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## Effective Censorship: Maintaining Control In China

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## Effective Censorship: Maintaining Control In China

### Keywords

copyright, china, incentives, Social Sciences, Political Science, Devesh Kapur, Kapur, Devesh

### Disciplines

Political Science



# Effective Censorship:

Maintaining Control in China

Michelle Yang

April 09, 2010

## **Acknowledgments**

My initial interest in this thesis topic was generated during the summer of 2009 when I was interning in Beijing. There, I had found myself unable to access a large portion of the websites I've grown so accustomed to in my everyday life. I knew from then that I wanted to write about censorship in China. Since that summer, the scope of the topic has changed greatly under the careful guidance of Professor Devesh Kapur. I am incredibly grateful for all the support he has given me during this entire process. This final thesis wouldn't be what it is today without his guidance. Professor Kapur, thank you for believing in me and for pushing me to complete this thesis! I would also like to extend my gratitude to both Professor Doherty-Sil and Professor Goldstein for taking time out of their busy schedules to meet with me and for providing me with indispensable advice. In addition, I would like to thank my friends and family for being so encouraging. Finally, I would like to thank Randy Fradin and Rahul Reddy for tirelessly proof-reading everything for me.

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## Chapter 1: INTRODUCTION

*“How can we provide the greatest access to information to the greatest number of people? Filtering our search results clearly compromises our mission. Failing to offer Google search at all to a fifth of the world’s population, however, does so far more severely.” -Andrew McLaughlin, Senior Policy Counsel at Google*

When Google entered the Chinese market in 2006, they faced heavy criticism worldwide for going against their company values and everything they stand for. Instead of offering the search engine available to the rest of the world (Google.com), Google, in compliance with the Chinese Government’s demands, agreed to release a heavily censored and information deprived Google.cn. Furthermore, in order to enter the Chinese market, Google also agreed to continuously self-censor its contents for as long as it remains in the Chinese market.<sup>1</sup> The issue of censorship once again rose to the forefront when Google discovered cyber attacks, originating from China, targeting its corporate infrastructure. Further investigation revealed that the attackers were primarily interested in accessing Gmail accounts of human rights advocates.<sup>2</sup> This time, Google’s response was diametrically different from the one they issued in 2006—this time, they threatened to pull out of the Chinese market.

The different statements issued by Google can be attributed to the discrepancy between the company’s envisioned model and the reality that exists today in China. According to Elliot Schrage, the VP of Global Communications at Google, Google entered the market in order to make a contribution to the access of information in China and because Google believed that the internet was transforming, or in better words, liberalizing China. Furthermore this liberalization will be expedited by demand by the people for more information and better services—competition among firms (or economic development) offering services and information will

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<sup>1</sup> Elliot Schrage Testimony before Congress on Internet in China.

<http://googleblog.blogspot.com/2006/02/testimony-internet-in-china.html>

<sup>2</sup> Google Blog: A New Approach to China. January 12, 2010. <http://googleblog.blogspot.com/2010/01/new-approach-to-china.html>

eventually lead to the demise of censorship.<sup>3</sup> However, recent developments and Google's overall experience in China has indicated otherwise.

### **1.1 Authoritarian Regimes and Maintaining Control**

The argument Google employed to justify their entrance into the Chinese government is not a new one. It is commonly believed that authoritarian regimes cannot maintain control after economic liberalization because it becomes too difficult to monitor every faucet of information flow. Scholars argue that development leads to improvements in infrastructure and technology which can allow for increased communications, and the emergence of intermediary organizations political competitors. All of these factors can challenge authoritarian control.<sup>4</sup> Therefore, economic growth and maintaining authoritarian control are two incompatible goals. This argument has been accepted by the international community ever since the fall of the Soviet Union.

The Soviet Union tried to pursue both economic development and information control through a pursuing a self-sufficient closed economy.<sup>5</sup> The ideal outcome was that the country would be able to maintain all forms of information flow while enjoying economic growth and development. However, the system of central planning proved to be too inflexible. The central government had control over every aspect of the economy—from communications to allocation of resources and levels of production. The scope of the project was simply too big for the government to impose such strict rules on. There were many degrees of inefficiency attributed to the limited scope of priorities assigned by the government. Finally, the subordinates carrying out

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<sup>3</sup> Elliot Schrage Testimony before Congress on Internet in China.

<http://googleblog.blogspot.com/2006/02/testimony-internet-in-china.html>

<sup>4</sup> Huber, Rueschemeyer, and Stephens, "The Impact of Economic Development on Democracy," *The Journal of Economic Perspectives*, Vol. 7, No. 3 (Summer, 1993): 75; Bruce Bueno de Mesquita and Downs "Development and Democracy," *Foreign Affairs*, Vol. 84, No. 5 (Sept. – Oct. 2005): 80.

<sup>5</sup> CIA World Fact Book. Accessed on April 5<sup>th</sup>, 2010. <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html>

the government's plans did not have sufficient information or knowledge, which resulted in high coordination costs that undermined the entire system.<sup>6</sup> Furthermore, as the economy develops, it becomes more complex. The problems faced by the economy are exacerbated because new factors are introduced into the model.<sup>7</sup> Eventually the set-backs would result in the economic depression or stagnation witnessed in the USSR during the Cold War. The drive for economic reform came under the regime of Gorbachev in the mid 1980s. The reform planned to move the USSR towards a market economy. Due to the economic system in place, it would have been impossible for Gorbachev to reform economic policy without incorporating some sort of political reform as well. This came in the form of loosening information controls. Karklins argues that this was Gorbachev's fatal mistake. Gorbachev started liberalizing information flow as an attempt to placate the public by demonstrating that the party was dealing with societal problems. However, the opposite effect occurred: this liberalization act allowed individuals and dissidents a public forum to broadcast their criticism.<sup>8</sup>

Although the USSR case successfully fits into the accepted theory, China is an entirely different story. China has been experiencing monstrous growth levels since Deng Xiaoping's economic reforms and is one of the fastest developing nations. GDP growth in China has averaged 9.9% between 1980 and 2008.<sup>9</sup> In terms of GDP adjusted for PPP, China ranks second, right after United States.<sup>10</sup> Despite the high levels of economic growth and development experienced by China in the last two decades, a very different picture exists in the political arena. The CCP is the sole political entity in China and it enjoys unchallenged authority. Even more

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<sup>6</sup> Richard E. Ericson, "The Classical Soviet-Type Economy: Nature of the System and Implications for Reform," *The Journal of Economic Perspectives*, Vol. 5, No. 4 (Autumn, 1991):12-21

<sup>7</sup> *Ibid*, 22-23.

<sup>8</sup> Rasma Karklins, "Explaining Regime Change in the Soviet Union." *Europe-Asia Studies*. Vol. 46, No. 1 (1994): 34.

<sup>9</sup> IMF, *World Economic Outlook 2009*. Accessed at: <http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf>

<sup>10</sup> World Bank 2008 data



surprisingly, China has been able to maintain said control in a much more technologically advanced society what the USSR faced. With the USSR, the regime only had to monitor print, television, and radio. These types of platforms can be easily controlled and monitored by the government through control over the agencies that broadcast and distribute the content— individuals did not have the ability to generate or distribute information on their own, and, thus, were dependent on the government for information.<sup>11</sup> However, in China, the masses are now able to make their opinions known. They can circumvent the government agency when it comes to information and news because they have access to far more advanced technologies, in particular the World Wide Web. The widespread presence of utilization of the internet and communications services like mobile phones and text messaging has connected the entire country. Furthermore, this also allows individuals to transfer and access information instantaneously. This new technology empowers the individual rather than the government. The question of interest in this case is: how has Chinese government been able to maintain its authoritarian regime despite the rapid economic liberalization taking place within the country?

Recent research on the subject has analyzed the conditions under which authoritarian regimes can be preserved along with economic development. Scholars capitalize on the reality that authoritarian regimes are able to create and manipulate political institutions to their advantage.<sup>12</sup> Keohane and Nye argue that, while the improvements in technology have increased access to information, “information does not flow in a vacuum.”<sup>13</sup> The change occurs in a system where political structure already exists. This is a system where political institutions are in place

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<sup>11</sup> Gayle Durham Hollander, “Recent Developments in Soviet Radio and Television News Reporting.” *The Public Opinion Quarterly*, Vol. 31, No. 3 (Autumn 1967): 359-365.

<sup>12</sup> de Mequita and Downs “Development and Democracy,” 2005; Chen, “Capitalist Development, Entrepreneurial Class, and Democratization in China,” *Political Science Quarterly*, Vol. 117, No. 3 (Autumn, 2002).

<sup>13</sup> Robert Keohane and Joseph Nye, “Power and Interdependence in the Information Age.” *Foreign Affairs*. Vol. 77, No. 5 (Sept/Oct, 1998): 81-94

to monitor and regulate the spread of information.<sup>14</sup> In essence they argue that states have institutional tools to counter the effect of information liberalization. Meanwhile, Bruce Bueno de Mesquita sets forth the argument that authoritarianism is maintained by the prohibition of “coordination goods,” whereas An Chen’s focus on China reveals that it is the planned capitalism and the gains it creates for entrepreneurs that allows the government to retain control.<sup>15</sup> These studies offer preliminary data on the topic, but they lack specificity of how control can be maintained in China and what factors affect the degree of information control.

## **1.2 Controlling Information Flow**

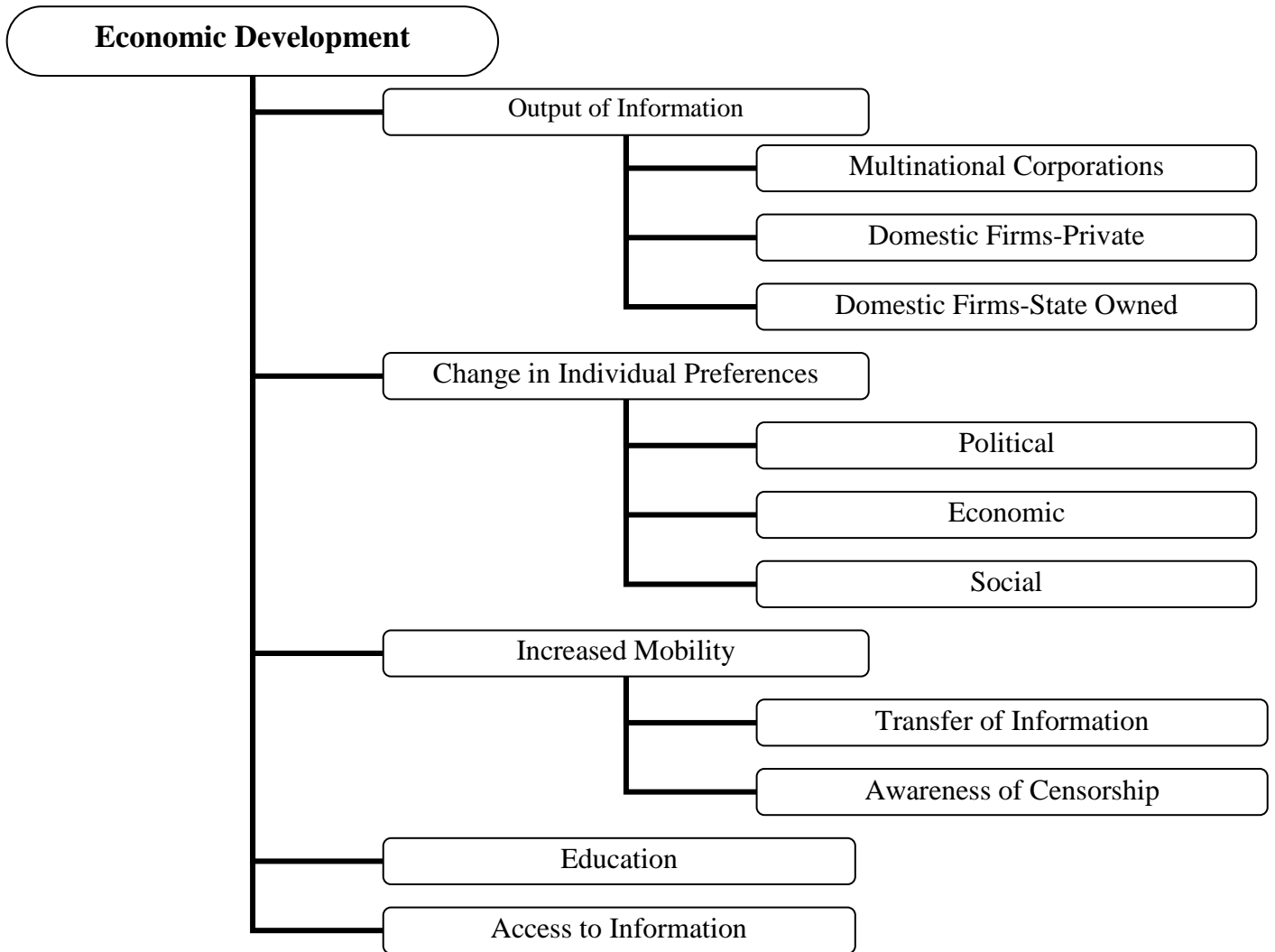
Maintaining censorship depends on many different factors, not all of which can be monitored by the governmental bureaucracy. As economic development brings transparency and global integration, it becomes harder for the government to control information on two levels. First, there are far too many channels of information to overlook, and second, access to information becomes necessary for maintaining development. Figure 1 (next page) shows the magnitude of change economic development brings to a nation in terms of censorship concerns. For example, development and trade forces a country to open up its borders, which allows more mobility on the people’s part and more information flow. This allows citizens to be exposed to new ideas and unadulterated sources of information from abroad. The breadth of information would contribute to an education revolution and create forums where new academic debates could occur. Furthermore, this new openness exposes the citizens to the extent of censorship present in their home country. As time progresses and the home country becomes more integrated, people will be aware of all the options available to them through the prolonged

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<sup>14</sup> Ibid, 82.

<sup>15</sup> Ibid, de Mesquita 84; Chen 407-412

Figure 1



interactions with the outside world. With knowledge of these options, the citizens will be able to decide for their own well-being, which might lead to changing preferences in the country. These preferences could have political, social, and economic implications for the country as a whole. On the economic front, the change would take place if people demand more goods or different goods. In order to survive and maintain its market position, firms will have to respond and comply with these demands. Furthermore, a likely demand that could be made would be for more information. The government might want to stifle this change, but paradoxically economic growth also depends on the transfer of technology and ideas across borders—information is essential to growth. Unfortunately for the government, the openness created by economic development means that the government would have to make a tradeoff between growth and control.

