and other telecommunications that diminish the boundary between nations, and the possibility of cross-border financial services. Telecommunications and financial services, indispensable to electronic commerce, have become indivisible and vital parts of the world economy and international trading interactions. With the trend of globalization, individual economies throughout the world intend to integrate with the world economy. It is thus desirable for them to make their domestic telecommunications and financial services markets accessible.

[254] M. Milde, "Foreword" in R.I.R. Abeyratne, *Emergent Commercial Trends and Aviation Safety* (Aldershot: Ashgate, 1999) at ix.

The WTO, the first-ever-international trading organization, has facilitated multilateral liberalization agreements on both telecommunications and financial services. The WTO members that account for more than 90 per cent of the world's telecommunications traffic and the world's financial services market shares signed respectively the WTO Basic Telecommunications Agreement (BTA) and Financial Services Agreement (FSA). Upon signing the two WTO agreements, WTO members allow each other, to the extent covered by their commitments, to access their domestic telecommunications and financial services markets.

China has pursued a membership in the world trade club GATT/WTO since 1986.[255] The liberalization of China's telecommunications and financial services sectors was one of the stickiest issues in China's WTO accession talks with WTO member countries. Due to historical concerns about sovereignty over the national telecommunications infrastructure, China's telecommunications services industry has always been kept under state control. It has continued being tightly closed even though China adopted an open-door policy while embarking on economic reforms in the late 1970s. Although many foreign financial institutions have since set up business in China, they are subject to various restrictions and regulations, particularly in the case of banking activities. In pursuit of WTO accession, China is urged to open up both telecommunications and banking services markets for large global corporations.[256]

In fact, there is both an external and internal incentive for liberalization of China's telecommunications and banking services industries. The external incentive is the world trend of globalization that requires market access to both markets, as telecommunications and financial services play vital roles in the world economy. The internal incentive is the need for further deregulation and commercialization of domestic telecommunications and banking markets. The commercialization of the latter has moved at a considerably slower pace by virtue of the sheer inertia of the pervious centrally planned system. In addition to the great burden of non-performing loans on the Big Four, they do not have sufficient

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255 See *supra* note 5.

256 In the telecommunications market, such as Finland's Nokia, Sweden's Ericsson and America's AT&T, Sprint, and Bell.

experiences of granting loans on a commercial basis. The deregulation of China's telecommunications industry has been achieved to the extent that market-dominating China Telecom was broken up and a competitive telecommunications market is in place. However, competition in the telecommunications market is as inadequate as it is in the banking market. It is hoped that foreign entrants will serve as stimuli to further domestic reforms in both industries respectively.

Moreover, market opening and foreign investment contribute to the development of the domestic telecommunications and financial services industries. The entry of foreign financial institutions brings substantial benefits such as access to foreign savings, technical transfer and a force for modernization. By increasing competition, foreign entrants create incentives for domestic firms to increase managerial efficiency, improve services, and make better use of advanced technology. An increase in competition will also benefit users directly. As domestic firms become more market-oriented and efficient, users will have a wider choice of products, better quality, and lower cost of services.

It has been evidenced that foreign participation plays a notable role in improving efficiency. Efficient telecommunications and financial sectors are important contributors to overall economic growth and stability. Yet, the development of the telecommunications and financial services sectors depends upon deregulation and other domestic measures. Foreign entry is only part of the liberalization process in both sectors.

This is especially true in the banking sector. The Asian Crisis of 1997-1998 demonstrated that an open financial market under an institutionally weak financial system would put overall economic growth and stability in jeopardy. The weaknesses in the financial systems of those countries that suffered from the Asian Crisis included: (1) inadequately supervised financial systems; (2) weak banking institutions; (3) inadequate risk assessments by banks; and (4) policy lending. These can be easily identified in China's banking sector. As argued by Dobson and Jacquet, foreign financial institutions and foreign entry are not, per se, associated with financial crises. Rather, they bring to light the problems in the presence of macroeconomic and regulatory weakness that there is the potential of financial crises. Protection against foreign entry would only mean foregoing the potential benefits of liberalization. The economy will be left in its inefficient state. That, in turn, leads to the amplification of its underlying weaknesses. As the entry of foreign financial institutions helps to strengthen and deepen the domestic financial system, they lessen the system's vulnerability to upheaval. What matters indeed is the quality and design of domestic financial reforms. It is therefore desirable to strengthen financial institutions and the supervisory system and to create a modern financial infrastructure to enforce market discipline before or during full-fledged liberalization.[257]

After all, it depends on individual countries to decide how quickly they will integrate their economies with the rest of the world and to determine the role that they wish foreign entrants to play in that process[258] and in the domestic economy. In the context of China, the levels of development and liberalization of the banking and telecommunications industries are not the same. China's telecommunications industry has seemingly, taking the metaphor in the Introduction of the thesis, arrived at the second floor of the castle, and is approaching the top floor as China realizes its commitments upon entry into the WTO, whereas China's banking sector, which is still underdeveloped, has to take a long journey toward the top of the castle. Chinese banking sector has to secure that the Big Four are strong enough to withstand foreign competition without a contagion of bankruptcy upon China's WTO accession. China's WTO concessions on telecommunications and banking services have demonstrated China's great leap of faith in liberalization and globalization.

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257 See W. Dobson and P. Jacquet, *supra* note 15 at 10.

258 In the case of financial services, the Asian Crisis demonstrates that potential problems remain in such integration given that the process is not planned and managed with great care. It does entail risks to have an open financial market without a sound financial system with a powerful regulatory institution and supervisory system. For general discussion on this issue, see L.L. Jacque, "The Asian Financial Crisis: Lessons from Thailand" (1999) 23-SPG Fletcher F. World Aff. 87, online: WL (TP-ALL).

However, when WTO members were seeking the most out of China from China's WTO accession and the Chinese leadership was trying to use WTO entry to solidify existing reforms and as an engine for further and more dramatic reforms in domestic market, little attention was given to how China would deliver on what it promised. China agreed, for example, to undertake all the obligations contained in the WTO Reference Paper on Regulatory principles. Yet, currently there is no a framework in place for regulatory oversight. The critical immediate challenge on China's accession to the WTO is how to ensure the implementation of China's commitments. If the judiciary is unable to review the exercise of administrative discretion for its consistency with China's international obligations, the WTO's dispute settlement body will be over-burdened by litigation involving China, which, in turn, will undermine foreign investors' confidence and interest in China's market. To provide a solid ground of legislative and policy frameworks for the implementation of China's WTO concession, China will have to enact fundamental legislative measures and abandon longstanding discretionary administrative practices. Furthermore, China has to establish independent, transparent prudential regulatory oversight over the next six years after accession. To facilitate the transition, Chinese courts should develop a judicial review doctrine to control the arbitrary use of administrative discretion and failure to comply with WTO obligations. Otherwise, China's commitments will look like a castle in the air.

For the rest of the world, the significance of admitting China into the WTO is that China will be bound by the rules of the WTO and this will help to continue economic reform. China will become embedded in global institutions. China's WTO entry will facilitate China's sectoral reforms by initial incorporation into Chinese law of WTO commitments. International norms can play a role in restoring China's domestic laws. It will also lock in what has been achieved in the liberalization transition in China's economy. Yet, the devil is in the details. The rest of the world will be watching how China is going to realize her WTO commitments. Whether the castle is in the air will have to be answered by China herself.

APPENDIX A

LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON COMMERCIAL BANKS[1]

(Adopted at the 13th Meeting of the Standing Committee of the Eighth National People's Congress on May 10, 1995, Promulgated by Decree No. 47 of the President of the People's Republic of China on May 10, 1995)

Contents

Chapter I

General Provisions

Article 1 This law is formulated to protect the legal rights and interests of the commercial banks, depositors and other clients, standardize the behaviors of the commercial banks, improve the quality of loan assets, strengthen the supervision and management and thus ensure the sound and stable operations of the commercial banks, safeguard financial order and promote the growth of socialist market economy.

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1 Online MOFTEC: <http://www.moftec.gov.cn/moftec/official/html/laws_and_regulations/_finance6.html> (date accessed 12 January 2000).

Article 2 Commercial banks referred to in this law are those enterprise legal persons which are established to absorb public deposits, issue loans, arrange settlement of accounts and engage in other businesses in accordance with this law and the "Company Law of the People's Republic of China".

Article 3 Commercial banks may have the following businesses in part or in whole:
(1) Absorb public deposits;
(2) Issue short-term, medium-term and long-term loans;
(3) Arrange settlement of both domestic and overseas accounts;
(4) Handle the discount of negotiable instruments;
(5) Issue financial bonds;
(6) Issue, cash and sell government bonds as agents;
(7) Buy and sell government bonds as agents;
(8) Do inter-bank lending and borrowing;
(9) Buy and sell per se or as agents foreign exchanges;
(10) Provide letter of credit (L/C) service and guarantee;
(11) Handle receipts and payments and insurance businesses as agents;
(12) Provide safe boxes; and
(13) Undertake other businesses approved by the People's Bank of China.
Business scopes of the banks are to be defined in the articles of association of the banks and reported to the People's Bank of China for approval.

Article 4 Commercial banks should work under the principles of efficiency, safety and fluid with full autonomy and full responsibility for their own risks, profits and losses and self-restraint.
Commercial banks do business in accordance with laws free from any interference by units and individuals.
Commercial banks undertake civil legal liabilities independently with their all properties as legal persons.

Article 5 Commercial banks follow the principles of equality, voluntariness, fair, faithfulness and credibility in their services to clients.

Article 6 Commercial banks should protect the legal rights and interests of their depositors against encroachment by any unit and individual.

Article 7 In issuing loans, commercial banks should made reliable checks on the creditability of the borrowers, and provide the loans on guarantee to ensure timely recovery of the loans.
Commercial banks are protected by law in duly recovery of principal and interest of the loans they extended.

Article 8 Commercial banks should abide by relevant stipulations of laws and administrative regulations in their businesses and must not do any harm to the interests of the State and the society.

Article 9 Commercial banks should follow the principle of fair competition in their business and should not be engaged in unfair competition.

Article 10 Commercial banks accept the supervision and administration of the People's Bank of China in accordance with laws.

Chapter II

Establishment and Organization of Commercial Banks

Article 11 The establishment of commercial banks should go through the process of examination and approval by the People's Bank of China.
Without the approval of the People's Bank of China, no unit or individual is allowed to do the business of a commercial bank such as absorbing the public deposit or call itself a bank.

Article 12 The establishment of a commercial bank should have the following conditions:

(1) A set of articles of association which accord with this law and the "Company Law of the People's Republic of China";
(2) The lowest amount of the registered capital as stipulated by this law;
(3) Chairman (president), general manager and other senior management personnel of the bank are available with professional knowledge and work experience;
(4) A complete organizational setup and management system;
(5) A business site as required accompanied with suitable safety and other relevant facilities.
In approving the application for establishing a commercial bank, the People's Bank of China should take into consideration the need of economic development and the competition in banking industry.

Article 13 The minimum registered capital for setting up a commercial bank is RMB 1 billion yuan. The minimum registered capital for setting up an urban cooperative commercial bank is RMB 100 million yuan, and the minimum registered capital for setting up a rural cooperative commercial bank is RMB 50 million yuan. The registered capital should be the actually paid capital.
The People's Bank of China may readjust the amount of minimum registered capital in accordance with the economic development, but the amount must not be lower than that stipulated in the preceding clause.

Article 14 In application for setting up a commercial bank, the following documents and data should be presented to the People's Bank of China:
(1) An application completed with the name, site, amount of registered capital, and business scope of the commercial bank to be set up;
(2) A feasibility study report; and
(3) Other documents and data as stipulated by the People's Bank of China.

Article 15 Should an application for setting up a commercial bank have been found in a accordance with the stipulations of Article 14 through examination, the applicant should fill out an application form and present the following documents and data:
(1) Draft articles of association;
(2) Credentials of the proposed senior management personnel;
(3) Certificate of capital issued by a legal capital inspection organ;
(4) List of names of shareholders and the amount of capital and number of stocks they each shared;
(5) Credibility certificates and relevant data of the shareholders who hold more than 10% of the registered capital;
(6) Business policy and plan;
(7) Data about the business site, safety and other relevant business facilities; and
(8) Other documents and data as stipulated by the People's Bank of China.

Article 16 The People's Bank of China will issue a license to the commercial bank which has been approved to be set up and the bank concerned should register with the State Administration for Industry and Commerce and get the business license.

Article 17 The stipulations of the "Company Law of the People's Republic of China" apply to the organizational forms and setups of the commercial banks.
If a commercial bank, which was set up before the promulgation of this law has its organization form and setup not entirely in accordance with the stipulations of the "Company Law of the People's Republic of China", it may continue to operate under the original form and setup, and when the stipulations of the preceding clause should be strictly applied is up to the decision of the State Council.

Article 18 A solely State owned commercial bank should set up a board of supervisors formed by representatives of the People's Bank of China and relevant government departments and specialists and representatives of the Bank's employees. The method of forming the board of supervisors is to be set by the State Council.
The board supervises over the quality of loan assets, proportion between assets and liability, present and added values of the State assets, and the bank's senior management personnel's violations of laws and administrative regulations and their damages to the interests of the bank.

Article 19 Commercial banks may set up branches both inside and outside of the People's Republic of China in accordance with the need of their business. The establishment of branches must be made under the examination and approval of the People's Bank of China. Branches of the commercial banks inside the People's Republic of China have no need to be set up in every administrative district.
The commercial banks should, according to relevant stipulations, allocate a suitable amount of operation funds to their branches which are set up inside the People's Republic of China. The aggregate sum of operation funds allocated to the branches must not exceed 60% of the total capital of the headquarters of a commercial bank.

Article 20 For setting up a branch of the commercial bank, the following documents and data should be presented to the People's Bank of China.
(1) An application clearly indicating the name, the amount of operational capital, the business scope and the site of the branch to be set up;
(2) Financial and accounting statements of the applicant in the recent two years;
(3) The credentials of the proposed senior management personnel;
(4) Operational policies and plans;
(5) The business site, safety and other relevant business facilities of the branch; and
(6) Other documents and data as stipulated by the People's Bank of China.

Article 21 Upon its approval of setting up, a branch of a commercial bank should get a license from the People's Bank of China and register itself with the license with the department of industry and commerce to get the business license.

Article 22 A commercial bank should exercise a financial system of unified accounting and fund control and level-to-level management in relevant to its branches.
A branch of a commercial bank does not have the qualifications of a legal person and thus shall operate within the business scope entrusted by the headquarters of the commercial bank in accordance with law. Its civil liabilities are to be undertaken by the headquarters.

Article 23 The approved establishment of the commercial banks and their branches will be announced by the People's Bank of China.
The People's Bank of China will revoke the operation licenses of a commercial bank or its branches and make an announcement of this if they fail to start their business in more than six months as from the date of getting the business licenses without justified reasons, or they stop their business for more than six consecutive months after they start their business.

Article 24 A commercial bank should have the approval of the People's Bank of China for one of the following changes:
(1) The change of its name;
(2) The change of its registered capital;
(3) The change of the site of the headquarters or branches;
(4) The readjustment of its business scope;
(5) The change of a shareholder who holds more than 10% of the total capital or the total amount of stocks;
(6) The revision of articles of association; and
(7) Other changes as stipulated by the People's Bank of China.
The change of chairman (president) and general manager should be reported to the People's Bank of China for an examination of their credentials.

Article 25 The separate and merge of commercial banks should follow the stipulations of the " Company Law of the People's Republic of China".
The separate and merge of commercial banks should be made under the examination and approval of the People's Bank of China.

Article 26 A commercial bank should use its operation license in accordance with the stipulations of laws and administrative regulations and is forbidden to falsify, fabricate, transfer, lease or lend the license.

Article 27 People involved in one of the following cases cannot be senior management personnel:
(1) People who have been declared guilty or fined for corruption, bribery, encroachment upon and embezzling property or undermining social economic order, or those who have been deprived of political rights because of committing crimes;
(2) People who have been chairman of directors or factory director or manager of a company or enterprise which has gone bankrupt because of poor management and are held responsible for the bankruptcy themselves;
(3) People who have been legal representatives of companies or enterprises whose business licenses had been revoked because of violations of laws and are held responsible for this themselves; and
(4) People who owe comparatively large amount of debt which is overdue.

Article 28 Purchase of more than 10% of the total shares of a commercial bank by any unit or individual should be made upon the approval of the People's Bank of China in advance.

Chapter III

Protections for the Depositors

Article 29 A commercial bank should follow the principles of voluntary deposit and free withdrawal, paying interest to depositors and keeping secret for depositors in handling individual deposits.
The commercial bank has the right to refuse any unit or individual to inquire about, freeze and deduct from individual deposits except the cases as stipulated by laws.

Article 30 A commercial bank has the right to refuse any unit or individual to inquire about the deposits of any other unit except the cases as stipulated by laws and administrative regulations; the commercial bank has the right to refuse any unit or individual to freeze and deduct the deposits of any other unit except the cases as stipulated by laws.

Article 31 A commercial bank should decide its own interest rates and announce them in accordance with the upper and lower limits for deposit interest set by the People's Bank of China.

Article 32 A commercial bank should pay a certain amount of deposit reserve funds to the People's Bank of China and keep adequate payment funds in accordance with the latter's stipulations.