### **1.3 Research Design and Hypothesis**

Given the scope of the topic, covering every factor would be impossible. Every factor is important to the censorship dialogue and each one would pose important implications to the study of information control. They would all benefit from individual focus, but due to the time constraint presented and the overall scope of the issue, rather than tackling all of these factors, I will pick one factor to study. As a student of both Economics and Political Science, balancing the competing interests of development and control are of utmost interest to me; in this situation, the conflict between growth and control is displayed most prominently in the discussion of how the government can maintain growth in the country without sacrificing its authority. In terms of censorship, both direct censorship and indirect censorship must be studied because they are both forms of control the government utilize; furthermore, this study will compare the two formulas to determine which form of censorship is actually the most effective in controlling the flow of

information. The hypothesis presented in this paper will be: the Chinese government's ability to control information flow stems predominately from its ability to persuade and convince individuals and firms to self-censor through offering economic incentives to align their interests with those of the government.

Chapter two of this thesis will focus on the role of direct censorship. For the purpose of this thesis, direct censorship will be defined as the channel of censorship that the government can mostly or completely regulate via its bureaucratic organizations. Therefore, it is of utmost importance to analyze the structure and function of the censorship bureaucracy in the Chinese Communist Party when talking about direct censorship. Furthermore, it is also necessary to determine what kind of information can be censored directly and what kind of capabilities the government has to engage in direct censorship. Chapter three will analyze the role of indirect censorship and how it contributes to the government's efforts to curtail information flow. Indirect censorship will be defined as the incentives created by the government to encourage self-censoring behavior from firms and individuals. It is important to study the means through which the government can incentivize firms and individuals alike to exercise self-control. On the flip side, attention must also be paid to why firms and individuals choose to engage in self-censorship because self-censorship can only work if it is voluntary. Therefore, this chapter will focus on how the CCP can manipulate the objectives of individuals, domestic firms, and multinational firms to agree with those of the party.

## **Chapter 2: DIRECT CENSORSHIP**

### **2.1 Censorship Bureaucracy**

Censorship is not a recent development in China. It has been present since the Ming Dynasty in the 1300s. The present form of censorship in China has its roots in the early Maoist

propaganda efforts during the civil war. The works of authors such as Solomon, Teiwes, Schurmann, Schoenhals, Whyte, Johnson, Yu, and Chang demonstrate that Mao was masterful in the art of propaganda—his regime used manipulative techniques to control information and to indoctrinate the people.<sup>16</sup> The current propaganda system, called the Chinese Communist Party Propaganda Department or the CCPPD, was created in 1977. It derives its form from the Maoist system and holds the purpose of spreading Communist thought, and promoting the party's policies. Due to the sensitive nature of the work done, the department is incredibly secretive and most employees must be highly educated with at least a Masters degree. In addition, the department head must be a politburo member.<sup>17</sup> The strict requirements reflect the magnitude of work done by the department: the bureaucracy has jurisdiction over every medium that transmits information.<sup>18</sup> Estimates in 2003 show that the department was responsible for overseeing 2,262 television stations, 2,119 newspapers, 9,074 periodicals, 1,123 publishing houses, hundreds of internal circulation papers, and all internet and mobile phone users.<sup>19</sup>

The department is a bureaucratic system with many different agencies in charge of the different media and social outlets. Furthermore, the department differentiates between internal and external propaganda. External propaganda is aimed towards promoting Chinese policies and

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<sup>16</sup> Richard Solomon, *Mao's Revolution and the Chinese Political Culture*, Berkeley: University of California Press, 1971; Frederick Yu, *Mass Persuasion in Communist China*, New York: Praeger, 1964; Michael Schoenhals, *Doing Things with Words in Chinese Politics*, Berkeley: University of California Institute of East Asian Studies, 1992; Alan P. L. Liu, *Communications and National Integration in Communist China*, Berkeley: University of California Press, 1971; Martin King Whyte, *Small Groups and Political Rituals in China*, Berkeley: University of California Press, 1974; Chalmers Johnson (ed.), *Ideology and Politics in Contemporary China*, Seattle: University of Washington Press, 1973.

<sup>17</sup> Anne Marie Brady, *Marketing Dictatorship: Propaganda and Thought Work in Contemporary China*. New York, NY: Rowman & Littlefield Publishers, Inc., 2008. 13-22.

<sup>18</sup> David Shambaugh, "China's Propaganda System: Institutions, Processes and Efficacy," *The China Journal*, No. 57 (January 2007): 28

<sup>19</sup> National Bureau of Statistics of China, *China Statistical Yearbook 2004* (Beijing: China Statistics Press, 2004): 844-46, 853; Xiao Qiang, Director of China Internet Project, Graduate School of Journalism, University of California, Berkeley, "Prepared Statement" for hearings on "China's State Control Mechanisms and Methods", the US-China Economic and Security Review Commission, 14 April 2005: 83.

ideas to the rest of the world.<sup>20</sup> On the other side of the spectrum, internal propaganda has the task at controlling information flow within the country, or essentially, censorship. Censorship guidelines and rules are passed down by the central government and then enforced on both national and local levels. Specifically, local level departments are supposed to monitor and censor “all non-classified sources of information in their region, including advertisement.”<sup>21</sup> Key departments that are enlisted in censorship or regulatory practices in the CCPPD include: State Administration of Radio, Film and Television (SARFT), the Ministry of Information Industries (Xinxi Chanye Bu; MII), the Ministry of Public Security (Gong an Bu; MPS), and the Ministry of State Security (Guojia Anquan Bu; MSS). The MPS and the MSS are jointly in charge of monitoring and controlling electronic communication and usage of the Internet whereas the MII has “overall management authority” with access to telephone lines, fiber-optic cables, cell phones, text messaging, faxes and et cetera.<sup>22</sup> It is important to note that the Ministry of Information Industries was created in 1998 by the National People’s Congress as a conglomeration of existing commissions and ministries. Most importantly, the MII was delegated the task of overseeing the telecommunications sector. It is in charge of granting licenses and providing hardware to the nation’s telecommunications network.<sup>23</sup> It was announced in 2008 that the MII was dissolved and its functions were taken over by the new Ministry of Industry and Information Technology (MIIT). In addition to the MII’s old duties, the MIIT is also in charge of supervision of IT development.<sup>24</sup>

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<sup>20</sup> David Shambaugh, “China’s Propaganda System: Institutions, Processes and Efficacy,” 48-49.

<sup>21</sup> Brady, Anne Marie. *Marketing Dictatorship*. 94.

<sup>22</sup> David Shambaugh, “China’s Propaganda System: Institutions, Processes and Efficacy,” 30.

<sup>23</sup> Tony Saich. *Governance and Politics of China*. *Comparative Government and Politics*. Ed. Galen A. Irwin. New York: Palgrave Publishers Ltd., 2001. 309.

<sup>24</sup> OpenNet Initiative (2009). “Internet Filtering in China: A Country Study.” [http://opennet.net/sites/opennet.net/files/ONI\\_China\\_2009.pdf](http://opennet.net/sites/opennet.net/files/ONI_China_2009.pdf)

## 2.2 Telecommunications Industry and Internet Services<sup>25</sup>

The telecommunications industry is perhaps the most important aspect to consider in terms of direct censorship. Not only does telecommunications link directly to the flow of information, but it also has economic implications. The industry existed under Mao as a government supported program. It was owned and operated by the Ministry of Posts and Telecommunications.<sup>26</sup> At that time, it could hardly be called an industry since the 300,000 or so existing phones were used for governmental and military purposes.<sup>27</sup> As an industry, telecommunications did not flourish until Deng Xiaoping called for a better national telecommunications infrastructure under the Four Modernizations in 1979 to sustain economic development.<sup>28</sup>

China's telecommunications industry generally followed the three rules of telecommunication development.<sup>29</sup> The first rule is that the government focuses on urban growth—early rates in the mid 1990s show that the national average number of telephones per 100 000 was 4.7 whereas the rate was around 14 to 20.2 for cities such as Beijing, Shanghai, and Tianjin.<sup>30</sup> The second aspect is state control over the industry—the government has had an established monopoly since the Mao era over the industry via the Ministry of Post and Telecommunications at first, and then by its successor, the Ministry of Information Industries (MII).

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<sup>25</sup> Though the telecommunications industry is defined as both phone and internet networks, authors such as Harwit normally define telecommunications as the phone sector; thus, going with that, in this paper, telecommunications will refer solely to non-internet related sectors whereas the internet/internet services sector will be referred to as the internet.

<sup>26</sup> Lin Jintong; Wan Yan. "Telecommunications in China." *Mobile Services and Application*, 2004: 5283.

<sup>27</sup> Eric Harwit "China's Telecommunications Industry: Development Patterns and Policies," *Pacific Affairs*, Vol. 71, No. 2 (Summer, 1998): 179

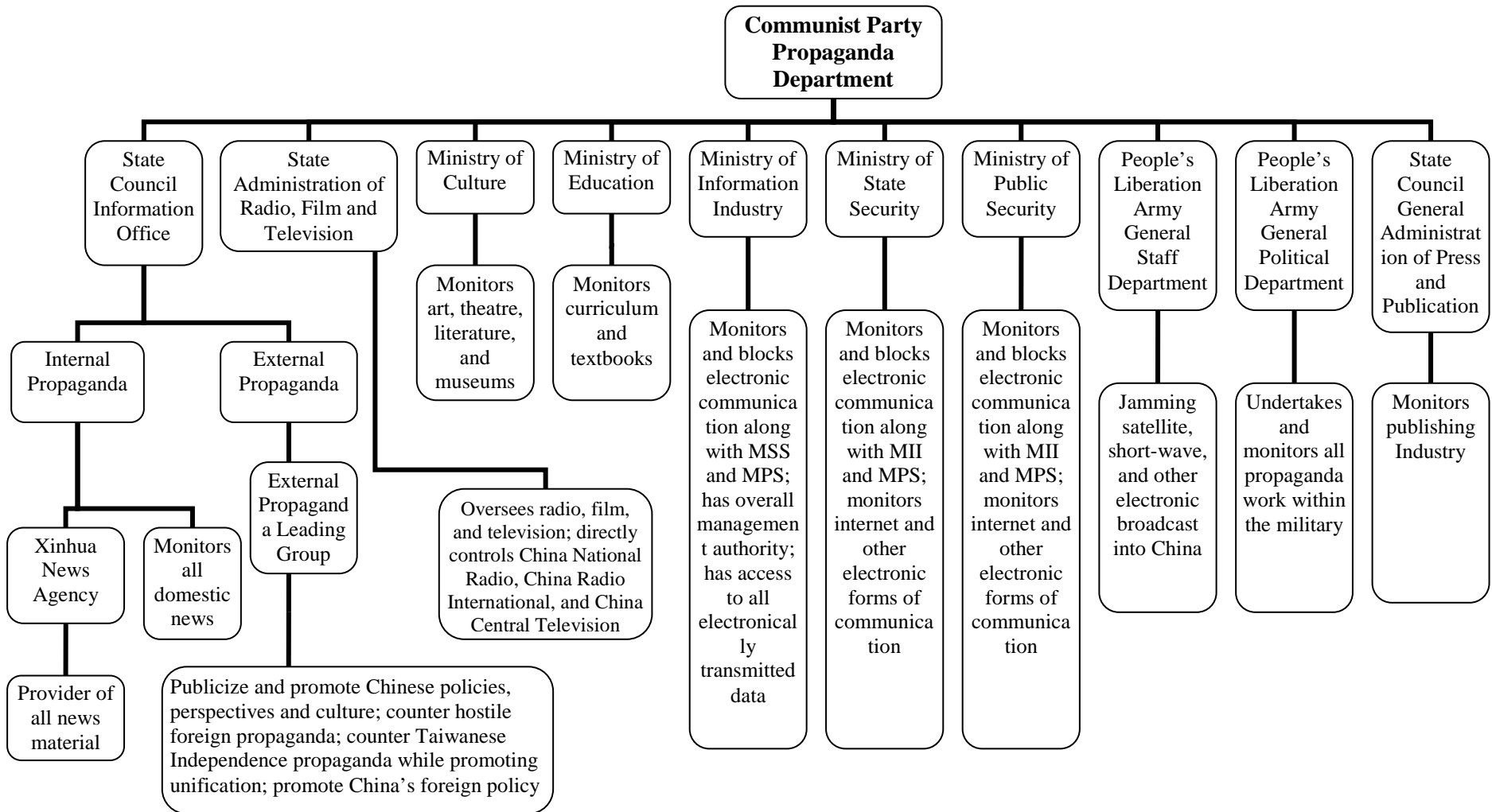
<sup>28</sup> Jia Lu and Ian Weber. "State, Power, and Mobile Communication: A Case study of China." *New Media Society*, Vol 9, No.6 (2007): 926.

<sup>29</sup> The three requirements are from Eric Harwit's "China's Telecommunications Industry: Development Patterns and Policies," 175; 178-179.

<sup>30</sup> Data from *China Statistical Yearbook 1996* (Beijing: China Statistical Yearbook 1996), pg. 77, 534.



**Figure 2**  
**Structure of the Communist Party Propaganda Department**



However, it must be kept in mind that the government did not forget about the economic aspect of telecommunications. When the telecommunications industry was first developing, the state owned China Telecom monopolized the market. However, as development pace picked up, the government recognized the need for a more competitive and more accessible network in order to promote global wireless integration. In order to achieve that, the government introduced new competition in the form of China Unicom in 1994 and insisted that China Telecom lower its access charges in 1998. Following that, China Telecom was split into China Telecom and China Mobile in 1999. In the next few years, the government would introduce many other players to the industry.<sup>31</sup> In addition, the ownership structure of the companies were significantly altered—China Mobile and China Telecom are both publically listed on both the New York Stock Exchange and the Hongkong Stock Exchange whereas China Unicom is traded on the Shanghai, Hongkong, and New York exchanges.<sup>32</sup> This change in ownership structure has provided the firms with considerable autonomy and has allowed them to improve the services and enhance the industry. Currently China's mobile carriers offer five types of value-added services: SMS (Short Messaging Service), WAP (Wireless Application Protocol), MMS (Multimedia Messaging Service), J2ME (Java 2 Micro Edition), and BREW (Binary Runtime Environment for Wireless).<sup>33</sup>

Lastly, the government utilizes protectionist measures to keep foreign competition out of the country.<sup>34</sup> At first foreign entities could not even invest in the Chinese telecommunications industry. This aspect did not change until the late 1990s when China allowed foreign companies

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<sup>31</sup> Nina Hachigian, "China's Cyber Strategy," *Foreign Affairs*, Vol. 80, No. 2 (March-April, 2001): 119

<sup>32</sup> See Google Finances

<sup>33</sup> Jia Lu and Ian Weber, "State, Power, and Mobile Communication: A Case Study of China," 931.

<sup>34</sup> Eric Harwit, "China's Telecommunications Industry: Development Patterns and Policies," 175; 178-179.

to supply equipment to the country.<sup>35</sup> But the caveat is that to become any sort of player in the Chinese market, the foreign companies, in partnership with a domestic firm, must apply directly with the government for a Joint Venture license.<sup>36</sup> Through the JVs, the foreign firms may help manufacture products within the country and contribute capital—they are not allowed management, operational or oversight duties.<sup>37</sup> The strict regulations on foreign investment lightened after China campaigned successfully to be a part of the WTO in 2001.<sup>38</sup> As a part of gaining WTO membership, China had to liberalize its telecommunications industry drastically, which included allowing foreign firms to invest directly in the domestic firms. Other considerations included making the regulatory system more transparent and just so that foreign firms would not be disadvantaged.<sup>39</sup> Despite the concessions to the WTO, foreign nations can only invest up to 49% share in the firms to ensure the state will remain the major stakeholder,<sup>40</sup>

The trends seen in the telecommunications industry are similar to those in the internet services sector. Like the telecommunications industry, internet services are the result of a state initiative.<sup>41</sup> China first developed its data network in 1987 focused on connecting universities and schools in order to facilitate scholarly exchange of information.<sup>42</sup> However, this was also an opportunity for the government to politicize its agenda. In 1999, the central government started the Government Online Project which publicized political information via websites created for central government agencies, State Owned Enterprises, and other local and national political

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<sup>35</sup> Kenneth DeWoskin, "The WTO and the Telecommunications Sector in China," *The China Quarterly*, 2001: 641.

<sup>36</sup> Aaditya Mattoo. "China's Accession to the WTO: The Services Dimension." *Journal of International Economic Law*. Vol. 2 No.6 (2003): 323.

<sup>37</sup> Eric Harwit. "China's Telecommunications Industry: Development Patterns and Policies," 190.

<sup>38</sup> China and the WTO. [http://www.wto.org/english/thewto\\_e/countries\\_e/china\\_e.htm](http://www.wto.org/english/thewto_e/countries_e/china_e.htm)

<sup>39</sup> Tony Saich. *Governance and Politics of China*. 309

<sup>40</sup> DeWoskin, "The WTO and the Telecommunications Sector in China," 641; Harwit "China's Telecommunications Industry: Development Patterns and Policies," 190.

<sup>41</sup> Kalathil and Boas. "The Internet and State Control in Authoritarian Regimes: China, Cuba, and the Counterrevolution." Working Papers 2001. pg.5.

<sup>42</sup> Harwit and Clark, "Shaping the Internet in China," *Asian Survey*, Vol. 42, No. 3 (May/June 2001): 382.

entities.<sup>43</sup> In fact, in 2005, the China Digital Times announced that 10 percent of Web sites available to Chinese internet users were established by government agencies.<sup>44</sup>

The focus eventually turned towards public consumption with the MII's predecessor, the MPT, as the regulator and the policy director of the sector. The services themselves were provided by the telecommunication companies under the MPT's jurisdiction. Private Internet Service Providers (ISPs) were allowed into the market but due to the high fixed costs and lack of capital, 90% of the independent providers were forced to leave the sector, leaving the MPT with a monopoly on Internet services.<sup>45</sup> In the 2000s, as the number of internet users grew, the government drafted laws containing requirements that Internet Content Providers had to meet in order to provide their services—these include prohibition of pornography, gambling, and counter-revolutionary materials.<sup>46</sup> Similarly to the telecommunications industry, the MII eventually allowed foreign investment in internet services, but they were solely capital investments with no say on content management. Furthermore, the government retains the power to nullify agreements as they deem necessary.<sup>47</sup>

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<sup>43</sup> Dali Yang. "The Great Net of China" 66.

<sup>44</sup> William Thatcher Dowell. "The Internet, Censorship, and China." *Georgetown Journal of International Affairs*. Vol. 112 (2006): 114.

<sup>45</sup> *Ibid*, 387-391

<sup>46</sup> "China Issues Long Awaited Internet Rules," *Agence France Presse*, October 3, 2000; There are 11 types of content that have been illegal to produce or disseminate: 1) violating the basic principles as they are confirmed in the Constitution; 2) endangering state security, divulging state secrets, subverting the national regime, or jeopardizing the integrity of national unity; 3) harming national honor or interests; 4) inciting hatred against peoples, racism against peoples, or disrupting the solidarity of peoples; 5) disrupting national policies on religion, propagating evil cults and feudal superstitions; 6) spreading rumors, disturbing social order, or disrupting social stability; 7) spreading obscenity, pornography, gambling, violence, terror, or abetting the commission of a crime; 8) insulting or defaming third parties, infringing on legal rights and interests of third parties; and 9) other content prohibited by law and administrative regulations; 10) inciting illegal assemblies, associations, marches, demonstrations, or gatherings that disturb social order; and 11) conducting activities in the name of an illegal civil organization.

This is listed in Article 19 of the Provisions on the Administration of Internet News Information Services (Internet News Information Services Regulations) (*hulianwang xinwen xinxi fuwu guanli guiding*), which was handed down by the State Council Information Office and the Ministry of Information Industry on September 25, 2005.

Translation is available at <http://www.cecc.gov/pages/virtualAcad/index.phpd?showsingle=24396>.

<sup>47</sup> Harwit and Clark, "Shaping the Internet in China," 399; Nina Hachigian. "China's Cyber-Strategy." 125.

Although the government has a level of control over information flow through their practices, the growth of telecommunications and internet use poses quite a problem for the government. The table below shows the incredible pace at which the Chinese telecommunications sector has grown.

**Table 1**

	Year						
	1950	1980	1990	1995	2000	2005	2008/2009
Land phone (users per 100)	0.056	0.43	1.11	4.66	20.1	N/A	27
Mobile Phone (in millions)	N/A	N/A	N/A	3.63	144	388	670
Internet (in millions)	N/A	N/A	N/A	0.002	22.5	111	338

When the mobile phone network was first set up, there were only 3.63 million users, but as of May 2009, there are 670 million cell phone users in China. Furthermore, the 670 million users in 2009 represent a 1691% increase from the total number of users in 2000.<sup>48</sup> In addition, as of 2007 fixed line users increased to 370 million, which is a 5185% increase from the 7 million users in 1990.<sup>49</sup> Furthermore, as of June 2009, there are 338 million internet users in China, which is a 1440% increase from the 22.5 million users in 2001.<sup>50</sup> The scope of both mobile and internet networks not only increases access to communication but also increases the speed and frequency at which people pass information. Thus, this communications increase makes it harder

<sup>48</sup> Xinhua: "China's cell phone users top 670 mln after 3G services start" [http://news.xinhuanet.com/english/2009-05/18/content\\_11397569.htm](http://news.xinhuanet.com/english/2009-05/18/content_11397569.htm); DeWoskin, 634.

<sup>49</sup> China Today: "China Statistics" <http://www.chinatoday.com/data/data.htm#Tel>; Harwit, "China's Telecommunications Industry: Development Patterns and Policies," 175.

<sup>50</sup> Harwit and Clark, "Shaping the Internet in China," 337; The Guardian, "China's Internet Use Surpass US Population," <http://www.guardian.co.uk/technology/2009/jul/16/china-internet-more-users-us-population>

for the government to maintain the flow of information. Compounded, this problem is exacerbated by the new improvements in technology, such as video recording phones, which allows users to pass on real time information through mobiles or the internet.<sup>51</sup>

The government's solution to the problem lies in the second and third trend of development—state ownership and controlled foreign investment. Both Harwit and DeWoskin argue that the restrictions placed on telecommunications are for purely economic reasons—the states gain a lot of revenue from operating the systems themselves and they wanted to protect their financial interests. On the other hand, the authors agree that the measures taken to control the Internet are purely for political reasons.<sup>52</sup> However, there is a discrepancy between these beliefs since actions taken by the government in the telecommunications industry are similar to those taken to retain control over data networks on the internet. In both cases, foreign companies are welcomed to invest in equity shares, but aren't allowed to partake in management decisions or outright develop their own services in each industry.<sup>53</sup> In addition, in statements issued by the MII, officials clearly state that both the telecommunications industry and Internet services are kept under state control due to security interests.<sup>54</sup>

In both cases, direct control over the companies providing services allows the government to directly monitor the flow of information to and from the people. However, direct control over the telecommunications industry is harder to achieve now due to the fact all three providers (China Unicom, China Telecom, and China Mobile) are publically listed. There does exist a caveat though—under state regulations, the state must own at least 51% of the equity

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<sup>51</sup> Geoffrey Taubman, "A Not So World Wide Web: The Internet, China, and the Challenges to Nondemocratic Rule," *Political Communication*, Vol. 15, (April 1998): 255-272.

<sup>52</sup> DeWoskin, "The WTO and the Telecommunications Sector in China," 632; Harwit "China's Telecommunications Industry: Development Patterns and Policies," 190.

<sup>53</sup> Ibid

<sup>54</sup> DeWoskin, "The WTO and the Telecommunications Sector in China," 632

shares in said companies.<sup>55</sup> Technically speaking, the companies themselves own the communications infrastructure and therefore can do whatever they want.<sup>56</sup> Thus it is in the government's best interest to retain a majority of the individual companies' share in order to possess any sort of operational control. The level of control is further enhanced by the fact that the government does not have to deal with the existence of a principal-agent dilemma where the industry and the government have different interests in mind. This principal-agent dilemma is reduced by the fact that censorship does not clash with the long-term goal of industry development and growth—both the government and the firms want to sustain growth in the sector. Therefore, the corporations know that cooperating with the government is in their best interest, and that they are unlikely to suffer negative consequences by doing so. In addition, the principal-agent dilemma is further dissolved by the existence of a revolving door policy in the telecommunications sector—all of the executive members on the board of directors in China Telecom, China Unicom, and China Mobile are past government officials who specialized in either telecommunications or information control.<sup>57</sup> It is important to differentiate between executive directors and non-executive directors because of their different roles. Executive directors are the ones who actually run the firm and are involved with the day to day operations of the firm. Therefore, in order to affect the operations of these firms, it is more advantageous for the government to have ties with these directors rather than the non-executive directors. As shown by Table 2, all of the executive directors have ties with the government.

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<sup>55</sup> Aaditya Matto. "China's Acession to the WTO." 324

<sup>56</sup> Harwit and DeWoskin imply that the infrastructure is not state property.

<sup>57</sup> See Board of Directors Info on websites: <http://www.chinatelecom-h.com/eng/company/directors.htm>; [http://www.chinaunicom.com.hk/en/corgover/gov\\_bod.html](http://www.chinaunicom.com.hk/en/corgover/gov_bod.html); <http://www.chinamobileltd.com/about.php?menu=2>

**Table 2-Board and Senior Management Composition<sup>58</sup>**

<b>Firms</b>	<b>Total Members</b>	<b>No Government Background</b>	<b>Central Government Censorship or Telecom Background</b>	<b>Local Telecom or Censorship Regulation Background</b>	<b>Other Government Background</b>
China Mobile	13 (9 executive directors, 4 non-executive directors)	4 (All non-executive directors)	4	5	0
China Telecom	14 (8 executive directors, 6 non-executive)	2 (All non-executive directors)	3	5	4
China Unicom	10 (4 executive directors; 6 non-executive directors)	4 (All Non-executive directors)	2	2	2

Thus, it can be assumed that these members have been fully indoctrinated by the government and are aligned with government attitudes when it comes to censorship.

The influence that the government has over the telecommunications sectors has helped the government maintain control and successfully execute its policies in many situations. This relationship was obvious in the wake of the Uighur demonstrations. The catalyst of the unrest was a brawl that happened in a Shaoguan factory between Hans and Uighurs in June. Some of the Han workers went into a Uighur dormitory, killed 2 Uighur males, and injured many others because there were rumors that the Uighurs had raped Han women in the factory. After the incident, many Uighurs felt that the government was playing down the number of casualties and

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<sup>58</sup> References can be found on the company websites. Also, this table shows the highest level of government position.



that the incident was not well handled. Thus, with the tensions rising, the unrest started on the evening of July 5<sup>th</sup>, 2009. Overnight, the fighting resulted in 156 deaths and more than 1000 casualties, many of whom were Han Chinese. The government moved quickly and locked down the city on July 6<sup>th</sup>. They imposed curfews and sent armed forces to patrol the neighborhoods.<sup>59</sup> In addition, the government was also able to cut off internet and phone access in certain areas of Xinjiang.<sup>60</sup> Coupled with movement restrictions for foreigners, the government was able to efficiently disconnect Xinjiang from the rest of the world. As of December 2009, the area still has neither internet access nor the ability to text message or make international calls.<sup>61</sup> The government's control and influence over the telecommunications industry is further demonstrated by the decree issued in January 2010 that text messaging in the country will be automatically scanned for "key words."<sup>62</sup> Furthermore, China Daily had mentioned that offenders of the policy (i.e. people who sent "illegal or unhealthy" messages) will find themselves suspended from accessing and using texting services. The government has already set up a special team to implement the policy.<sup>63</sup> In this situation, there must be full cooperation between the state and the firms.

Similarly, although ICPs (internet content providers) are not beneficiaries of state funding, the government still has a high degree of direct control over access and services provided. Primarily the government can control the operations of the firms through state regulations. For example, like with network providers, foreign investors may invest in ICPs (technology transfers)

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<sup>59</sup> Edward Wong. "China Locks Down Restive Region After Deadly Clashes," *New York Times*. July 6, 2009.