Article 33 A commercial bank should guarantee the payment of the principal and interest of the deposits and must not delay and refuse to pay the principal and interest of the deposits.

Chapter IV

Basic Rules Governing Loans and Other Businesses

Article 34 A commercial bank should issue loans in accordance with the need of the national economy and social development and under the guidance of the State industrial policies.

Article 35 In issuing loans, a commercial bank should closely check the use of the loan by the borrower, the repayment ability of the borrowers and the mode of repayment of the loans.
For extending a loan, a commercial bank should clearly separate the process of checking and actual lending and the lending should go through checking and approval by various levels.

Article 36 A borrower should provide guarantee for commercial bank loans. A commercial bank should strictly check the repayment ability of the guarantors, the ownership and value of the mortgage and working assets and the possibility of claims to them.
A borrower which has been proved having sure credibility for repayment through checks and assessments by the commercial bank may not provide guarantee for the commercial bank.

Article 37 Upon a loan, the commercial bank and borrower concerned should strike a written contract to clearly define the category, purpose, amount interest rate, repayment period and mode of repayment of the loan, liabilities in case of violating the contract and other stipulations which both sides deem in necessary.

Article 38 A commercial bank should decide the interest rates of loans in accordance with the upper and lower limits of loan interest set by the People's Bank of China.

Article 39 A commercial bank should abide by the following stipulations in ratio between assets and liabilities:
(1) Capital sufficiency rate must not be less than 8%;
(2) The ratio between the balance of loans and the balance of deposits must not exceed 75%;
(3) The ratio between the balance of circulating assets and the balance of circulating liabilities must not be lower than 25%;
(4) The ratio between the balance of loan of one borrower and the balance of capital of the commercial bank must not exceed 10%; and
(5) Other stipulations of the People's Bank of China governing such ratios.
If a commercial bank which was set up before the promulgation of this law has a ratio between assets and liabilities not in accordance with the stipulations of the preceding clause it should readjust the ratio to suit the stipulations in a certain period of time. The specific methods for such an adjustment are to be decided by the State Council.

Article 40 Commercial banks are not allowed to issue credit loans to people who have connections with the bank and the conditions for issuing guaranteed loans to people who have connections with the bank must not be more favorable than those for such loans to other borrowers.
The people who have connections with the bank as referred to in the preceding clause are:
(1) The directors, supervisors, management personnel, credit loan business dealers of the commercial bank and their close relatives; and
(2) Companies, enterprises and other economic organizations which have the people mentioned in the preceding clause as investors or senior management personnel

Article 41 No unit or individual is allowed to force the commercial banks to issue loans or provide guarantees. In other words the commercial banks have the rights to refuse any unit or body to force it to do so.
The solely State owned commercial banks should issue loans to special projects which have been approved by the State Council. The State Council will adopt corresponding measures to make up for the losses of the banks because of issuing the loans. To adopt what measures is up to the decision of the State Council.

Article 42 Borrowers of loans should repay the principal and interest of the loans on time.
If a borrower cannot repay the guaranteed loan on time, the commercial bank which issues the loan has the right to ask the guarantor to repay the principal and interest of the loan or enjoy the priority of repayment by security in accordance with law. Fixed assets or stocks obtained by a commercial bank in the course of exercising the banks' ownership of mortgage must be handled within one year as of the date of obtaining them by the bank.
A borrower should undertake liabilities in accordance with the contract if cannot repay the credit loan on time.

Article 43 Commercial banks are not allowed to make trust investment, trade in shares or make investment in fixed assets of non-self use within the People's Republic of China.
Commercial banks are not allowed to make investment in non-banking institutions and enterprises within the People's Republic of China. For investments in the kind made before the promulgation of this law the State Council will work out rules to deal with them.

Article 44 In handling account settlement businesses such as honor, remittance and trust acceptance negotiable instruments, a commercial bank should honor and enter the receipts and payment into the account book within the set period of time and must not hold down the bill or money order or return them in violating the law. The stipulations about the set period for honoring and entering the receipts and payment into the account book should be announced.

Article 45 A commercial bank should have the approval for issuing monetary bonds or for borrowing from overseas in accordance with laws and administrative regulations.

Article 46 Inter-bank lending should be made in accordance with the time limit as set by the People's Bank of China, and the longest time limit should not be more than four months. It is forbidden to use the borrowed inter-bank funds to issue fixed assets loans or to make investment.
Funds for inter-bank lending should be restricted to those idle funds after fully paying the deposit reserve funds, standing funds and the due loans to the People's Bank of China. Funds borrowed from interbank lending should be used for making up for the settlement of the accounts, shortage of the inter-bank balance and the need of temporary working funds.

Article 47 Commercial banks must not raise or lower interest rate as against the stipulations or absorb deposits and issue loans through unjustified means.

Article 48 Enterprises and institutions can choose on their own will a commercial bank to open their own basic accounts for daily transference and settlement of accounts and cash receipts and payment, but cannot open two or more basic accounts.
No unit or individual is allowed to open a private account for the deposits of the funds of a unit.

Article 49 The business hours of commercial banks should be convenient to clients and should be publicly announced. Commercial banks should be fully open to business within the announced business hours and not to close or shorten the business hours on their own will.

Article 50 In handling business and providing services, a commercial bank will charge service fees in accordance with the stipulations of the People's Bank of China.

Article 51 Commercial banks should keep financial accounting reports, business contracts and other data in accordance with relevant State regulations.

Article 52 Employees of commercial banks should abide by laws and administrative regulations and other operational rules and must not perform the followings:
(1) Use their own position to ask for or accept bribery or accept commissions or service charges under various titles in violation of State regulations;
(2) Use their own position to embezzle, divert and encroach upon the funds of the banks and clients;
(3) Privately issue loans to or provide guarantee for relatives and friends in violation of relative regulations;
(4) Serve concurrently in other economic organizations; and
(5) Engage in other behaviors that violate laws, administrative regulations and rules governing business management.

Article 53 Employees of commercial banks must not leak the State and commercial secrets they acquire during their term of service.

Chapter V

Finance and Accounting

Article 54 Commercial banks should establish and improve their own financial accounting system in accordance with laws, the unified accounting system formulated by the State and the relevant stipulations of the People's Bank of China.

Article 55 Commercial banks should, in accordance with the relevant State stipulations, truly record and totally report its business activities and financial affairs, prepare its annual financial affairs report and timely send the report to the People's Bank of China and Ministry of Finance. Commercial banks must not set up other accounting books other than that set up according to law.

Article 56 Commercial banks should publish their business and auditing reports for the previous accounting fiscal year in accordance with the regulations of the People's Bank of China within the last three months of every accounting fiscal year.

Article 57 Commercial banks should draw bad debt reserve funds to reverse the bad debt in accordance with relevant State regulations.

Article 58 The accounting fiscal year of a commercial bank begins on January 1 and ends on December 31 of the Gregorian calendar.

Chapter VI

Supervision and Management

Article 59 Commercial banks should, in accordance with the regulations of the People's Bank of China, formulate their own business regulations and establish and improve their operation, cash management and safety systems.

Article 60 Commercial banks should establish and improve their own auditing and checking system on deposits, loans, account settling and bad debts.
Commercial banks should keep regular auditings, checkings and supervisions on the work of their branches.

Article 61 Commercial banks should regularly send statements of assets and liabilities, losses and benefits and financial accounting as well as other data to the People's Bank of China.

Article 62 The People's Bank of China has the right to check and supervise the deposits, loans, account settling and bad debts of the commercial banks at any time in accordance with the stipulations of Chapters III, IV and V of this law. During their work of checking and supervision the checkers and the supervisors should present their legal certificates. Commercial banks should provide financial accounting data, business contracts and other information about its business and management in accordance with the requirements of the People's Bank of China.

Article 63 Commercial bank should accept the auditing and supervision of the auditing departments in accordance with laws.

Chapter VII

Take-Over and Termination

Article 64 The People's Bank of China may take over a commercial bank whenever a creditility crisis which would seriously affect the interests of the depositors has happened or may happen.
The purpose of a take-over is to take necessary measures against the commercial bank which is to be taken over to protect the interests of the depositors, and restore the normal operation ability of the bank. The right and liabilities of the taken-over bank will not change because of the take-over.

Article 65 The People's Bank of China decides to organize and carry out the take-over. The take-over decision should have the following contents:
(1) The name of the commercial bank which is to be taken over;
(2) The reason for the take-over;
(3) The organization to execute the take-over; and
(4) The time limit for the take-over.
The take-over decision will be published by the People's Bank of China.

Article 66 The take-over will begin at the date of execution of the take-over decision.
The organization which executes the take-over will execute the business and management power of the commercial bank beginning from the date of taking over.

Article 67 The People's Bank of China may decide to extend term of the take-over upon its expiration but the term of extension cannot exceed two years.