<sup>60</sup> Dan Martin, "China says web access cut off due to riots" *Agence France Presse* July 7, 2009. <http://newsinfo.inquirer.net/breakingnews/infotech/view/20090707-214343/China-says-Web-access-cut-off-due-to-riots>

<sup>61</sup> Richard Stone, "Internet Blockade in Xinjiang Puts a Strain on Science," *Science*, Vol. 326 No. 5959 (Dec 2009). <http://www.sciencemag.org/cgi/content/full/326/5959/1471>

<sup>62</sup> Sharon LaFraniere, "China to Scan Text Messages to Spot 'Unhealthy Content.'" *New York Times*. January 19, 2010.

<sup>63</sup> Li Xinzhu and Cui Xiaohuo. "Text Message Service Cut Off for 'Bad' Words." *China Daily*. January 19, 2010.

but cannot interfere with management of the content provided.<sup>64</sup> The second way is through direct monitoring of the information provided by the ICPs. First of all, the ICPs are regulated by the central State Council and they have to apply for a license from said council in order to operate. The ICPs must also provide content that appears on their site and records of users on the site for two months before they apply for the license.<sup>65</sup> But more impressive than all the rules and regulations is the fact that these ICPs rely on the government for news content—they are not allowed to generate their own news and must only republish government approved content.<sup>66</sup> In doing so, the government is turning these ICPs into a propaganda tool for the state.

The Chinese government does not have to go through ICPs themselves in order to limit material available on the internet. The government has developed their own tool to control information flow—the Great Firewall, as it is known in Western nations. To support the system, the government also have around 30, 000 human cyber-police to monitor Internet content.<sup>67</sup> Although sometimes faulty, the Great Firewall is one of the government’s most sophisticated tools to deal with foreign data. In fact, the OpenNet Initiative of 2009 concluded that China consistently operates one of the most extensive, technologically sophisticated, and broad-reaching system of Internet filtering in the world on a consistent basis.<sup>68</sup> The firewall relies on a router on the Chinese fiber-optic pipelines that filters search results or website requests made by Chinese users. If the request is on the government’s blacklist or contains sensitive keywords such as “falun gong” or “Tiananmen,” the router would automatically block those results.<sup>69</sup> Although

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<sup>64</sup> Eric Harwit, “Shaping the Internet” 399

<sup>65</sup> Thomas Lum. CRS Report for Congress: “Internet Development and Information Control in the People’s Republic of China.” Feb. 10, 2006. 4

<sup>66</sup> Nina Hachigan, “China’s Cyber Strategy” 124.

<sup>67</sup> Thomas Lum. CRS Report for Congress: “Internet Development and Information Control in the People’s Republic of China.” 6.

<sup>68</sup> OpenNet Initiative (2009). “Internet Filtering in China: A Country Study.” [http://opennet.net/sites/opennet.net/files/ONI\\_China\\_2009.pdf](http://opennet.net/sites/opennet.net/files/ONI_China_2009.pdf)

<sup>69</sup> Clive Thompson, “Google’s China Problem,” *The New York Times*, April 23, 2006.

there are ways to circumvent the Firewall via proxy servers, improvements have been made by the government to tighten its control. As early as the summer of 2009, many of the proxy servers have been blocked and are thus inaccessible. In addition, the government has become better at differentiating between different types of media—Time magazine itself was not blocked but its China blog was.<sup>70</sup>

The government has been able to demonstrate that it exercises a lot of control via its bureaucratic organizations and ties with the players in both telecommunications and internet services. Through direct censorship, the government can control the flow of information and control access to services due to the fact that they only have to patrol wires and networks. Direct censorship is easy for the government to maintain; however, this is not to say that the government can control all kinds of information flow. In fact, direct censorship only delays the transfers of ideas and information—it merely creates inconveniences. In fact, sensitive information that could be considered counter-revolutionary could remain online for hours or days.<sup>71</sup> Furthermore, there are many ways that people can circumvent censorship either via proxy servers or simply by foregoing internet interactions. Direct censorship, at best, can only be considered a filter with a time lag. So, in this sense, direct censorship is not effective. In order for censorship to be effective, it has to have an ideological aspect to it. Censorship must be able to influence people so that they have no incentive or motivation to circumvent the direct censorship—they are happy with what they can access. In a way, these people are voluntarily following the rules of censorship. This trend already exists in China and therefore direct censorship becomes inadequate in the study of why the government has been so effective at

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<sup>70</sup> Based on my own experience in China from May 2009-August 2009

<sup>71</sup> Rebecca MacKinnon. "Flatter World and Thicker Walls? Blogs, Censorship, and Civic Discourse in China" *Public Choice*. Volume 134, Numbers 1-2 (January, 2008): 38.

maintaining control because it does not address the issue of compliance. So thus, it becomes necessary to study the contribution of indirect censorship to maintaining control in China.

### **Chapter 3: INDIRECT CENSORSHIP**

A predominate theory on why self-censorship works in China relies on the effectiveness of fear tactics. Scholars argue that it is the fear of punishment that drives the compliance shown in China.<sup>72</sup> However, these fear tactics do not explain the entire trend of voluntary compliance that exists in China. A 2005 Chinese Academy of Social Sciences (CASS) study on urban Chinese internet use found that people mostly use the internet for entertainment purposes instead of news or politics due to the sensitive nature of many political topics.<sup>73</sup> In addition, a 2000 CASS study found that 10% of users admitted to regularly using proxy servers, 25% said that they occasionally used proxy servers whereas, in 2005, the same survey was given and only 3% of people used proxy servers regularly while 5.9% of people said that they used proxies occasionally.<sup>74</sup> In addition, Rebecca MacKinnon presents anecdotal evidence that many people know how to use proxy servers but they choose not to because they can access everything they want via major Chinese websites that comply with government regulations.<sup>75</sup>

It is clear that the people have the means to circumvent the censorship apparatus but they rarely take advantage of such technology. Furthermore, the argument of retribution in the case of individuals is unsubstantiated—the use of proxy servers, when available, does not constitute an offense so grievous that would result in the government taking actions to punish said offenders.

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<sup>72</sup> Kalathil and Boas, “The Internet and State Control in Authoritarian Regimes” 6; Clive Thompson, “Google’s China Problem (and China’s Google Problem).”

<sup>73</sup> Guo L., and Bu, W. (2001). Survey report of Internet use and its influence: Beijing, Shanghai, Guangzhou, Chengdu and Changsha 2000. Beijing: Chinese Academy of Social Sciences

<sup>74</sup> Guo L., and Bu, W. (2001). Survey report of Internet use and its influence: Beijing, Shanghai, Guangzhou, Chengdu and Changsha 2000. Beijing: Chinese Academy of Social Sciences; Guo L. et al. (2005). Surveying Internet use and impact in five Chinese cities. Chinese Academy of Social Sciences (Funded by the Markle Foundation).

<sup>75</sup> MacKinnon. “Flatter World and Thicker Walls? Blogs, Censorship, and Civic Discourse in China.” 33.

Therefore, in the absence of fear-induced activity, I argue that the voluntary compliance shown by the population is merely a reaction to incentives provided by the government such that the interests of the people and the government are aligned. A more comprehensive study would focus on the influence of both the central government and local governments; however, this paper will only analyze the role of the central government in inducing compliance. Therefore, this section will study how the central government has been able to promote self-censorship successfully through the development of nationalism in individuals, and the provision of economic incentives to firms.

### 3.1 Nationalism in China

Nationalism is a relatively new development in China. Up until the start of the Republican Period (1912-1949), culturalism was the dominant Chinese source of identity.<sup>76</sup> Culturalism, as a form of identity, was based on the common heritage and beliefs that were shared by the people. While culturalism is based on shared identity and heritage, nationalism, as it developed in China, is built on the humiliation and shame felt during the periods of European imperialism and Japanese aggression.<sup>77</sup> The goal of Chinese nationalism is to restore China's position as a global superpower and return it to greatness. The Chinese are determined to never experience the same humiliation and shame again.<sup>78</sup> Like Xiao Gongpin argues, Chinese

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<sup>76</sup> James Townsend, "Chinese Nationalism" *The Australian Journal of Chinese Affairs*, No. 27 (January 1992): 97-130.

<sup>77</sup> Lei Guang, "Realpolitik Nationalism: International Sources of Chinese Nationalism" *Modern China*, Vol. 31, No. 4 (October 2005): 487-514.

<sup>78</sup> Steven Mosher, *Hegemon: China's Plan to Dominate Asian and the World*. San Francisco: Encounter Books, 2000. ; Ross Terrill, *The New Chinese Empire: And What It Means for the United States*. New York: Basic Books, 2003; Andrew Nathan and Robert Ross, *The Great Wall and the Empty Fortress: China's Search for Security*. New York: W. W. Norton, 1997; Richard Bernstein and Ross Munro, "The Coming Conflict with America" *Foreign Affairs* Vol. 76, No. 2 (March/April, 1997): 18-33.

nationalism is of a reactive-defensive type where it is activated in response to negative stimulus from foreign forces.<sup>79</sup>

The first successful use of Nationalism came in 1923 in Sun Yat-sen's "The Three People's Principles" where he calls for national solidarity in the face of foreign oppression.<sup>80</sup> Leading up to this event, China had suffered through the Opium Wars, the Boxer Rebellion, which led up to the invasion of China by 8 foreign countries, and the unjust 21 demands China was forced to accept in Versailles. In all of these events, China saw its wealth and territories stripped away and divided amongst foreign nations. Sun Yat-sen's speech was a call for the Chinese people to stand up for themselves—China could no longer afford to be a heap of loose sand. This message has been reiterated by every leader since then, but most famously, it was repeated by Mao in 1949, when he first came to power. He mentions in his iconic speech at Tiananmen Square that China has finally stood up—the nation will no longer be subjected to insult and humiliation. In time, he adds, China will emerge as one of the leading powers in the international sphere.<sup>81</sup> It is this desire to restore China's glory that drives nationalism, and it is in the name of nationalism that the government conducts both its domestic and foreign policy.

From Mao's disastrous social plans to Deng's economic reform to the current economic plans, every leader has used nationalism to bolster support for modernization initiatives.<sup>82</sup> In this respect, nationalism is a part of state policy in a way where the state tries to create a sense of "nationhood" among the citizens and demands the citizens to subordinate their interests to those

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<sup>79</sup> Xiao Gongqin "Zhongguo Minzu Zhuyi de Lishi yu Qianjing" (The History and Future of Chinese Nationalism), *Zhanlue yu Guanli*, Vol.2 (1996): 62.

<sup>80</sup> Theodore DeBary and Richard Lufrano. *Sources of Chinese Tradition: 1600 Through the Twentieth Century*. Vol. 2, 2<sup>nd</sup> Edition. New York: Columbia University Press, 1999. 320-321; Kenneth Lieberthal, *Governing China: From Revolution Through Reform*. 2<sup>nd</sup> Edition. New York: W.W Norton, 2004. 31.

<sup>81</sup> William A. Callahan, "National Insecurities: Humiliation, Salvation, and Chinese Nationalism" *Alternatives* Vol. 29 (2004): 199-218.

<sup>82</sup> Suisheng Zhao, "Chinese Nationalism and Its International Orientations" *Political Science Quarterly*, Vol. 115, No. 1 (Spring, 2000): 1-33

of the state.<sup>83</sup> Therefore, it is through this perspective that current nationalism must be studied. Throughout the late 1990s and the 2000s, Chinese nationalism has grown steadily as a reaction to China's perceived rise. The pinnacle of support came in the form of the 2008 Olympics. Since the ping-pong diplomacy, sports have been seen as a form of soft-power that can measure the level of economic modernization of a country.<sup>84</sup> As a continuation of that belief, the Olympic Games have become a tool to promote the culture and elite status of the host country—the Olympics have become a symbol of economic modernization and international status.<sup>85</sup> The success of the 2008 Olympic Games, both in terms of China's performance and the international attention surrounding the games, marks a new era for China. China has proved to the world that it is once again in the position it formerly occupied. Furthermore, with the international recognition of Chinese modernization, the CCP has shown itself capable of aligning the interests of the people with those of the party.<sup>86</sup> This success has bolstered CCP legitimacy and has allowed the party to enjoy more liberties when it comes to its policies.

Although China has been able to overcome the century of humiliation and proved that it is once again a force to be reckoned with, a part of present nationalism is still a reaction to Western infringements on Chinese sovereignty and Western biases. This mistrust of the West has been steadily building up over the years, and, as a consequence, this has led the Chinese people to believe that government censorship is a necessary tool. The first offense took place during the

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<sup>83</sup>Michael Hunt, "Chinese National Identity and the Strong State: The Late Qing-Republican Crisis" in Lowell Dittmer and Samuel S. Kim, eds China's Quest for National Identity. Ithaca, NY: Cornell University Press, 1994. 63.

<sup>84</sup>Xin Xu "Modernizing China in the Olympic Spotlight: China's National Identity and the 2008 Beijing Olympiad. *The Editorial Board of the Sociological Review*, 2006. 90-107.

<sup>85</sup>Susan Brownell, Training the Body for China; Sports in the Moral Order of the People's Republic. Chicago: The University of Chicago Press. 314; Andrew Morris, "'How Could Anyone Respect Us?': A Century of Olympic Consciousness and National Anxiety in China." *Brown Journal of World Affairs*. Volume 14, No. 2 (Spring/Summer 2008): 35.

<sup>86</sup>Xin Xu "Modernizing China in the Olympic Spotlight: China's National Identity and the 2008 Beijing Olympiad. 94.

1999 Kosovo War. On May 7, 1999, the US with NATO approval launched an airstrike in Belgrade, where 3 Tomahawk cruise missiles destroyed the Chinese embassy. Following the strike, President Clinton and NATO claimed that the attack was an accident caused by outdated information.<sup>87</sup> However, few Chinese citizens believed this explanation and believed the attack was an infringement of national sovereignty. Such an attack only served to remind the Chinese of the humiliation and suffering they endured a century ago.<sup>88</sup> This feeling of Western imperialism further intensified when a damaged American EP-3 spy plane landed on Hainan Island in 2001 because it symbolized another breach of sovereignty.<sup>89</sup> But the final blow came in March 2008, when riots in Lhasa, Tibet broke out. According to official statistics, eighteen civilians and one police officer were killed; 382 civilians and 241 police officers were injured; five hospitals, seven schools, eighty-eight vehicles, and 120 buildings were set on fire; and 908 shops were looted.<sup>90</sup> However, instead of sympathizing with the victims, the Western media saw the unrest as a result of Chinese oppression and directed a media war against China.<sup>91</sup> The coverage by the foreign media was followed closely by Chinese netizens. These netizens discovered many discrepancies and falsifications within the reports. For example, CNN cropped a picture of a Chinese man raising his arm to block a blow from a Tibetan youth who was holding a stick. In the original picture the man was also surrounded by other weapon wielding Tibetans. Furthermore, Fox published a photo captioned “Chinese troops parade handcuffed Tibetan prisoners in trucks” when the actual photo was taken in India with Indian police dragging the

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<sup>87</sup> BBC News “Embassy Strike a ‘Mistake’” <http://news.bbc.co.uk/2/hi/europe/338557.stm>

<sup>88</sup> Peter Gries, “Tears of Rage: Chinese Nationalist Reactions to the Belgrade Embassy Bombing” *The China Journal*. No. 46 (July 2001): 26-27.