Article 68 The take-over terminates in one of the following cases:
(1) The term set by the take-over decision expires or the extension of the term decided by the People's Bank of China expires;
(2) The commercial bank concerned has restored its normal business ability before the term of the take-over expires; and
(3) The commercial bank is emerged or declares bankrupt before the end of the term of the take-over.

Article 69 A commercial bank should apply to the People's Bank of China for a disbandment due to merger, seperation or reasons set in the articles of association of the bank and the application should be accompanied with the reasons for the disbandment and the plan for balance settlement such as paying the principal and interest of the deposits. And then the bank shall disband upon approval of the People's Bank of China.
The commercial bank to be disbanded should set up a group for settling accounts in accordance with laws and pay its debts such as the principal and interest of deposits. The People's Bank of China shall supervise over the settling process.

Article 70 If a commercial bank is dismantled because of a revoke of its business license, the People's Bank of China should, in accordance with law, set up a group for settling accounts in time, and pay its debts such as the principal and interest of deposits in time according to the plan for accounts settlement.

Article 71 If the commercial bank cannot pay the due debts, it will be declared bankrupt by the people's court in accordance with law and with the agreement of the People's Bank of China. When a commercial bank is declared bankrupt, the people's court will organize the People's Bank of China and other relevant departments to set up a group for setting accounts with the bank.
While the bankrupt commercial bank is undergoing the process of account settlement it should first pay the principal and interest of the individual depositors after paying the fees for account settling, employees' wages and labor insurance which are in arrears.

Article 72 Commercial banks should terminate their operations upon a disbandment, dismantlement and bankruptcy.

Chapter VIII

Legal Liabilities

Article 73 Whenever the appearance of one of the following cases that would do harm to the property of the depositors and other clients occurs, commercial banks concerned should undertake to pay the delayed interest and other civil liabilities:
(1) The bank delays or refuses to pay the principal and interest of the deposits without any reasons;
(2) The bank refuses to honor instruments, does not enter receipts and payments into account book, holds down bills or instruments or returns the instruments in violation of the stipulations governing account settling;
(3) The bank illegally inquires about, freezes or deducts deposits of individuals or units; and
(4) Other behaviors of the bank that would violate the stipulations of this law and do harm to the depositors and other clients.

Article 74 The People's Bank of China shall order a commercial bank to correct one of the following cases, confiscate its illegal earnings if any and impose a fine which is anything between one to five times the illegal earnings or between RMB100, 000 yuan and 500, 000 yuan if no illegal earnings. The People's Bank

of China may order the bank to stop its business or revoke its business license if the case is especially serious and the bank refuses to correct within a set time; and criminal responsibilities will be affixed if the case is so serious to constitute a crime:
(1) The bank issues financial bonds or borrows funds from overseas without approval;
(2) The bank buys and sells government bonds or buys and sells and acts as an agent to buy and sell foreign exchanges without approval;
(3) The bank is engaged in trust investment and stock business or invests in fixed assets of non-self use within the country;
(4) The bank makes investment in non-banking financial institutions and enterprises;
(5) The bank issues credit loans or guaranteed loans with better condition than those to similar borrowers to people who have connections with the bank;
(6) The bank provides an accounting report that is fake or with important facts held back;
(7) The bank refuses the auditing, checking and supervising of the People's Bank of China, and
(8) The bank leases or lends out business license.

Article 75 The People's Bank of China shall order a commercial bank to correct one of the cases stated in Article 73 of this law or one of the following cases, and confiscates its illegal earnings if any and impose a fine which is one to three times the illegal earnings, or impose a fine between RMB 50, 000 yuan and 300, 000 yuan if no illegal earnings:
(1) The bank does not pay the deposit reserve funds in accordance with the proportion set by the People's Bank of China;
(2) The bank does not operate with the set ratios in concern of capital, deposits and loans, fluid of assets, loans to the same borrower, and balance sheet as set by the People's Bank of China;
(3) The bank sets up a branch without approval;
(4) The bank separates or merges without approval;
(5) The bank engages in inter-bank lending exceeding the set time limit or uses the borrowed interbank money to issue fixed assets loans; and
(6) The bank raises or lowers interest rates in violation of stipulations or resorts to unjustified means to absorb deposits and issue loans.

Article 76 Disciplinary actions shall be taken against the leading and other personnel of a commercial bank who have direct responsibilities for the cases in the preceding three articles; criminal responsibilities shall be affixed if the case is so serious to constitute a crime.

Article 77 The People's Bank of China shall order the correction of one of the following cases, and confiscate illegal earnings and impose a fine of one to three times the illegal earnings, or between RMB 50, 000 yuan and 300, 000 yuan if no illegal earning:
(1) The word "bank" is used in a title without approval;
(2) Purchase more than 10% of the total volume of the shares of a commercial bank without approval; and
(3) Opening of a private account for the funds of a unit.

Article 78 The People's Bank of China shall order a commercial bank to correct if it does not send relevant documents and data to the People's Bank of China in accordance with relevant stipulations or violates the stipulations of Article 24 of this law and does not report the changes for approval; if it refuses to correct within a set time, the People's Bank of China will impose a fine of RMB10, 000 yuan to 100, 000 yuan against the commercial bank.

Article 79 Criminal responsibilities shall be affixed on those who set up a commercial bank on their own without the approval of the People's Bank of China or illegally absorb public deposits or absorb public deposits in a disguised way; and the above actions shall be banned by the People's Bank of China. Criminal responsibilities shall be affixed on those who fabricate, change and transfer the business license of a commercial bank.

Article 80 If a borrower obtains loans by cheating and the case is so serious as to constitute a crime, criminal responsibilities shall be affixed.

Article 81 Criminal responsibilities shall be affixed on employees of commercial banks who, taking advantage of their own position, ask for and accept bribery or violate State regulations to accept various forms of discount and service charges.
If loans or guarantees provided as mentioned in the preceding clause have caused damages those who are responsible shall undertake the whole or part of the responsibilities of repayment.

Article 82 Criminal responsibilities shall be affixed on employees of the commercial banks who, by taking advantage of their own position, embezzle, divert or encroach upon the funds of the bank or the clients and the cases are so serious as to constitute a crime; and disciplinary action shall be taken against those whose case does not constitute a crime.

Article 83 Disciplinary action shall be taken against employees of a commercial bank who violate this law and are derelict of their duty, causing damages; criminal responsibilities shall be affixed if the case is so serious as to constitute a crime.
Those who cause damage because of issuing loans to or providing guarantee for relatives and friends should undertake the whole or part of the responsibilities of repayment.

Article 84 Disciplinary action shall be taken against employees of a commercial bank who leak the State and commercial secrets they have accessed to during their service; criminal responsibilities shall be affixed if the case is so serious as to constitute a crime.

Article 85 Disciplinary action shall be taken against those who are directly in charge or responsible for forcing commercial banks to issue loans or provide guarantee; those who cause damages for the actions should undertake the whole or part of the responsibilities of repayment.
Disciplinary action shall be taken against employees of a commercial bank who do not refuse to provide forced loans or guarantees; those who cause damages for the action should undertake relevant responsibilities of repayment.

Article 86 Upon refusal to the decisions of punishments by the People's Bank of China, commercial banks and their employees may take the procedures to the people's court in accordance with the " Administrative Procedure Law of the People's Republic of China".

Chapter IX

Supplementary Provisions

Article 87 Commercial banks which were set up with approval in accordance with the regulations of the State Council need not go through the formalities of check and approval before this law is promulgated.

Article 88 This law applies to the foreign-funded commercial banks, Sino-foreign joint venture commercial banks and the branches of foreign commercial banks in China, and if there are special laws and administrative regulations governing them, they should follow such special laws and regulations.

Article 89 The relevant regulations of this law apply to both urban and rural credit cooperative in their businesses such as handling deposits, issuing loans and settling accounts.

Article 90 The relevant regulations of this law apply to the postal enterprises in their postal deposits and remittance services.

Article 91 This law goes into force as of July 1, 1995.

APPENDIX B

LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON THE PEOPLE'S BANK OF CHINA[1]

(Adopted at the Third Session of the Standing Committee of the Eighth National People's Congress and promulgated by Decree No.46 of President of the People's Republic of China on March 18,1995)

Contents

Chapter I

General Provisions

Article 1 This law is formulated for the purpose of establishing the status and functions of People's Bank of China (PBC), ensuring the correct formulation and implementation of the State monetary policies, instituting and perfecting a macro-control system through the central bank and strengthening supervision and administration over the banking industry.

Article 2 PBC is the central bank of the People's Republic of China.
As the central bank, PBC shall formulate and implement monetary policies and exercise supervision and control over the banking industry in the country under the leadership of the State Council.

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[1] Online MOFTEC: <http://www.moftec.gov.cn/moftec/official/html/laws_and_regulations/finance5.html> (date accessed: 12 January 2000).

Article 3 The aim of monetary policies is to maintain the stability of the value of the currency and thereby promote economic growth.

Article 4 PBC shall perform the following functions:
(1) Formulate and implement monetary policies in accordance with the law;
(2) Issue Renminbi (RMB) and control its circulation;
(3) Examine, approve, supervise and administer banking institutions in accordance with regulations;
(4) Supervise and control the financial market in accordance with regulations;
(5) Promulgate ordinances and rules concerning financial administration and business;
(6) Hold, administer and manage the State foreign exchange reserve and gold reserve;
(7) Manage the State treasury;
(8) Maintain the normal operation of the systems for making payments and settling accounts;
(9) Be responsible for statistics, investigation, analysis and forecasting for the banking industry;
(10) Engage in relevant international banking operations in its capacity as the central bank of the State; and
(11) Other functions assigned to it by the State Council.
In order to implement monetary policies, PBC may carry out financial operations in accordance with the relevant provisions of Chapter IV of this law.

Article 5 PBC shall report its decisions concerning the annual supply of banknotes, interest rates, foreign exchange rates, and other major issues specified by the State Council to the State Council for approval before implementation.
PBC shall immediately carry out decisions on matters concerning monetary policies, but not specified in the preceding paragraph, and report them to the State Council for the record.

Article 6 PBC shall submit to the Standing Committee of the National People's Congress an annual report on monetary policies and the supervision and administration of the financial affairs.

Article 7 PBC shall, under the leadership of the State Council, independently implement monetary policies, perform its functions and carry out its operations according to law free from any intervention by local governments or government departments at all levels, public organizations or individuals.

Article 8 All capital of the PBC is allocated by the State and owned by the State.

Chapter II

Organization

Article 9 PBC shall have a governor and a certain number of deputy governors.
The governor of PBC shall be nominated by the Premier of the State Council, and affirmed by the National People's Congress for the post but whereas the National People's Congress is not in session, affirmed by the Standing Committee of the National People's Congress and appointed or removed by the president of the People's Republic of China for the post. The deputy governors of the PBC shall be appointed or removed by the Premier of the State Council.

Article 10 PBC shall institute a system in which the governor assumes the full responsibility. The governor shall direct the work of PBC and the deputy governors shall assist the governor in his/her work.

Article 11 PBC shall establish a monetary policy committee whose functions, composition and working procedures shall be prescribed by the State Council and reported to the Standing Committee of the National People's Congress of the record.

Article 12 PBC shall, for performing its functions, establish branches as its representative organs and exercise centralized and unified leadership and control over those branches.

The branches of the PBC, after being authorized by the Bank, shall be responsible for the supervision and control of the banking operation and for handling relevant business operations in the areas under their respective jurisdiction.

Article 13 The governor, deputy governors and other staff of PBC shall be diligent in carrying out their functions, refrain from abuse of power, malpractices for gaining private interests, or holding posts concurrently in any other banking institution, enterprise or foundation.

Article 14 The governor, deputy governors and other staff of PBC shall keep State secrets according to law and be obligated to keep secrets of the banking institutions and the clients under their supervision and control.

Chapter III

Renminbi

Article 15 The legal tender of the PBC is Renminbi (RMB). Renminbi shall be used for repaying all public or private debts according to its face value within the territory of the People's Republic of China and not be whatsoever rejected by any organization or individual.

Article 16 The basic unit of Renminbi is the yuan and the units of fractional currency of Remminbi are the jiao and the fen.

Article 17 Renminbi shall be printed, minted and issued solely by PBC.
PBC shall make public announcement of the issuing date, face values, designs, patterns and specifications of a new Renminbi issue.

Article 18 Any counterfeiting, altering or illegal printing or minting of Renminbi is prohibited. Selling or buying counterfeit or altered Renminbi is prohibited. Transportation, possession or use of counterfeit, altered or illegally printed or minted Renminbi is prohibited. Deliberate damaging of Renminbi is prohibited. Illegal use of the image of Renminbi in propaganda materials, publications or other commodities is prohibited.

Article 19 No organization or individual may print or issue promissory notes as substitutes for Renminbi to circulate on the open market.

Article 20 The damaged or soiled Renminbi shall be exchanged in accordance with the regulations of PBC and PBC shall be responsible for collecting and destroying the aforesaid Renminbi.

Article 21 PBC shall establish a Renminbi issue treasury and its branches shall establish subsidiary issue treasuries. The subsidiary issue treasuries shall, in allocating Renminbi issue funds, act on the order of allocation from their superior treasury. No organization or individual may use the issue fund in violation of the relevant regulations.

Chapter IV

Business Operations

Article 22 PBC may use the following instruments to implement the monetary policies:
(1) reserve fund at a required ratio deposited in PBC by banking institutions under demand;
(2) base interest rates fixed by the central bank;
(3) rediscount for banking institutions which have opened accounts in PBC;
(4) provision of loans for commercial banks;
(5) deals in State bonds and other government bonds and foreign exchange on the open market; and
(6) other monetary policy instruments defined by the State Council.

PBC may work out the specific conditions and procedures when applying the monetary policy instruments set forth in the preceding clauses to implement monetary policies.

Article 23 PBC shall manage the State treasury in accordance with the laws and administrative rules and regulations.

Article 24 PBC may issue government bonds to banking institutions and organize to exchange government bonds on behalf of the financial department of the State Council.

Article 25 PBC may open accounts for banking institutions as needed, but may not overdraw the accounts of the banking institutions.

Article 26 PBC shall organize or assist in organizing banking institutions in settling inter-institutional accounts, coordinating such activities and providing such services. PBC shall work at specific procedures for such operation.

Article 27 PBC may, for the implementation of monetary policies, determine the amounts, repayment schedules, rates of interest and forms of loans to commercial banks, but the time limit for such loans shall not exceed one year.

Article 28 PBC must not give any overdrawal in exceeding financial budget of the government or directly subscribe to or act as sole sales agent for State bonds and other government bonds.

Article 29 PBC must not provide loans to the local governments, governmental departments of various levels, non-bank financial institutions and other organizations or individuals except to non-bank financial instituations specially permitted by the State Council.
PBC must not act as financial guarantor for any organization or individual.

Chapter V

Supervision and Control over the Banking Industry

Article 30 PBC shall, in accordance with the law, exercise supervision and control over banking institutions and their business operations to maintain the legitimate, stable and sound operation of the banking industry.

Article 31 PBC shall, in accordance with relevant regulations, examine and approve the establishment, change, termination and scope of business of a banking institution.

Article 32 PBC shall have the power to audit, check and supervise at any time the deposits, loans, account settling, bad debts and other business affairs of banking institutions.
PBC shall have the power to check and supervise the raising or lowering of interest rates on deposits or loans by banking institutions in violation of regulations.

Article 33 PBC shall have the power to demand banking institutions to submit balance sheets of their assets, statements of profit and loss and other financial and accounting reports and materials in pursuance of regulations.

Article 34 PBC shall be responsible for compiling comprehensive statistics and accounting statements for the national banking system and for publishing them in accordance with relevant State provisions.

Article 35 PBC shall guide and supervise the business operations of the State banks responsible for implementing State policies.

Article 36 PBC shall establish and perfect auditing and checking system for and strengthen its control over the banking system.

Chapter VI

Finance and Accounting

Article 37 PBC shall exercise independent control over its financial budget.
The budget of PBC shall be incorporated in the central budget after it has been examined and verified by the financial department of the State Council.

Article 38 PBC shall turn over to the State treasury the entire net profit from its every accounting fiscal yearly income minus annual expenditures after withdrawing funds for its general reserve at a proportion determined by the financial department of the State Council.
Losses sustained by PBC shall be offset by State allocations.

Article 39 PBC shall abide by the laws, administrative rules and regulations and the unified State accounting system in managing its revenue and expenditures and in accounting and be subject to the respective auditing and supervision of the audit institution and the financial department of the State Council in pursuance of the law.

Article 40 PBC shall, within three months after the end of every fiscal year, complete balance sheets of its assets, statement of profit and loss and relevant accounting reports, prepare its annual report and publish them in accordance with relevant regulations of the State.
The fiscal year of the PBC begins on the first of January and ends on the thirty-first of December of the Gregorian calendar.

Chapter VII

Legal Liabilities

Article 41 Anyone who illegally prints or mints Renminbi, sells counterfeit Renminbi, or knowingly transports counterfeit money or illegally printed or minted money shall be investigated for criminal responsibilities in accordance with the law.
Anyone who alters Renminbi or sells altered Renminbi or knowingly transports altered Renminbi shall, if the case constitutes a crime, be investigated for criminal responsibilities and shall, if the circumstances are not serious enough, be punished by the public security organ with a detention of no more than 15 days and a fine of no more than RMB 5,000 yuan.