<sup>89</sup> Lei Guang “Realpolitik Nationalism”

<sup>90</sup> China Daily. “Eighteen civilians and one police officer killed by Lhasa rioters” March 22, 2008.

<sup>91</sup> Mingsheng Li “Chinese Nationalism in an Unequal Cyber War” *China Media Research*. Vol. 5 No. 4 (2009): 63.



man away. Other news agencies like BBC, the Washington Post, and the New York Times all engaged in such fraudulent activities.<sup>92</sup>

In the West, there is a belief that Chinese response over such incidents is orchestrated by the government; furthermore, it is also common for those in the West to think that it is the uneducated, propaganda fed section that believes in the anti-West movement in China right now<sup>93</sup> However, as many scholars point out, this is a mistaken assumption and the Chinese have legitimate reason to be angry. In addition, contrary to belief, those who were the most outraged by the hypocrisy and displayed the most nationalistic feelings were actually the well-educated, technologically savvy, multilingual youth that the West has identified as China's hope for democracy.<sup>94</sup> The obvious antagonism shown by the West in this event was viewed by the Chinese as the West's move to deny China its proper place in the international sphere. It places the West in a negative light and pledges more civilian support for the Chinese government. In fact, there is already belief amongst the people in China that censorship is necessary because the clearly biased Western media tries to create havoc in China by presenting misleading facts—the government is only trying to protect its citizens from these falsehoods.<sup>95</sup> Although there are some inaccuracies in the reporting done by the Western media, it does not mean that the incidents reported on, such as the plight of the Tibetans, are not serious problems. The protestors do have legitimate reasons for rebelling—they have been severely oppressed by the government

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<sup>92</sup> Ibid, 67.

<sup>93</sup> Ibid, 68-69

<sup>94</sup> Kishore Mahbubani, "Tibet Through Chinese Eyes" *Newsweek*. April 26, 2008; Peter Gries, "Tears of Rage: Chinese Nationalist Reactions to the Belgrade Embassy Bombing"; Joshua Kurlantzick, "Angry Young Men" *The National*. November 28, 2008.

<sup>95</sup> This view is taken by Townsend in "Chinese Nationalism and Its International Orientation" pg. 12 and substantiated by my own interviews conducted during the summer of 2009, where I questioned a cross-section of the Chinese population on the topic. Those interviewed included party officials, students attending western universities, students attending Chinese universities, university professors, urban Chinese workers with a formal education background, rural Chinese workers with no formal education, rural Chinese workers in urban cities, Chinese business owners, and top executives at Chinese branches of foreign firms.

and treated as second class citizens. The government's actions toward these repressed groups cannot be condoned, but the party has been able to get away with these gross misdemeanors. The government was able to manipulate the media to deflect blame and take focus off of its actions by putting the spotlight on the wrongs committed by Western media.

### **3.2 Firm Objectives and Censorship**

The government cannot rely solely on nationalism amongst its citizens to induce self-censorship because individual citizens are not the only actors in an economically developed society. Firms act as individual agents in society as well, and they often have far more influence over the development of a nation than individual citizens; thus, it is necessary for the government to influence the behavior of firms as well. A principal-agent problem exists with any government-firm interactions where one party tries to induce certain behaviors from the other due to the possible misalignment of interests. In the case of indirect censorship in China, the central government serves as the principal that tries to induce the agents, or the firms, to adopt self-censorship measures. The only way the government can induce such behavior from the firms is to reduce or completely eliminate the possible conflicts of interest. So, in understanding why firms comply with the Chinese government demands, it becomes necessary to study firm objectives and whether they are aligned with government interests. It has been long accepted that firms predominately try to increase their long-run market value.<sup>96</sup> This implies a multi-period game where firms must invest in strategies that would better their overall position in the long run. Thus, firms might have to make tradeoffs in between the periods such that they would sacrifice some of their current position for future gains. However, because firms exhibit risk aversion, such a tradeoff would only occur if the value of future gains clearly outweighs the present losses

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<sup>96</sup> Michael Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function" *Business Ethics Quarterly*, Vol 12, No. 2 (April 2002): 235-236; SJ Grossman and JE Stiglitz, "On Value Maximization and Alternative Objectives of the Firm," *The Journal of Finance*, Vol. 32, No 2 (May 1977): 389-402).

and also if this move puts the firm in an optimal position to take advantage of arising opportunities.<sup>97</sup>

Given the value maximization objective of the firms, it is clear, that as far as censorship is concerned, the interests of the firms do not conflict with those of the government as long as self-censorship does not negatively affect the firm's performance in the market. But this is not the case for many firms because self-censorship usually involves deploying both technological and labor capabilities that would raise the costs of production incurred by the firms. Therefore, the government must be able to compensate for the higher costs through economic incentives that could offset the costs or through promises of higher potential earnings. However, this outcome overstates the relative bargaining power of the firms because it must be noted that given the position of the Chinese market, the government can leverage the firms through its role as the market regulator and its ability to make "take it or leave it" offers to firms. This leverage is further enhanced by the presence of competition in the overall market. Therefore, the following sections will study how the Chinese government is able to persuade firms to undertake self-censorship roles through economic incentives.

### **3.3 Economic Incentives for Domestic Firms**

The previous chapter touched on how the Chinese government could effortlessly monitor state owned enterprises due to the government's majority shareholder status in those companies. Private enterprises differ from public or state-owned enterprises in terms of objectives. For private firms, the only objective they have is to maximize profits. Which means the government faces the challenge of introducing political concerns to the objective of private firms. This task can be avoided as long as the economy is dominated by state owned entities. The government

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<sup>97</sup> Jean-Marc F Blanchard, "China, Multinational Corporations, and Globalization: Beijing and Microsoft Battle Over the Opening of China's Gates," *Asian Perspective* Vol. 31, No. 3 (2007): 67-102.

will not have to implement some kind of apparatus to control private entities due to their relative insignificance. However, because private entities do play a significant role in the Chinese economy, direct control over functions is hard to achieve. The government has to either find other means to monitor and influence behavior, or they need to minimize the number of private enterprises.

The Chinese government is able to accomplish such grandiose goals because the market in China is not completely liberalized. Victor Nee describes the current economic situation in China as one of “politicized capitalism.” This system is one where there is no clearly defined boundary between the political and economic spheres, and, as a result, the state is very much involved in, and retains much influence over, the economic sphere.<sup>98</sup> This involvement can manifest in the monitoring and enforcement of regulations in the economy that could affect the performance of firms or their abilities to access resources. This section will analyze the areas where the central government does retain those powers to affect firm operations and how the government’s actions actually undermine the size and role of the private sector. Specifically, focus will be put on how the government’s ability to affect firms’ investment and operational plans shape firm strategies. Furthermore, this section will also look at how the government can influence the actions of individual entrepreneurs through political means.

In order to incentivize agents to carry out the principal’s objectives, the principal must be able to provide positive reinforcement for compliance and negative reinforcement for disobedience. Furthermore, the reinforcement must affect the agent in a way such that it is in the agent’s best interest to comply. In the case of obtaining compliance from the firms, the government must be able to leverage the firms’ own objectives against them. The primary

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<sup>98</sup> Victor Nee, Sonja Opper, and Sonia M.L Wong, “Politicized Capitalism: Developmental State and the Firm in China.” January 7, 2004 Working Paper, pg. 1-2

objective of firms is to survive and maximize profit; furthermore, the survival of firms depends on how readily they can access capital to fund both operational and investment purposes.

Therefore, the government can control firm access to resources and use this control to influence the behavior of the firms. The Chinese government has indeed created conditions where capital is incredibly difficult to access—Yasheng Huang and Stephan Haggard have found that private firms in China are among the most constrained in terms of access to capital in the global market. This limitation can be attributed to both the structure of the banking system in China and the laws regulating equity ventures.

Typically, firms fund their projects either by taking on debt or by issuing equity. In China, financing through bank loans has become the second most prevalent form of funding—around 30% of funding that private firms obtain are from banks. However, when you look at total loans given by the banks, loans given to private firms in China are incredibly rare even though the market has become more open. In fact, under market liberalizing conditions, private firms should be receiving more loans from banks because their market share will have increased over time. However, opposite trend exists in China. In the 1990s, the private sector found itself receiving less funds than it did in the 1980s.<sup>99</sup> This anomaly is due to the structure of the banking system in China. The current banking system in China is dominated by four state-owned banks: the Industrial and Commercial Bank of China, People's Construction Bank of China, the Bank of China, and the Agriculture Bank of China. Due to the ownership structure of the banks, the government actually has the jurisdiction to decide who to give loans to. June Ma has pointed out that the government imposes an annual credit ceiling on how much banks can lend out to firms. This can be found in the government's investment plans along with designated allocations to

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<sup>99</sup> Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*. New York, NY: Cambridge University Press, 2008, 8-9.

projects that the government considers significant.<sup>100</sup> Banks have become a tool to propagate the government's political agenda—the allocation of resources by banks has become an indicator to the firms of government policy and objectives.<sup>101</sup> The lack of funding and the politicized decision making process provides firms with incentives to comply with the government because, in order for private firms to obtain funding, they would have to demonstrate that they are in agreement with government policies.

Government control over access to funding does not stop at bank loans. The government is also able to monitor and regulate other investment projects firms undertake. Victor Nee has illustrated in his study that the government has a lot of influence over financial decisions such as 1) mergers 2) investment plans, 3) market entry, and 4) IPO listings and share issuance.<sup>102</sup> All of these measures require approval from the government; however, the process with IPO listings and share issuance is unlike the others in that it requires long term interaction between the firms and the government. With mergers, investment plans, and market entry, the firms only need to obtain permission once, but the government always has a role in regulating how a firm can raise equity. The government's role begins in the regulations concerning the Chinese stock markets. Both the Shanghai and Shenzhen exchanges were created in 1990.<sup>103</sup> The stock markets are unique in that they have a dual tier system. The primary market is where enterprises make their initial offerings and the secondary market is where shareholders trade stocks. Under the Chinese system, firms could either make an internal offering or a public offering.<sup>104</sup> Under internal offerings, the firm can only sell stock to its employees whereas public offering issue stock to the

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<sup>100</sup> Jun Ma, *The Chinese Economy in the 1990s*, New York, NY: St. Martin's Press, Inc., 2000, 63.

<sup>101</sup> Stephan Haggard and Yasheng Huang, "The Political Economy of Private Sector Development in China," 344.

<sup>102</sup> Victor Nee, Sonja Opper, and Sonia M.L Wong, "Politicized Capitalism: Developmental State and the Firm in China." January 7, 2004 Working Paper, 20.

<sup>103</sup> Franklin Allen, Jun Qian, and Meijun Qian, "China's Financial System: Past, Present, and Future," in *China's Great Economic Transformation* eds Loren Brandt and Thomas Rawski. New York, NY: Cambridge University Press, 2008, 510

<sup>104</sup> Jun Ma, *The Chinese Economy in the 1990s*, 78.

public. In order to offer shares to the public, firms have to be listed on the stock exchange and go through an IPO (initial public offering). In China, applying for an IPO is a highly complicated and highly politicized process. Currently there is a quota on the number of firms that can qualify for public listing.<sup>105</sup> The number of firms allowed to become publically listed is annually decided jointly by the China Securities Regulatory Commission (CSRC), the State Planning Committee (SPC), the State Economic System Reform Commission (SRC), and the People's Bank of China (PBC or the central bank of China).<sup>106</sup> Finally, approval for an IPO is made by the CRSC, based on factors such as the firm's financial and management conditions, market conditions, and, ambiguously, current government policies.<sup>107</sup>

Factors such as conditions of the market and conditions of the firm seem perfectly reasonable in talking about IPO approval, but, the introduction of “current government policies” as a requirement serves no economic or financial purpose whatsoever. This ambiguous requirement merely politicizes the process. Essentially, this requirement says that firm actions have to be in accordance with policies that the government deems important regardless of the type of policy. This is where censorship starts playing a role—censorship requirements are something the state takes very seriously. Firm compliance with censorship policies can actually determine when and if the firm gets approved for its IPO. The strategic value of complying with government censorship guidelines is exemplified in the cases of Sina.com and Netease. Both Netease and Sina are internet portals that provide news services and other informational content.

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<sup>105</sup> Julian Du and Chenggang Xu, “Market Socialism or Capitalism? Evidence From Chinese Financial Market Development” in Janos Kornai and Yingyi Qian eds *Market and Socialism: In the Light of the Experiences of China and Vietnam*. IEA Conference Volume No. 146. New York, NY: Palgrave MacMillian, 2009, 91.

<sup>106</sup> Jun Ma, *The Chinese Economy in the 1990s*, 79.

<sup>107</sup> Ibid

Netease was founded in 1997 whereas Sina was created in 1999.<sup>108</sup> Although both websites offered similar services, the approaches taken by the firms differed drastically. Sina took a far more cautious approach towards providing news content. For example, Sina's online news stories were just republished copies of stories printed by the state controlled news agencies.<sup>109</sup> In addition, Sina requires its users to register with the website with their real identities. In contrast, Netease took a far more liberal approach to its services. Netease does not require user registration and merely reminds the users of government policies and the implications of violating said policies.<sup>110</sup> Furthermore, Netease also offers a bulletin board for its users to post opinions on political and social issues. This bulletin board has been used by some to criticize and vilify the government. These public posts directly challenge the mainstream message that the government supports. One prominent case occurred during the 2008 Olympic bid process. Both Sina and the government focused on commemorating China's successful bid whereas negative posts denouncing the decision were found on Netease.<sup>111</sup> Although Netease offered more liberal services, it still followed the law, but its censorship practices were ambiguous and did not meet the terms of government demands. On the contrary, Sina provided services that were, without a doubt, fully in compliance with the censorship requirements. As a result of these differing strategies, Sina was rewarded for its cautious approach—the firm was approved for listing before Netease.<sup>112</sup> The timing of the IPO is critical because it affects the firm's competitiveness in the market. In allowing Sina to launch its IPO first, the government gave the firm an edge over its competitors because it can now raise more capital to use towards other operational or financial

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<sup>108</sup> Hu Xin, "The Surfer-in-Chief and the Would-Be Kings of Content" in Stephanie Hemelryk Donald, Michael Keane, and Yin Hong eds *Media in China: Consumption, Content and Crisis*. New York, NY: Routledge Curzon, 2002, 194.