Article 42 Anyone who buys conterfeit or altered Renminbi or knowingly holds or uses conterfeit or altered or illgally printed or minted Renminbi shall, if the case constitutes a crime, be investigated for criminal responsibilites and shall, if the circumstances are not serious enough, be punished by the public security organ with a detention of no more than 15 days and a fine of no more than RMB 5,000 yuan.

Article 43 In the event that anyone illegally uses the image of Renminbi in propaganda materials, publications or other commodities, PBC shall order to make corrections and destroy the illegally used image of Reminbi, confiscate any income illegally obtained and impose a fine of no more than RMB 50,000 yuan.

Article 44 In the event that anyone prints or sells promissory notes as substitutes for Renminbi for circulation on the open market, PBC shall order to cease the illegal practice and impose a fine of no more than RMB 200,000 yuan.

Article 45 In the event that anyone violates the laws or administrative rules or regulations regarding administration of banking, PBC shall order to cease the illegal practice and give administrative sanctions in accordance with the law; if the case constitutes a crime, criminal responsibilities shall be affixed.

Article 46 Upon refusal to administrative punishments, administrative procedures shall be taken in accordance with the "Administrative Procedure Law of the People's Republic of China".

Article 47 Whereas PBC commits any of the following acts, the person directly in charge and other persons held directly responsible shall be subject to administrative punishments; if the case constitutes a crime, criminal responsibilities shall be affixed in accordance with the law:
(1) Provide loan in violation of the stipulations in clause 1 of Article 29;
(2) Provide financial guarantee for a unit or an individual; or
(3) Use the currency to issue fund without authorization.
Whereas the aforesaid acts result in losses, the person directly in charge and other persons held directly responsible shall bear part of or all the liabilities for compensation.

Article 48 Whereas a local government or any other administrative organ, public organization or individual forces PBC and its functionaries into providing loans or guarantee in violation of Article 29 of this law, the person directly in charge and other persons held directly responsible shall be subject to administrative punishments in accordance with the law; if the case constitutes a crime, they shall be investigated for criminal responsibilities according to law and shall bear part of or all the liabilities for compensation for any resultant losses.

Article 49 Any functionary of PBC who divulges any State secret shall, if the case constitutes a crime, be investigated for criminal responsibilities according to law; if the circumstances are not serious enough, he/she shall be subject to administrative punishments according to law.

Article 50 Any functionary of the PBC who commits embezzlement, bribery, malpractice for personal gain, abuse of powers, or neglect of duties shall, if the case constitutes a crime, be investigated for criminal responsibilities according to law; if the circumstances are not serious enough, be subject to administrative punishments according to law.

Chapter VIII

Supplementary Provisions

Article 51 This Law shall go into effect as of the date of its promulgation.

APPENDIX C

REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA GOVERNING FINANCIAL INSTITUTIONS WITH FOREIGN CAPITAL[1]

(Promulgated on February 25, 1994)

Contents

Chapter I

General Principles

Article 1 These Regulations are formulated in order to meet the needs of opening to the outside world and economic development, strengthen and improve the management of financial institutions with foreign capital.

Article 2 Financial institutions with foreign capital mentioned in these Regulations refer to the following financial institutions that are established and operate in China upon approval in accordance with the relevant laws and regulations of the People's Republic of China: (1) subsidiary banks incorporated by

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1 Online: <http://www.chinalaw.net/dcd001/owa/cei.fgdetail_query?incode=112203199401> (date accessed: 12 January 2000).

foreign capital whose head offices are in China (hereinafter referred to as foreign banks); (2) branches of foreign banks in China (hereinafter referred to as foreign bank branches); (3) banks incorporated jointly by foreign and Chinese equity institutions (hereinafter referred to as equity joint-venture banks); (4) finance companies incorporated by foreign capital whose head offices are in China (hereinafter referred to as foreign finance companies); and (5) finance companies incorporated jointly by foreign and Chinese financial institutions (hereinafter referred to as equity joint-venture finance companies). The State Council determines the locations that are open to financial institutions with foreign capital.

Article 3 Financial institutions with foreign capital shall abide by the laws and regulations of the People's Republic of China, and shall not engage in activities that harm the social and public interests of the People's Republic of China. The legitimate business operation and lawful rights and interests of the financial institutions with foreign capital shall be protected by the laws of the People's Republic of China.

Article 4 The People's Bank of China is the sole regulatory authority responsible for the regulation and supervision of the financial institutions with foreign capital; the branches of the People's Bank of China exercise routine regulation and supervision of the financial institutions with foreign capital in their jurisdiction.

Chapter II

Establishment and Registration

Article 5 The minimum registered capital for a foreign bank or an equity joint-venture bank shall be in amount of a freely convertible currency equivalent to RMB 300 million yuan; and that for a foreign finance company or an equity joint-venture finance company shall be in amount of a freely convertible currency equivalent to RMB 200 million yuan, of which, the paid-up capital shall not be below 50 percent of the registered capital. The head office of a foreign bank branch shall allocate a working capital in a freely convertible currency equivalent to no less than RMB100 million yuan to its branches without any repayment or recompense.

Article 6 The applicant for the establishment of a foreign bank or a foreign finance company is subject to the following conditions: (1) the applicant is a financial institution; (2) the applicant has maintained a representative office in China for two years or longer; (3) the total assets of the applicant at the end of the year prior to its application are not be below US $ 10 billion; and (4) there is a sound system for financial regulation and supervision in the home country or region of the applicant.

Article 7 To establish a foreign bank branch, the applicant is subject to the following conditions: (1) the applicant has maintained a representative institution in China for two years or longer; (2) the total assets of the applicant at the end of the year prior to the application shall not be below US $ 20 billion; and (3) there is a sound system for financial regulation and supervision in the home country or region of the applicant.

Article 8 To establish an equity joint-venture bank or equity joint-venture finance company, the applicant is subject to an the following conditions: (1) each partner to the joint-venture is a financial institution; (2) the foreign partner has a representative institution in China; (3) the total assets of the foreign partner at the end of the year prior to the application are not be below US $ 10 billion; and (4) there is a sound system for financial regulation and supervision in the home country or region of the applicant.

Article 9 The applicant for the establishment of a foreign bank or a foreign finance company shall submit to the People's Bank of China a written application together with the following documents: (1) a letter of application specifying: the name of the foreign bank or finance company to be set up, the registered capital and paid-up capital, the intended business activities, etc., (2) a feasibility study; (3) the articles of association of the intended foreign bank or finance company; (4) a photocopy of the business license issued by the relevant regulatory authorities of the country or region in which the applicant is incorporated; (5) the annual reports of the applicant for the last three years; and (6) other documents required by the People's Bank of China.

Article 10 To establish a foreign bank branch, the head office of the foreign bank shall submit to the People's Bank of China a written application together with the following documents: (1) the application signed by the legal representative specifying: the name of the branch to be set up by the foreign bank, the amount of working capital free from repayment allocated by the parent company, the intended business activities, etc.; (2) a photocopy of the business license issued by the relevant regulatory authorities of the country or region in which the applicant is incorporated; (3) the annual reports of the applicant for the last three years; and (4) other documents required by the People's Bank of China.

Article 11 To establish an equity joint-venture bank or a finance company, the partners to the equity joint-venture shall submit to the People's Bank of China a jointly written application together with the following documents: (1) the application for the establishment of an equity joint-venture bank or a finance company specifying: the name of the intended equity joint-venture bank or finance company to be set up, the names of all the partners to the joint-venture, the amount of the registered capital and paid-up capital, the proportion of the capital contributions of all parties to the joint-venture, the intended business activities, etc.; (2) a feasibility study; (3) the contract for the equity joint-venture and the Articles of Association of the joint venture bank or finance company to be set up; (4) a photocopy of the business licenses issued by the relevant regulatory authorities of the country or region in which the applicants are incorporated; (5) the annual reports of the applicants for the last three years; and (6) other documents required by the People's Bank of China.

Article 12 Except the annual reports, all documents required in Article 9, Article 10 and Article 11 hereof, if written in a foreign language, shall have a Chinese translation attached.

Article 13 The applicant shall be given a formal application form when the People's Bank of China approves the application for the establishment of a financial institution with foreign capital after preliminary examination. The application shall be considered rejected if the applicant fails to receive the formal application form within 90 days from the date of application.

Article 14 The applicant shall, within 60 days from the date of receiving the formal application form, present to the People's Bank of China the completed form and the following documents for ratification: (1) a list of the key executives of the intended financial institution with foreign capital and their resumes; (2) a power of attorney granted to the key executive officer of the intended financial institution with foreign capital; (3) in case of applying for setting up a foreign bank branch, a letter of guarantee from the head office specifying the responsibility for the tax and debt obligations incurred by the foreign bank branch; and (4) other documents required by the People's Bank of China.