<sup>109</sup> *Ibid*, 195.

<sup>110</sup> *Ibid*, 196.

<sup>111</sup> *Ibid*, 197

<sup>112</sup> *Ibid*, 195



functions. Not only do firms have an incentive to comply with censorship demands before their IPO, but it is also in the firms' best interests to maintain this compliance afterwards as well. The government's influence over the firms' capability to raise equity does not stop with IPOs. In fact, firms must seek approval for all share issuance decisions after the IPO.<sup>113</sup> The government can either punish or reward behavior as it deems necessary. Through this power, the government ensures that it will receive continual compliance from the firms because both the survivability and growth potential of the firms depends on their compliance.

As a result of all the restrictions concerning fundraising, State-Owned Enterprises are heavily favored over private firms. As Lance Gore points out, the success of enterprises depends on the support they can get from the government in the form of loans, tax breaks and project approvals.<sup>114</sup> However, most of these economic incentives are reserved for state owned entities. Therefore, given the setup of the financial system in China, there is no benefit for firms to remain private entities. Firms are actually incentivized to change their ownership status. In fact, Yasheng Huang points out that it is very difficult to define the private sector in China.<sup>115</sup> The most obvious discrepancy can be seen in share issuing SOEs. These firms are technically private, but they are under the control of the government. But there are other types of firms with more ambiguous ownership structures. One such type would be collective firms that take the form of township and village enterprises (TVEs). These firms retain their revenue rights, but they are still very much government controlled in that the government has to give approval for investment and

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<sup>113</sup> Victor Nee, Sonja Opper, and Sonia M.L Wong, "Politicized Capitalism: Developmental State and the Firm in China," 26.

<sup>114</sup> Lance Gore, *Market Communism: The Institutional Foundation of China's Post-Mao-Hyper-Growth*. Hong Kong: Oxford University Press, 1998, 99.

<sup>115</sup> Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, 13.

employment strategies undertaken by the firms.<sup>116</sup> Another prevalent example is the existence of legal-person shareholding firms. Legal-person shareholding status indicates that other corporations have a majority stake in the firm issuing the shares. In China's case, the firms who hold the majority stake are State Owned Enterprises. These "private firms" would then become subsidiaries or affiliates of the SOEs, and thus, in terms of its ownership structure, become an SOE.<sup>117</sup>

The transition from the private sector to the pseudo-public sphere is known in the Chinese market as "red-hatting." Red-hatting is a viable financial strategy for firms because it allows the firms to obtain access to resources that were previously unavailable to them such as bank loans, power, rations, and political protection.<sup>118</sup> This removes the barriers to fundraising and eliminates all of the unfair regulations these firms faced. Not only does this move eliminate all the barriers private enterprises faced previously, but it also gains them access to information pertaining to government objectives and agendas. These firms can place themselves in a better position to receive more benefits through their knowledge on government goals. Furthermore, this move allows firms to invest and take part in many of the high-growth sectors that are prohibited to private industries. All in all, this move improves firms' growth potential, viability and competitiveness.

In the cases of the collective firms and the legal person shareholding firms, these firms are often counted as part of the private sector even though their ownership status and control apparatus indicate otherwise. Both of these types of entities actually make up a large proportion

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<sup>116</sup> Stephan Haggard and Yasheng Huang, "The Political Economy of Private Sector Development in China" in *China's Great Economic Transformation* eds Loren Brandt and Thomas Rawski. New York, NY: Cambridge University Press, 2008, 341.

<sup>117</sup> Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, 15-16.

<sup>118</sup> Lance Gore, *Market Communism: The Institutional Foundation of China's Post-Mao-Hyper-Growth*, 147; Kelly Tsai, *Capitalism without Democracy: The Private Sector in Contemporary China*, 58.

of the Chinese market. Including these firms in the private sector inflates the actual size of the sector—in 1998, legal-person shareholding firms accounted for 40% of the private sector, and in 2005, these firms accounted for 31.4% of the entire Chinese market.<sup>119</sup> This revelation brings to light a surprising trend—the actions taken by the government have the effect of limiting the role and influence of the private sector. By doing so, the government is insuring that it has more control over the overall economy and the effects of liberalizing the market. After all, actions are much easier to monitor and influence if direct control can be exerted over the firms. This essentially aligns the interests of the firms to those of the government without any form of coercion—firms are willingly trading compliance for economic gains. Willing compliance is always easier to maintain than coercion because the firms will not alter their behavior under willing compliance unless their entire objective structure changes. Unless the government renegades on its promises and barring any unpredictable events, these objectives will not change.

Although pseudo-private firms gain economic benefits from changing their ownership status, the previous trends do not fully explain why purely private entrepreneurs comply with government demands. Although entrepreneurs can gain financial profits through compliance, they are still facing an ambiguous legal system that can be easily manipulated by the government to take away the same gains. The most glaring absence of legal assurance lies in the fact that entrepreneurs in China do not enjoy property rights. The lack of property rights indicates the fact that the government can take advantage of any profitable situation and force the entrepreneurs to give up their claims to what they have established. This is illustrated in the Xiu Shui market case. Xiu Shui was a market established by local vendors in Beijing. The original market was an outdoors market analogous to flea markets in the United States. Vendors would sell cheap local goods, produce, and counterfeit designer goods. By 2004, Xiu Shui market had become a

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<sup>119</sup> Ibid

valuable and well-known brand name to tourists and local residents alike. Xiu Shui market at that time came to represent a rent-extraction opportunity for the government. Due to the lack of property rights, the government was able to shut down the original market and create a new indoors market without undergoing any sort of legal procession. With the new market, the government auctioned the right to manage the space to a private firm. The private firm then started auctioning off the sections, and as a result of high bidding prices, only one third of the original merchants were able to lease stalls in the new market. These merchants essentially lost all rights to collect the profits from the brand that they helped to build.<sup>120</sup>

This is a serious offense that cannot be mitigated with the provision of financial gains because these gains can be taken away arbitrarily. With the types of restrictions that entrepreneurs face, the question remains, why do they still stay in the system? Why is the private sector in China still growing? Kellee Tsai argues that private entrepreneurs do not exit the market because they do not have any other alternatives.<sup>121</sup> Furthermore, exiting the market would also require government approval and the process of exiting would be costly. This is only one part of the argument. The more logical conclusion is that private entrepreneurs have gained trust in the political system because of the latest government policies. As the market grows, the government knows that they cannot alienate the growing number of private entrepreneurs, or as they are called in China, capitalists. Private entrepreneurs have found themselves being included more in the decision making process. Entrepreneurs can actually collectively voice their concerns through state corporatist trade organizations such as All-China Federation of Industry and Commerce (ACFIC). These organizations are actually state organized and membership is

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<sup>120</sup> Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*. New York, NY: Cambridge University Press, 2008, 234-235.

<sup>121</sup> Kellee S. Tsai, *Capitalism without Democracy: The Private Sector in Contemporary China*. Ithaca, NY: Cornell University Press, 2007. 57.

mandatory. These trade organizations, in turn, let businessmen access the political sphere and influence policies to their advantage.<sup>122</sup> In addition, the entrepreneur's political influence has been increased in a more direct way. In 2001, in his July 1<sup>st</sup> speech, former President Jiang Zemin lifted the archaic CCP membership ban on capitalists and formally invited entrepreneurs to join the party.<sup>123</sup> In allowing party membership, entrepreneurs can directly present their interests to the party and influence party policy. Furthermore, as evidenced by the same speech, the party has recently shown concern and understanding for the plight of the entrepreneurs. The party has publically announced that problems such as corruption and bank reforms are state priorities in order to placate the private sectors.<sup>124</sup> This exemplifies that the state does have the private sector's concerns at heart and is taking action to fix the problems. In a sense, all of these measures taken by the government are ways to reassure the private sector without sacrificing its control over the individuals or the market. Allowing private entrepreneurs to become party members and to organize in trade organizations assuages their fears by including them in the system, but also, it allows the government to keep an eye on these individuals to make sure they are complying with protocol.

In addition to influencing financial factors, the government can also affect personnel decisions in firms.<sup>125</sup> This influence is most apparent in the board structure of publically listed firms. Under Chinese law, listed companies must have a two-tier board structure. They have a board of directors whose job and makeup is very much like that of their western counterparts. The board is elected by the top managers of the firm, and with approval of the board, the CEO

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<sup>122</sup> Ibid, 61-62.

<sup>123</sup> Jiang Zemin's Speech at the Meeting Celebrating the 80th Anniversary of the Founding of the Communist Party of China, July 1, 2001. Translation can be found at: <http://www.china.org.cn/e-speech/a.htm>

<sup>124</sup> Kellee S. Tsai, *Capitalism without Democracy: The Private Sector in Contemporary China*, 80.

<sup>125</sup> Victor Nee, Sonja Opper, and Sonia M.L Wong, "Politicized Capitalism: Developmental State and the Firm in China," 19-20.

and other top managers can become members of the board. Companies must also have a board of supervisors, which constitutes the second tier of the board structure. The board of supervisors monitors firm operations and top firm personnel. Members of the board usually include shareholder and employee representatives along with individuals with government background.<sup>126</sup> The governmental influence does not stop with the board of supervisors; in fact, a 2007 study found that around 200 of the 625 publically listed firms had CEOs who were affiliated with the party.<sup>127</sup> The placement of government members in these firms plays a two-fold role. Through the placement of party officials in these positions, the government can insure that they can maintain informal network ties with decision makers in the firms.<sup>128</sup> Additionally, these members directly influence the decisions made by the firm, so in this respect, the government can be assured that the decisions made by the firms will be aligned with the interests of the government. This assurance predominately comes from the fact that these members owe their success and position to government support; therefore, they are first and foremost loyal to the government. The second implication is that the government can obtain compliance without providing financial incentives. Without having to cede economic benefits to firms, the government can issue the same policies as before and therefore maximize revenues extracted from these firms.

The government's influence over individuals in private enterprises does not stop with its ability to place party members in key positions. Over the past 20 years, China has experienced a rise in what is called "bureaucratic entrepreneurship," or better described as a rise in the number

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<sup>126</sup> Franklin Allen, Jun Qian, and Meijun Qian, "China's Financial System: Past, Present, and Future," 546.

<sup>127</sup> Ibid

<sup>128</sup> Victor Nee, Sonja Opper, and Sonia M.L Wong, "Politicized Capitalism: Developmental State and the Firm in China," 19-20.

of party members engaging in private businesses.<sup>129</sup> In fact, many private businesses are owned by party members who want to take advantage of the opportunities. In 1991, 7 % admitted to being part of the party; whereas, in 2003, 33% said that they were party members.<sup>130</sup>

Furthermore, Kellee Tsai has also found that the proportion of private entrepreneurs with state enterprise or party backgrounds is rising. In 1997-1998, 11.5% of private enterprise workers were former state enterprise employees. In 2002, 47.2% of the survey responders say that they used to work for state owned enterprises and 23.5% of the responders were former managers of state owned enterprises.<sup>131</sup> The rise of bureaucratic entrepreneurship has given the central government more control over firm activities. These party members do not only respond to economic incentives, but also political incentives provided by the government.<sup>132</sup> Like board members and CEOs, these party officials owe their success to their higher ups in the central government. Furthermore, many of these party members still retain their functions within the party, where they dictate regional economic policy. Their performance in both fields is monitored and evaluated by the central government. This evaluation can affect both their private business and their status in the party. If these officials operate within the rules and carry out government objectives, they are rewarded with performance bonuses<sup>133</sup> So, for these bureaucratic entrepreneurs to succeed in both private business and in the party, they need to align their actions with the objectives of the policy set forth by the central government—they need to know what is taboo and what is acceptable at all times.<sup>134</sup> In this way, the central government

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<sup>129</sup> Lance Gore, Market Communism: The Institutional Foundation of China's Post-Mao-Hyper-Growth, 101.

<sup>130</sup> Kellee S. Tsai, Capitalism without Democracy: The Private Sector in Contemporary China, 62.

<sup>131</sup> *Ibid*, 73-76

<sup>132</sup> Lance Gore, Market Communism: The Institutional Foundation of China's Post-Mao-Hyper-Growth, 101.

<sup>133</sup> Barry Naughton, "Market Economy, Hierarchy and Single Party Rule" in Janos Kornai and Yingyi Qian eds Market and Socialism: In the Light of the Experiences of China and Vietnam. IEA Conference Volume No. 146. New York, NY: Palgrave MacMillian, 2009, 145.

<sup>134</sup> Lance Gore, Market Communism: The Institutional Foundation of China's Post-Mao-Hyper-Growth, 106-107.

control is strengthened because it gets to set one national agenda which is carried out by all of the bureaucratic entrepreneurs without the need for supervision from above.

### **3.4 Experience of Multinational Corporations**

The relationship between the Chinese government and multinational corporations is a complex one. The government's first goal is to receive as much foreign investment as possible to promote domestic growth. However, at the same time, it also wants to control the effects of foreign investment. Opening up the country to foreign investment inevitably means loosening border controls, allowing more individual mobility and greater information flows. If this effect is not maintained correctly, the government could face serious consequences that could jeopardize its political power. So it is within the government's interest to allow the optimal degree of freedom needed for economic growth and still maintain political control. Therefore, the government's subsequent goal is to gain compliance from the foreign firm when it comes to political or social issues that the government has a stake in. There are many arguments pertaining to why firms invest abroad. These arguments include market structure imperfections, market failure imperfections, market disequilibrium, and government imposed distortions. However, the two most salient arguments explaining the rise of investment in China are market disequilibrium and government imposed distortions. The market disequilibrium argument states that firms invest abroad because of segmentation in the world markets—the rates of return are not the same across countries. Essentially, firms invest in areas that have higher rates of profit. Whereas, in government imposed distortions, firms invest abroad because government policies can create conditions to incentivize investment.<sup>135</sup>

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<sup>135</sup> A.L. Calvet, "A Synthesis of Foreign Direct Investment Theories and Theories of the Multinational Firm," *Journal of International Business Studies*, Vol. 12, No. 1 (Spring-Summer 1981): 43-59.