Article 15 The financial institution with foreign capital shall, within 30 days from the date of receiving the approval document of the People's Bank of China, raise and transfer to China the required paid-up capital or working capital, and then register with the industry and commerce administration authorities in accordance with law after the transferred capital is verified by a certified public accountant registered in China. It shall also register with a taxation office, in accordance with law, within 30days from the date when it enters into operation.

Article 16 The financial institution with foreign capital shall apply to the State Administration of Exchange Control for the issuance of the Foreign Exchange Operation License within 30 days from the date of approval by the People's Bank of China.

Chapter III

Scope of Business

Article 17 Subject to approval by the People's Bank of China, a foreign bank, aforeign bank branch or an equity joint-venture bank shall be allowed to conduct some or all of the following business activities: (1) foreign currency deposit-taking; (2) foreign currency lending; (3) foreign currency bill-discounting; (4) approved foreign exchange investment; (5) foreign exchange remittance; (6) foreign exchange guarantee; (7) import and export settlement; (8) foreign currency dealing and brokerage; (9) exchange of foreign currencies and bills denominated in foreign currency; (10) foreign currency credit card payment; (11) custody and safe-deposit box service; (12) credit verification and consultation; and (13) approved business activities in domestic currency and other foreign currencies.

Article 18 Subject to approval by the People's Bank of China, a foreign finance company or an equity joint-venture finance company shall be allowed to conduct some or all of the following business activities; (1) foreign currency deposit of US $ 100,000 in minimum for each deposit with a maturity of three months or longer; (2) foreign currency lending; (3) foreign currency bill-discounting; (4) approved foreign exchange investment; (5) foreign exchange guarantee; (6) foreign currency dealing and brokerage; (7) credit verification and consultation; (8) foreign exchange trust business; and (9) approved business activities in domestic currency and other foreign currencies.

Article 19 The foreign currency deposit-taking specified in this chapter refers to the following deposits denominated in foreign currencies: (1) inter-bank deposits both in China and abroad; (2) deposits taken from the non-bank clients located outside China; (3) deposits taken from foreigners in China; (4) deposits taken from overseas Chinese and compatriots from Hong Kong, Macao, and Taiwan; (5) deposits taken from enterprises with foreign investment in China; (6) re-deposits as occurred as a result of lending by financial institutions with foreign capital to non-enterprises with foreign investment; and (7) other approved foreign exchange deposits.

Article 20 The foreign exchange remittance specified in this chapter refers to the inward remittance from abroad and the outward remittance by enterprises with foreign investment, foreigners, overseas Chinese and compatriots form Hong Kong, Macao, and Taiwan on the mainland of China.

Article 21 The import and export settlement specified in this chapter refers to such business as the import and export settlement of enterprises with foreign investment, the export settlement of approved non-enterprises with foreign investment, and the import settlement occurred as a result of their lending conducted by foreign banks, foreign bank branches, and equity joint-venture banks.

Chapter IV

Supervision and Administration

Article 22 The deposit and lending rates as well as various types of fees charged by a financial institution with foreign capital shall be determined by itself in accordance with the relevant rules and regulations of the People's Bank of China.

Article 23 To conduct deposit-taking business, a financial institution with foreign capital is required to deposit reserves with a local branch of the People's Bank of China. The reserve ratio shall be determined, and adjusted when necessary, by the People's Bank of China. The deposit reserves are free of interest.

Article 24 Thirty percent of the working capital of a foreign bank branch shall be maintained in the form of interest-bearing assets designated by the People's Bank of China, including the deposits held with the banks designated by the People's Bank of China.

Article 25 The total assets of a foreign bank, an equity joint-venture bank, a foreign finance company, or a equity joint-venture finance company shall not exceed twenty times the sum of its paid-up capital plus reserves.

Article 26 The loans granted to an enterprise and its related enterprises by a foreign bank, an equity joint-venture bank, a foreign finance company, or an equity joint-venture finance company shall not exceed thirty percent of the sum of its paid-up capital plus reserves, except those specially approved by the People's Bank of China.

Article 27 The gross investment of a foreign bank, an equity joint-venture bank, a foreign finance company, or an equity joint-venture finance company shall not exceed thirty percent of the sum of its paid-up capital plus reserves, with the exception of that made to a financial institution and approved by the People's Bank of China.

Article 28 The fixed assets maintained by a foreign bank, an equity joint-venture bank, a foreign finance company, or an equity joint-venture finance company shall not exceed forty percent of the sum of its paid-up capital plus reserves.

Article 29 A financial institution with foreign capital shall ensure the liquidity of its assets. The specific requirements to financial institutions with foreign capital on their assets, liquidity shall be made separately by the People's Bank of China.

Article 30 Deposits taken from within the territory of the People's Republic of China by a financial institution with foreign capital shall not exceed forty percent of its total assets.

Article 31 A financial institution with foreign capital shall make provisions fund for non-performing (bad) assets in accordance with the relevant procedures as stipulated by the State.

Article 32 A foreign bank, an equity joint-venture bank, a foreign finance company, or an equity joint-venture finance company whose paid-up capitals below the level of its registered capital, shall supplement the paid-up capital by transferring twenty-five percent of its post-tax profit each year until the sum of the paid-up capital plus reserves equals to the registered capital.

Article 33 A financial institution with foreign capital shall employ at least one Chinese citizen as its senior executive.

Article 34 A financial institution with foreign capital shall employ certified public accountants registered in China. Such employment shall be subject to the confirmation by the relevant local branch of the People's Bank of China.

Article 35 A financial institution with foreign capital shall gain approval from the People's Bank of China and conduct the related registration with an industry and commerce administration department in accordance with the law in any of the following cases: (1) establishment of an affiliate; (2) adjustment or transfer of registered capital, increase or decrease of working capital; (3) change of the institution's name or business address; and (4) replacement of senior executives.

Article 36 A financial institution with foreign capital shall submit to the People's Bank of China and its related branches financial statements and other relevant data.

Article 37 The People's Bank of China and its branches have the right to examine and audit the operational management and financial situation of a financial institution with foreign capital.

Chapter V

Dissolution and Liquidation

Article 38 In case of a self-termination of its business activities, a financial institution with foreign capital shall submit a written application to the People's Bank of China 30 days before the termination, and will be dissolved and liquidated after the Bank's examination and approval.

Article 39 The People's Bank of China may order a financial institution with foreign capital which is unable to meet its liabilities to cease operation and make repayment within a limited period of time. If it has recovered redeemability and wants to resume business within the time limit, it shall apply to the People's Bank of China for resuming business; if it fails to recover redeemability beyond the time limit, it shall enter into liquidation.

Article 40 In case of the termination of a financial institution with foreign capital due to dissolution, cancellation under the law or because of the declaration of bankruptcy, matters concerning its liquidation shall be handled under the stipulations of relevant Chinese laws and regulations.

Article 41 Upon the completion of liquidation, a financial institution with foreign capital shall reregister itself at the original registration agency within the legal time limit.

Chapter VI

Penalties

Article 42 In case of a financial institution with foreign capital established in violation of the stipulations of Chapter II hereof and without approval, the People's Bank of China shall outlaw it, confiscate its illegal gains and may, together, fine an amount of foreign exchange equivalent to RMB50,000-100,000 yuan.

Article 43 In case of a financial institution with foreign capital conduction the business activities beyond its approved business scope and in violation of the stipulations of Chapter III hereof, the People's Bank of China or its relevant branch institutions shall order it to cease those business activities which are beyond its approved business scope and confiscate its illegal receipts from the non-approved business activities, and a penalty of an amount of foreign currency equivalent to RMB 10,000-50,000 yuan shall also be imposed.

Article 44 In case of a financial institution with foreign capital conducting the business activities in violation of the relevant stipulations of Chapter IV hereof, the People's Bank of China or its relevant branches are entitled to order it to rectify, readjust its business or supplement Sufficient funds accordingly, and a penalty of an amount of foreign currency equivalent to RMB 5,000-30,000 yuan shall also be imposed.

Article 45 In case of a failure of a financial institution with foreign capital to render financial statements and related data in violation of the relevant stipulations of Chapter IV hereof, the People's Bank of China or its relevant branches shall serve a warning, circulate a notice, and demand the submission of them within a time limit, and a penalty of an amount of foreign currency equivalent to RMB 3,000-20,000 yuan shall also be imposed.

Article 46 In case of a failure to comply with these regulations, a financial institution with foreign capital shall not only be penalized under the relevant stipulations of Article 43, Article 44 and Article 45 of this Chapter, but it may also be ordered to cease operation, and even have its business license suspended by the People's Bank of China where serious offenses are committed.