Foreign investment in China began as a reaction to stimulus provided by the Chinese government. In 1979, Deng Xiaoping overturned thirty years of isolationist economic policy and introduced an open door economic policy. This change was perhaps inspired by the success of Japan and the four Asian tigers, but, most importantly, Deng also realized that foreign investment was necessary to Chinese development on the whole.<sup>136</sup> China established and introduced Special Economic Zones (SEZs), Open Cities, tax exemptions, duty free imports of raw materials and technology in order to encourage investment. All of these measures had the effect of lowering the risk and uncertainty of investment, which allows firms to feel more confident committing resources and equity in China.<sup>137</sup> During the first 5 years following the policy announcement, investment trickled in slowly due to uncertainty about the Chinese market. Then, from 1983 to 1991, investment picked up when the government introduced policies that provided more economic freedoms and incentives to the MNCs. Finally, in 1994, China became the second largest recipient of foreign investment, a position China more or less retains today.<sup>138</sup> During this period of growth, China became a substantial consumer market as a result of its economic development. By this time, whatever reservations MNCs had were diminished—China had become the future of economic growth. Between 1979 and 2005, the GDP grew at an average of 9.56%.<sup>139</sup> Then from 2005 onward, China has experienced growth around the 8% mark.<sup>140</sup> This is an impressive feat considering that the rest of the developed world has experienced stagnant or contracting growth during this period. Furthermore, as the rest of the

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<sup>136</sup> Shang-Jin Wei “Foreign Direct Investment in China: Sources and Consequences,” in Takatoshi Ito and Anne Krueger (eds) *Financial Deregulation and Integration in East Asia*, NBER-East Asia Seminar on Economics, Vol. 5, University of Chicago Press.

<sup>137</sup> David Tse, Yigang Pan, and Kevin Au, “How MNCs Choose Entry Modes and Form Alliances: The China Experience,” *Journal of International Business Studies*, Vol. 28, No. 4 (4<sup>th</sup> Quarter, 1997): 784

<sup>138</sup> Ibid, 784

<sup>139</sup> World Bank data; China Daily, March 20, 2006 “China’s GDP Growth to Average 7.5% in 2006-2010” [http://www.chinadaily.com.cn/china/2006-03/20/content\\_547065.htm](http://www.chinadaily.com.cn/china/2006-03/20/content_547065.htm)

<sup>140</sup> BBC, October 22, 2009, “China economic growth accelerates” <http://news.bbc.co.uk/2/hi/8319706.stm>; World Bank data.

world economy tanked under the current financial crisis, China cemented its role as the home of future economic growth by posting growth levels similar to those they experienced before the crisis. It is in the best interests of firms to develop in China so they can take advantage of this growth.

The attractiveness of the Chinese market has another implication—it has given the Chinese government more bargaining power with respect to Multinational Corporations. It is the tool that the government can use to gain compliance from foreign firms without sacrificing economic growth. In this case, the government can demand firms to comply with the rules and regulations that it has put forth or else the firm will forego the chance to profit from China's growth. However, this is not to say that firms lack any bargaining power—the Chinese government needs foreign firms in order to gain access to more modernized technology and practices that would maintain China's development and growth. But, when it comes to purely political considerations, firms will defer to the government since compliance would bring rewards whereas defiance would result in complete exclusion from the Chinese market.

The model used above can be applied to the case of censorship. Upholding censorship is considered a state interest and therefore cannot be compromised. Therefore, the government requires companies dealing in media and technology to follow the rules they set forth. The first example of compliance came from the Star TV case, when Rupert Murdoch tried to break into the Chinese market in 1993. News Corp bought Star TV for 3 billion dollars and Murdoch soon announced to the world that modern technology had “proved an unambiguous threat to totalitarian regimes everywhere.”<sup>141</sup> Following this announcement, the Chinese government moved to ban the ownership of private satellite dishes and started promoting cable TV as a

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<sup>141</sup> NY Times, June 26, 2007 “Murdoch's Dealings in China: It's Business, and It's Personal”  
[http://www.nytimes.com/2007/06/26/world/asia/26murdoch.html?\\_r=1&pagewanted=print](http://www.nytimes.com/2007/06/26/world/asia/26murdoch.html?_r=1&pagewanted=print)

cheaper alternative to these services.<sup>142</sup> This move ended up harming Murdoch's ability to compete on the Chinese market at the same time as it increased access to government media. Murdoch was losing money in his investment due to his refusal to comply with the government. However by 1996, Murdoch was able to turn his fortune around. He teamed up with Liu Changle, a former radio host with party connects, to create Phoenix TV.<sup>143</sup> Murdoch's approach with Phoenix TV was very different. This venture was welcomed and accepted by the Chinese government because it complied with all rules and steered away from sensitive political topics. Furthermore, Murdoch took this compliance one step further—the Chinese government wanted an outlet to promote its views globally and Murdoch provided them with the chance to do so. Phoenix TV transmitted its Chinese broadcast globally.<sup>144</sup>

The Murdoch lesson would be remembered by future corporations trying to gain access to the Chinese market. Companies like Yahoo and Microsoft entered the market in the mid 90s and showed full compliance with government regulations; however, they too were frustrated by the complications that still existed. Like Murdoch, these firms would turn to establishing Joint Ventures with local firms in order to capture more market share and revenues.<sup>145</sup> These joint ventures served two roles: they helped the companies to navigate the Chinese market better and they also made sure that these foreign firms complied with Chinese regulations. Given the ownership classification of the telecom and technology industries in China, many of the firms that partner up with MNCs are state owned enterprises. These firms are fully aligned with the government objectives. Furthermore, even private firms have an interest in complying with

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<sup>142</sup> Michael Curtin, "Murdoch's Dilemma, or What is the Price of TV in China?" *Media Culture Society* Vol. 25, No. 2 (2005): 159-160.

<sup>143</sup> NY Times, "Murdoch's Dealings in China"

<sup>144</sup> Ibid

<sup>145</sup> Yahoo turned over its China business to Alibaba in 2004 and in the 2000s Microsoft entered into a series of JVs see NY Times, Jan 16, 2010 "China Where US Internet Companies Often Fail" and Jean-Marc Blanchard, "China, Multinational Corporations, and Globalization: Beijing and Microsoft Battle Over the Opening of China's Gates," 93-99.

government regulations concerning censorship—they have everything to lose if they challenge the government. Thus, these firms are unlikely to do so, and, in fact, these firms would often go further than what the government requires just to be safe. For example, when Yahoo sided with Google on the latest cyber-attack case, its Chinese partner, Alibaba, came out publically to criticize Yahoo for its statement<sup>146</sup>

MNCs have been harshly criticized for their censorship roles in China by international groups such as Amnesty International and Freedom House. However, for the public, this topic has only been brought to attention by the recent Google case. For Google, this case represents the culmination of years of internal deliberation and tense debate with the Chinese government despite the firm's compliance with regulations. Therefore, this case is an example that illustrates the hardships stilled faced by many Multinational corporations in China. However, recent events have also brought to light the other side of the same coin. There are also Multinational firms who have succeeded and gained from the system—Cisco is one such firm. Like Google, the firm has found itself in the foreground of the censorship discussion because of its role in providing censorship equipment to the Chinese government. The relevancy that these two firms bring to both the MNC experience in China and to current events make them good case studies for this discussion. Therefore, the next section will detail the alignment of government demands with firm objectives through an analysis of the interactions between the Chinese government and both Google and Cisco.

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<sup>146</sup> NY Times, January 17, 2010. “Chinese Site Criticizes Investor for Its Google Support.”

### 3.4a Case Studies:

#### 1. Google:

Google was founded by Sergey Brin and Larry Page in 1998 with the mission to “organize the world’s information and make it universally accessible and useable.”<sup>147</sup> The company quickly gained market share and grew rapidly in the succeeding years. Finally, in 2004, Brin and Page took the company public. At the time of the IPO, Google released another letter in which it reiterated its mission to make the world a better place and adopted the motto of “Don’t Be Evil.”<sup>148</sup> The commitment to this motto was most famously highlighted in December 2005, when Google refused to provide user information to the Department of Justice. Google was subpoenaed along with other internet search firms to provide records as a part of the effort to uphold the Child Online Protection Act.<sup>149</sup> However, Google’s victory did not last long and the firm found itself being criticized and attacked for giving in to the Chinese government when it announced that it will launch a self-censored version of Google.com, which is called Google.cn, in China.<sup>150</sup>

Google’s interactions with the Chinese government did not begin there. In fact, Google first accessed the Chinese market when it added Chinese language capabilities to its search engine. However, due to the censoring practices of the Chinese government, Google.com was constantly being monitored and filtered by the Great Firewall. The website was also reported to be randomly subjected to blockages. Google reported on its blog that the Chinese users of Google faced many difficulties: the entire website would be inaccessible 10% of the time,

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<sup>147</sup>James O’Rourke, Brynn Harris and Allison Ogilvy “Google in China: Government Censorship and Corporate Reputation.” *Journal of Business Strategy*. Vol. 28, No. 3 (2007): 12.

<sup>148</sup> Larry Page and Sergey Brin. “Letter from the Founders: “An Owner’s Manual” for Google Shareholders.” Found on [http://investor.google.com/ipo\\_letter.html](http://investor.google.com/ipo_letter.html)

<sup>149</sup> O’Rourke, “Google in China: Government Censorship and Corporate Reputation,” 13

<sup>150</sup> BBC News, “Google Censors Itself For China,” January 25, 2006, <http://news.bbc.co.uk/2/hi/technology/4645596.stm>

Google News was always blocked, and Google Images only worked sporadically.<sup>151</sup> Furthermore, even when the users could access the website, it was incredibly slow due to the filtering done by the government.<sup>152</sup> Finally, on January 26, 2006, Google decided to launch a Google.cn that would comply with government demands for self-censorship. The reason given by the firm was that launching Google.cn was the lesser of two evils—they did not want to deprive Chinese citizens of a Google search engine. Furthermore, they believed that Google’s presence in China, in addition to continual internet development would one day render censorship obsolete.<sup>153</sup> Until then, however, Google would not offer services such as blogger or gmail to protect user privacy.<sup>154</sup> The issue of censorship was pushed to the background until January 12, 2010, when Google announced that the firm experienced cyber-attacks of Chinese origins which resulted in both “theft of intellectual property” and individual gmail accounts belonging to human rights activists being compromised.<sup>155</sup> In light of these attacks, which were believed to be government supported, Google announced that it was unwilling to continue censoring its services. Then, on March 22<sup>nd</sup>, Google announced that it will discontinue its Google.cn website and redirected users to its Hong Kong homepage.<sup>156</sup>

Although Google frames its actions through ethical or moral lenses, the arguments put forth by the firm are not adequate enough to explain the actions it took. After all, Google is a firm and it is the firm’s first and foremost objective to maximize long term profit. Therefore, economic arguments must be introduced in order to explain the entire story. When Google first entered the Chinese market in 2000, there were only 22.5 million internet users, or 1.7% of the

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<sup>151</sup> Google Blog: “Google in China,” January 27, 2006. <http://googleblog.blogspot.com/2006/01/google-in-china.html>

<sup>152</sup> Google Blog: “Testimony: The Internet in China” February 15, 2006. <http://googleblog.blogspot.com/2006/02/testimony-internet-in-china.html>

<sup>153</sup> Ibid

<sup>154</sup> Google Blog: “Google in China”

<sup>155</sup> Google Blog: A New Approach to China. January 12, 2009.

<sup>156</sup> Google Blog: A New Approach to China: An Update. March 22, 2009

nation's population; however, by 2006, the number of users increased to 137 million people. The Chinese internet and telecom industry had become one of the fastest developing ones and one of the most profitable industries globally due to both demand from the people and from continued government support.<sup>157</sup> Therefore, financially, it was in foreign telecom companies' best interest to enter the Chinese market due to both the high growth potential and low risk—China was where all of the future growth would occur. At the time of Google's announcement to enter the market, the firm was facing fierce competition from some of the native firms such as Baidu and Sohu. In fact Baidu offered services that were 7 times faster than that of Google.<sup>158</sup> Essentially, Google was offering sub-par services in the Chinese market and the firm stood to lose market share and any chance of remaining competitive in the market if it did not employ self-censorship. In offering a censored search engine, Google had insured that it will have a place in the Chinese market and will be in a position to benefit from the future expected growth.

Google's decision to practice self-censorship is consistent with the solution of the principal-agent dilemma. The action required of the agent by the principal does not compromise any fundamental objectives they hold. Furthermore, complying with the principal's wishes actually enhances the agent's ability to meet its own objectives. Therefore, the interests of the agent and the principal were aligned. But this alignment was not permanent--when Google decided to pull out of China, it was clear that the interests of the two parties had diverged. First of all, Google did not enjoy the revenues or market shares it desired. In 2009 there were an estimated 384 million users and the industry posted revenues of 10.9 billion USD.<sup>159</sup> However, Google only captured 80 million of the users, or 33% of the total market, while Baidu is the industry leader with 63% market share, a number that has increased steadily over the past few

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<sup>157</sup> Harwit and Clark, "Shaping the Internet in China."

<sup>158</sup> Google Blog: Testimony: The Internet in China.

<sup>159</sup> TMT China, "China's Internet revenue hits \$10.89 bln in 2009" <http://tmt.interfaxchina.com/news/2555>

years.<sup>160</sup> In addition, Google posted miniscule revenues of 300 million dollars in 2008, which only represents 1.4 percent of its global revenues.<sup>161</sup> Given the lack of growth, Google would have less incentive to comply with actions. Furthermore, this incentive was lessened by the theft of intellectual property in the cyber-attacks. This loss could have resulted in Google's corporate secrets and projects being revealed to its competitors. If this had occurred, Google would have lost a lot more than the miniscule gains they extracted in China. Therefore, the move to discontinue its Google.cn could have been a strategic move to protect its corporate secrets. The decision to discontinue the search engine could have also been reached due to the fact that Google will not actually jeopardize the majority of its revenues from China. Most of Google's revenue actually comes from Chinese businesses posting ads on Google.com and from ads that they run on a network of Chinese websites; thus, as long as Google retains its sales and advertising network, they will continue to receive these sources of revenue.<sup>162</sup> In Google's official blog entry on the pull-out, the firm directly says that it will keep both its R&D forces and its Sales forces in China.<sup>163</sup>

## **2. Cisco:**

Cisco Systems was founded in 1984 by Len Bosack and Sandy Lerner with the goal to enable networks to connect with each other and share information from different locations.<sup>164</sup> Cisco is now the largest maker of internet infrastructure products in the world. In essence, Cisco provides the equipment that allows network access to the Internet. It enjoys a majority market share in both the enterprise router and network switch markets, which comprise the backbone of internet communication between and within firms and internet service providers. Cisco provides

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<sup>160</sup> NY Times. January 16, 2010 "China, Where US Internet Companies Often Fail"

<sup>161</sup> NY Times, January 15, 2010 "For Google, a Threat to China With Little Revenue at Stake"

<sup>162</sup> NY Times, January 20, 2010 "Google Hopes to Retain Business Unit in China."

<sup>163</sup> Google Blog: March 22, 2010 "A New Approach to China: An Update."

<sup>164</sup> Cisco Corporate Timeline: [http://newsroom.cisco.com/dlls/corporate\\_timeline.pdf](http://newsroom.cisco.com/dlls/corporate_timeline.pdf)



these products and services to both businesses and governments alike. However, as of late, Cisco has been criticized for practicing what some see as unsavory business dealings; in particular, the firm is attacked for providing the Chinese government with the capabilities and necessary training to run its massive censorship system.

Cisco first entered the Chinese market in 1994, but its first interaction with the government came in 1998 when CEO John Chambers unveiled a telecommunications plan for China. In this plan, Chambers outlined the economic potential that would be created by the adoption of a widespread and robust data communications network; furthermore, he emphasized that Cisco would be able to lead the change and connect China to the rest of the world.<sup>165</sup> Cisco was taken up on its offer. In 2001, it was estimated that Cisco revenues from China was around 1 billion USD.<sup>166</sup> In 2004, Cisco signed contracts where it would provide the Chinese government with its 12000 series routers to upgrade the Chinese network. These routers all contain filtering capabilities used to prevent internet attacks; however, they can also be reconfigured to be used for censorship.<sup>167</sup> Since then, Cisco has expanded its business in China and has been the recipient of many lucrative government contracts. In 2009, Cisco reaffirmed its commitment to doing business in China. In addition to its 16 billion dollar multiyear investment, Cisco will also be opening 140 Cisco Networking Academy institutions to “provide information communication technology skills to students” along with a new business unit in China to represent the Greater-China region.<sup>168</sup>

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<sup>165</sup> Cisco News Room: “John Chambers Unveils Telecommunications Vision in China "China to be a major player in the Internet Economy," says Cisco CEO” September 21, 1998 <http://newsroom.cisco.com/dlls/fsfnisapic0c9.html>

<sup>166</sup> William Thatcher Dowell, “The Internet, Censorship, and China,” 113.

<sup>167</sup> Thomas Lum, CRS Report for Congress, 8

<sup>168</sup> MIS-Asia: Cisco Aims at China Market with Restructuring January 13, 2010. <http://www.mis-asia.com/news/articles/cisco-aims-at-china-market-with-restructuring>; Cisco Newsroom: Cisco Underscores Continued Commitment to China, Jan. 13, 2009: [http://newsroom.cisco.com/dlls/global/asiapac/news/2009/pr\\_01-14.html](http://newsroom.cisco.com/dlls/global/asiapac/news/2009/pr_01-14.html)

Although evidence shows that the Chinese censorship capabilities come from Cisco routers and switches, the firm has been adamant in denying any role in building up China's censorship capabilities. The company argues that Cisco offers the same products globally and did not alter any of the routers or switches sold to the Chinese government. Furthermore, the censorship capability talked about is the same feature that protects users from viruses or cyber-attacks and therefore cannot be disabled. Cisco further exonerates its behavior by suggesting that because Cisco is not an ICP or an ISP, it does not have the power to determine how the equipment is used and for what purpose it is used for.<sup>169</sup> While Cisco tries to deflect blame, it is impossible that the firm did not know what its equipment was used for; furthermore, there are implications that the firm has willingly worked with the government to build up the government censorship program.

The first and foremost piece of evidence comes from an internal Cisco presentation from 2002 that was leaked online. In this presentation, Cisco outlined what the Chinese government's telecommunication development plan looked like. These plans included: reforming the existing organizational structure, reforming police forces, advancing information communications, advancing the golden shield project, and fixing existing challenges.<sup>170</sup> To achieve each goal, the government must obtain more advanced technology to support the growing network. Although these measures seem innocuous, in the case of the Golden Shield project (synonymous with the "Great Firewall"), the government's direct goal is to enhance its censorship capabilities. The evidence that Cisco knew what purpose its equipment was going to be used for can be found on slide 58, where Cisco included a slide titled "Cisco Opportunities." In this slide, Cisco

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<sup>169</sup> Cisco General Counsel Testimony (May 20, 2008) [http://blogs.cisco.com/news/comments/general\\_counsel\\_mark\\_chandler\\_testifies\\_before\\_congress/](http://blogs.cisco.com/news/comments/general_counsel_mark_chandler_testifies_before_congress/)

<sup>170</sup> Cisco Presentation made in 2002, [http://www.wired.com/images\\_blogs/threatlevel/files/cisco\\_presentation.pdf](http://www.wired.com/images_blogs/threatlevel/files/cisco_presentation.pdf)

highlighted the quality and reliability of their equipment, the access to technical training, and the provision of operational maintenance.<sup>171</sup> It was later disclosed by Terry Alberstein, a senior director of corporate communications in China, that the firm had sold 100,000 USD worth of routers and switches to be used in the Golden Shield project.<sup>172</sup>

Cisco's alignments with the government are also extremely evident from the firm's own publicized statements. On January 13, 2009, CEO Jim Sherriff described the projects Cisco had with government agencies as having the goals of focusing on "education, R&D [...] and the building of a harmonious society"<sup>173</sup> Harmonious society is the term Premier Hu Jintao coined in 2005 to explain the government's new vision for China. Ideally, this policy espouses maintaining economic development and growth without neglecting any of the socio-political problems existing in China.<sup>174</sup> Ideally, this policy will usher in democracy and reinforce rule of law; however, in practice, the policy supports "prosperity, solidarity, and consensus" and "a ruler's ability to balance his desire to be lenient with the need to be harsh toward his people."<sup>175</sup> Harmonious society, then, is just another tool to "harmonize" the nation under the will of the government. In referencing government policies, Cisco is showing that it is aware of government goals and that it is aligned with the government—the firm is willing to comply with government demands.

Cisco's willingness to comply is derived from the fact that China and the developing world is where future growth in network and infrastructure development lies. In most developed

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<sup>171</sup> Cisco Presentation made in 2002, slide 58

<sup>172</sup> Wired.com "'Great Firewall' of China Was a Chance to Sell More Routers," May 20, 2008  
<http://www.wired.com/threatlevel/2008/05/leaked-cisco-do/>

<sup>173</sup> Cisco Newsroom: Cisco Underscores Continued Commitment to China Jan. 13, 2009:  
[http://newsroom.cisco.com/dlls/global/asiapac/news/2009/pr\\_01-14.html](http://newsroom.cisco.com/dlls/global/asiapac/news/2009/pr_01-14.html)

<sup>174</sup> John P. Geis II and Blaine Holt, "'Harmonious Society': Rise of the New China" *Strategic Studies Quarterly*, Vol 3, No 4 (Winter 2009): 75-94. (pg. 75).

<sup>175</sup> John Delury, "'Harmonious' in China." Policy Review April and May 2008. <http://gees.org/documentos/Documen-02891.pdf>

nations, the market for Cisco's goods is already saturated and Cisco itself has captured more than 70% of that market. Whereas, in China, Cisco has only secured 49% of the market and the potential for growth is still extremely high because of the need for further development.<sup>176</sup> Furthermore, Cisco's compliance with government rules has handsomely rewarded the firm—the government needs Cisco's help in realizing its development plan. To date, Cisco has received contracts with all three major telecom companies in China in addition to contracts with some of the biggest banks as well.<sup>177</sup> Its willingness to comply is also due to the lack of negative consequences. Unlike companies such as Google and Yahoo, Cisco does not have a direct role in censorship—it only provides the equipment that supplies network access. As a provider of equipment, Cisco does not have the responsibility of upholding the privacy or needs of any individual because the firm does not decide how the equipment is used—that is in the jurisdiction of the state, ICPs, and ISPs. Furthermore, this also implies that Cisco, unlike Google, will not suffer a breach of its own corporate security because it does not have information pertaining to parties of interest to the government. Also, as the leading provider of routers and switches, Cisco is unlikely to suffer any backlash from its decisions—companies and governments will still need Cisco's help in maintaining and updating their networks and network infrastructure because there is no better substitute. Therefore, given these conditions, there are no incentives for Cisco to change its strategy any time in the future.

Both case studies reiterate the theme of this chapter—indirect censorship is best encouraged through non-coercive means. The government is able to retain control and influence over firms and individuals alike because the party can manipulate its power and resources to

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<sup>176</sup> MIS-Asia: Cisco Aims at China Market with Restructuring

<sup>177</sup> Cisco Corporate Timeline; Cisco newsroom: Cisco Signs Cooperation Agreements with China Mobile and China Construction Bank June 24, 2008 [http://newsroom.cisco.com/dlls/global/asiapac/news/2008/pr\\_06-24.html](http://newsroom.cisco.com/dlls/global/asiapac/news/2008/pr_06-24.html); China Unicom's Strategy of "Chayihua" Sets Them Apart in the Marketplace [http://www.cisco.com/web/about/ac79/docs/success/china\\_unicom.pdf](http://www.cisco.com/web/about/ac79/docs/success/china_unicom.pdf)

appeal to the desires of those they want to control. Through appealing to patriotic feelings, the government can build support for themselves while vilifying its enemies and critics. Through the use of financial tools and market regulations, the government is able to persuade firms that it is in their best interest to comply with the government on policies such as censorship. Furthermore, the appeal of compliance is intensified by the reality of the situation—the government knows what firms value and it plays to these objectives. Firms are better able to reach their objectives through aligning themselves with the government because they will enjoy more financial benefits and face less stringent requirements.

## **Chapter 4: CONCLUSION**

In the previous chapters, it has become very obvious that China is a unique case in the study of how authoritarian regimes can maintain growth. Unlike the former Soviet Union, the CCP did not have to choose between pursuing economic growth and development or maintaining political authority in the nation. The Chinese government has been able to do both, and its ability to do so can be attributed to its two tiered censorship programs that control the output of information. The lower level, or direct censorship, acts like a rudimentary filter that serves a two-fold purpose. The first is to block information on highly sensitive topics, such as Tibet or human rights. The second purpose for direct censorship is to provide a monitoring or oversight capability for the government. This task is a relatively easy one because of the government's control over the physical entities that produce and provide the output channels.

Although the direct censorship system is very sophisticated, it is not infallible. There will always be ways to circumvent the system. Proxy servers are an example of how individuals can bypass internet censorship. Furthermore, as China becomes more technologically integrated, it will become harder and more costly to control all channels of communication due to the sheer

volume of individuals connected to the network and due to the growing number of communication tools available. Therefore, effective control over information requires the government to develop a more elegant approach. The government must be able to convince firms and individuals that they have no interest in disobeying the government—there must be willing compliance. In this case, willing compliance would take the form of self-censorship. The government is able to induce self-censorship through the manipulation of objectives. On the individual side, the government is able to induce agreement through appealing to the nationalistic feelings of the population. This shifts focus away from government actions and strategically directs anger towards other targets such as the West. This blame deflection builds more support and approval for government policies.

To gain firm cooperation, the government must be able to appeal to the firms' objectives. Both domestic and multinational corporations have the same goal—profit maximization. With said goal, the Chinese government can use its growing market as leverage against the firms. China's rapid pace of growth and development makes it one of the most desirable investment opportunities in the world. As the gatekeeper to said market, the Chinese government has the ability to give or deny firms access the market. In the case of the MNCs, the government is able to use this power to persuade the firms. By complying with the government, the firms attain the opportunity to profit while incurring a small cost. However, failure to comply would result in exclusion from the market and the loss of potential profits and market share. Given these options, it is in the best interest of the firms to comply.

The Chinese government has a far wider array of inducement tactics with its interactions with domestic firms. Not only can the government dictate access to the market, but it also controls access to resources and funding. In this case, the government can affect the overall

survivability of the firm. Furthermore, government influence is magnified by the fact that there is an increasing presence of party members in private businesses. These entrepreneurs are inherently different from pure capitalists because they owe their success to the party and because they have been indoctrinated by the party. Therefore, when these entrepreneurs make decisions, they do not just consider the economically optimal solution but also the politically and socially acceptable solution as well.

This thesis does not try to extrapolate future implications, nor does it try to generalize the findings. This thesis only serves to explain why the Chinese government has been able to control information up to this point. Even then, the scope of the paper presented is very limited and more research must be done to study the effects of other factors that can define the degree of control the government can retain over information flow. Furthermore, the viability of government policies must be studied in full. As of now, the self-censorship system is effective because the government can align the interests of the firm with those of the party. In addition, time should be devoted to studying where the government can maintain its incentive structure forever. Currently, the system is highly dependent on the performance of the Chinese economy; however, in order to sustain economic growth and development, the government must introduce financial reforms that would change the structure of the market and probably diminish the role the government has. Furthermore, with respect to multinational corporations, Google's recent decision shows the frictions do exist between MNCs and the Chinese government. MNCs find themselves facing discriminatory practices and unreasonable demands which continuously undermine their ability to post profits or gain market share.<sup>178</sup> If the government continues to uphold such policies,

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<sup>178</sup> Jean-Marc F Blanchard, "China, Multinational Corporations, and Globalization: Beijing and Microsoft Battle Over the Opening of China's Gates,"

eventually, the MNCs will have no incentive to practice self-censorship. In such a case, it is very likely that the control system will fail.



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