Article 47 In case of breach of other laws and regulations of the People's Republic of China, a financial institution with foreign capital shall be penalized by the relevant authorities according to law.

Chapter VII

Supplementary Provisions

Article 48 These Regulations are also applicable to the financial institutions established and operated on the mainland of China by financial institutions from such regions as Hong Kong, Macao, and Taiwan.

Article 49 The regulatory procedures for representative offices established in China by financial institutions with foreign capital are to be formulated separately by the people's Bank of China.

Article 50 The People's Bank of China shall be responsible for the interpretation of these Regulations and for the formulation of the detailed rules for the implementation of these Regulations.

Article 51 These Regulations are effective as of 1 April 1994. The Regulations Governing Foreign Banks and Sino-Foreign Equity Joint-Venture Banks in the Special Economic Zones of the People's Republic of China promulgated by the State Council on 2 April 1995 and the Procedure Regulating Financial Institutions with Foreign Capital and Sino-Foreign Equity Joint-Venture Financial Institutions in Shanghai ratified by the State Council on 7 September 1990 and issued by the People's Bank of China on 8 September1990 are to be abolished simultaneously.

APPENDIX D

CHINA'S ULTIMATE COMMITMENTS VS. CHINA'S APRIL OFFER

In the April 1999 talks, China, for the first time ever, made commitments to open up its telecommunications sector. In the financial sector, China made a considerable commitment to opening the market. However, both the securities and banking sectors remained under discussion, without arriving at any conclusion.

Comparing China's ultimate commitments with China's April offer:

Telecommunications

1. Timetables for phasing out geographic restrictions for paging, value-added services and mobile/cellular services have been accelerated by 2 years; (note: in the U.S. bilateral agreement it was 5 years for mobile/cellular services)
2. China's April offer on the investment in telecommunications was more aggressive. In April 1999, China allowed 49% foreign investment in all services -- no timetable was set though -- and 51% foreign ownership for value added and paging services in 4 years. In its ultimate commitments, China allowed 49% foreign ownership in mobile services within 5 years of accession; 49% in international and domestic land and sea (not mobile) services within 6 years; 49% in most other services upon accession; and 50% in value-added services within 2 years.

Banking

Banking sectors remained in discussion in the April talks. Half a year later, China committed to a significant timetable for phasing out restrictions for foreign financial institutions providing banking services in China.

Insurance

1. In the April talks, China offered the US access to key cities of priority US interest in 2 to 3 years. However, China's ultimate commitments have accelerated the period scheduled to eliminate all geographic limitations by 2 years, that is, all geographic limitations will be eliminated in 3 years.
2. China's commitments to product scope and prudential criteria have remained the same.
3. Commitments to non-life insurance remain the same.
4. The ultimate commitments offered complete opening of reinsurance to foreign providers upon accession, accelerated April's offer, which was 51% ownership on accession and would form wholly owned subsidiaries in 2 years.
5. The ultimate commitments also provided a timetable for brokerage.
6. China first agreed to 50% ownership for the life insurer on accession, and agreed to phase in the right to a 51% share in a joint venture in 1 year in the April talks. In the end, China allowed only 50% foreign ownership in life insurance joint ventures, without mentioning the allowance of percentage of share in a joint venture.

Securities

Securities remained under discussion in the April talks. In the end, China agreed on a 33% stake in fund management enterprises upon accession, and 49% after 3 years. Foreign underwriters will also be allowed to invest up to 33% in joint ventures.

	Current Conditions	April Concession[1]	Post-Accession Conditions
Telecommunications	Closed to foreign investment China now allows its telecommunications bureaucracies very wide discretion to apply arbitrary and discriminatory standards.	**Regulatory Principles:** Implementation of the Reference Paper on Regulatory Principles (including cost-based pricing, interconnection rights, and the establishment of an independent regulatory authority.) Technology-neutral scheduling. **Scope of Services:** All geographic restrictions for paging and value-added services phased out within 4 years of accession; mobile/cellular within 5 years; and domestic wireline services within 6 years. Beijing, Shanghai, and Guangzhou, will open immediately on accession in all telecommunications services. **Investment:** 49% foreign investment in all services, and 51% foreign ownership for value added and paging services in 4 years.	•**Regulatory Principles**: Implementation of the Reference Paper on Regulatory Principles (including cost-based pricing, interconnection rights, and the establishment of an independent regulatory authority.) Technology-neutral scheduling. •**Geographic Scope**: All geographic restrictions for paging and value-added services phased out within 2 years of accession; mobile/cellular within 3 years (note: U.S. bilateral was 5 years); and domestic wireline services within 6 years. Beijing, Shanghai, and Guangzhou, will open immediately on accession in all telecommunications services. •**Investment**: 49% foreign ownership in mobile services within 3 years of accession (note: U.S. bilateral was 5 years); 49% in international and domestic land and sea (not mobile) services within 6 years; 49% in most other services upon accession; 50% in value-added services within 2 years.
Banking	Local-currency business with Chinese clients is prohibited. Narrow geographic restrictions on where foreign banks may operate. Foreign financial institutions require approval–granted on a discretionary, case-by-case basis–for new representative offices and branches.	This sector remained under discussion. -- note: the US' negotiations were trying to seek full rights for foreign banks to handle both local and foreign currency business transactions; the rights to serve Chinese as well as foreign customers; and liberalize investment.	Gain full market access within 5 years of accession. •Be able to conduct local-currency transactions with Chinese enterprises 2 years after accession. •Be able to conduct local-currency business with Chinese individuals from 5 years after accession. •Non-banks be able to conduct motor vehicle finance upon accession without restrictions (note: U.S. bilateral had been auto finance). •Foreign banks will have the same rights (national treatment) as Chinese banks within designated geographic areas. •Geographic and customer restrictions will be removed 5 years after accession.

[1] See "Market Access and Protocol Commitments" online USTR: <http://www.ustr.gov/> (date accessed: 24 May 1999).

Insurance	Foreign companies may operate only in Guangzhou and Shanghai. Restrictive licensing practices have limited the number of foreign insurers in China's market to less than 20, and restricted each company to a narrow range of operations. Foreign companies must join with government-approved Chinese partners, and are unable to sell group or pension policies.	**Geographic Limitations** -- Foreign property and casualty firms permitted to insure large-scale risks nationwide immediately upon accession, and all geographic limitations for future licenses eliminated over 5 years, allowing access to the key cities of priority U.S. interest in 2 to 3 years. **Product Scope:** - China will expand the scope of activities for foreign insurers to include group, health and pension lines of insurance, which represent about 85% of total premiums, phased in over 5 years. **Prudential Criteria** - China agrees to award licenses solely on the basis of prudential criteria, with no economic needs test or quantitative limits on the number of licenses issued. **Investment** -- China agreed to allow majority ownership, remove onerous joint venture requirements on foreign life insurers, and phase out internal branching restrictions. *Life insurers* may now choose their own joint venture partners (as opposed to the present policy, under which partners are chosen for insurers by Chinese authorities), will allow 50% ownership on accession, and will phase in the right to 51% share in a joint venture in 1 year. *Non-life and reinsurance*, China will allow 51% ownership on accession and form wholly owned subsidiaries in 2 years.	•**Geographic scope**: Foreign property and casualty firms permitted to insure large-scale risks nationwide immediately upon accession, and all geographic limitations eliminated in 3 years. •**Product Scope**: China will expand the scope of activities for foreign insurers to include group, health, and pension lines of insurance, which represent about 85% of total premiums, phased in over 3 years (note: U.S. bilateral was 5 years). Brokerage services are also covered (Note: added in Europe bilateral) •**Prudential Criteria**: China has agreed to reward licenses solely on the basis of prudential criteria, with no economic needs test or quantitative limits on the number of licenses issued. •**Investment**: *Life Insurance*- 50% foreign ownership in life insurance joint ventures. Life insurers will be able to choose their own joint-venture partners with management control permitted (note: last element added in Europe bilateral). *Non-life*- Upon accession, China will allow the establishment of branches, or 51% ownership in joint ventures, and will permit the formation of wholly foreign-owned subsidiaries in 2 years. *Reinsurance*- Completely open to foreign providers upon accession. *Brokerage*-50% foreign ownership upon accession, majority in 3 years, completely open in 5 years (note: added in Europe bilateral).
Securities	Closed to foreign investment. Underwriting by foreign banks of domestic securities and foreign-currency denominated securities is prohibited.	This sector remained under discussion.	•Foreign financial institutions will be allowed a 33% stake in fund management enterprises upon accession. The stake will rise to 49% after 3 years. •Foreign underwriters will also be allowed to invest up to 33% in joint ventures. •Joint ventures in which US firms have minority stakes will be allowed to underwrite domestic securities issues as well as underwrite and trade in foreign-currency denominated securities (debt and equity); and will be allowed to engage in fund management on the same terms as Chinese firms.

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