Comparative Case Studies of Rent-Seeking in China’s State-Owned Enterprises: the Ministry of Railway and China Mobile

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COMPARATIVE CASE STUDIES OF RENT-SEEKING IN CHINA’S STATE-OWNED ENTERPRISES: THE MINISTRY OF RAILWAY AND CHINA MOBILE

SUBMITTED TO
PROFESSOR MINXIN PEI
AND
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BY
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FOR SENIOR THESIS
FALL 2012
DECEMBER 3, 2012
Acknowledgments

I would like to thank my mother, who has shared conversations with me about China’s political future and the biochemistry field’s problematic bidding process. I would like to thank my father, who convinced me the importance of understanding economics in understanding China today.

I would like to thank my reader Professor Minxin Pei. This thesis would not have been as grounded or analytical without his incisive comments. His eloquent lectures in Comparative Government and Chinese Politics courses informed my academic interest in this topic. I would like to thank Mr. Evan Osnos for shedding light on China’s corruption during my summer internship researching for him. Without his warm encouragement and resources, my research on the high speed railway industry would not have been as thorough.

I would also like to acknowledge journalists working in China who take many risks to document malpractice and expose patronage of powerful institutions, specifically reporters writing for Caixin and Caijing magazines. My thesis would not have been written without the excellent materials and investigative angles provided in their pieces. Their valiant efforts continue to inspire me to research on China’s political economy.

“中国人民大学正门口有一块大石头，上面写着‘实事求是’四个大字，人们说你到人民大学要么往左走要么往右走，因此不是左倾就是右倾，你就不能实事求是，否则就会撞得头破血流。”

—贺卫方
Abstract

The problem of rent-seeking in China’s state-owned enterprises has worsened since the rapid increase in infrastructure investment, such as telecom and railway. State-owned enterprise reform in China has given licensing power to officials and executives without sufficient checks and balances. The Chinese government plans to introduce corporate governance structures and encourage private investment for the previously state-dominated industries, such as the railway industry, in the next decade. Yet these formalities cannot eradicate the political problem of corruption. This thesis will examine rent-seeking through the case studies of China Mobile’s former deputy general manager and Communist Party secretary Zhang Chunjiang’s patronage network in the value-added service industry and the Ministry of Railway’s ex-Minister Liu Zhijun’s patronage networks in the high speed railway project. Both central agents committed collective rent-seeking against the will of the principal through their subsidiaries.
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I. Introduction

“Changing the system,” or gaizhi, is one of China’s main policy initiatives that has targeted restructuring state-owned enterprises since Reform and Opening.¹ Yet gaizhi does not equate to privatization and has created many public-private hybrids, such as joint ventures between state-owned and privately-owned businesses.² The vast majority of the state-owned enterprises (SOEs) that have issued shares on domestic and oversea stock exchanges are classified as non-state firms, but they are still tightly controlled by the state.³ Due to the lack of checks and balances such as independent accounting and legal institutions, profits from gaizhi in China financed rising corruption among Chinese officials and executives. Rent-seekers could reap more profits from the growing flow of value than before gaizhi. In 2011, The People's Bank of China made public a confidential study stating that 800 billion yuan had been siphoned overseas by thousands of government officials and state-owned companies from the mid-1990s to 2008. Furthermore, the state monopolizes imports of foreign technology for high speed rail and other construction projects. Vague intellectual property rights and closed bidding allowed people with administrative power to rent-seek through contracts. Yet corruption can inflate economic growth for building more infrastructure projects, since the Party allocates trillions of dollars in fixed

“Between 1995 and 2001, the number of state-owned and state-controlled enterprises fell by nearly two-thirds, from 1.2 million to 468,000, and the proportion of urban workers employed in the state sector fell by nearly half, from 59 percent to 32 percent.”
² Ibid.
investment through state banks in the form of cheap loans. The books are opaque and subject to manipulation when the state assesses SOE-generated growth. Chinese officials thus can receive both kickbacks from SOE investments and the credit for economic growth generate by such investments.

Under Chairman Jiang Zemin and Premier Zhu Rongji, the 1990s saw a hiatus in SOE reform. Previous literature on corruption exposes tensions between *gaizhi* efforts and government control. Hon Chan argues that the major SOE reforms in 1998 have presented the Party with a difficult trade-off between maintaining political primacy and achieving economic modernization. The *nomenklatura* or ruling elite encapsulates the contradictory desires of the party-state—continuing political control despite efforts for marketization. Guo Yong and Hu Angang further identify Chinese corruption in this era as: administrative monopoly, a unique form that has emerged in the gradual economic reform process in China. They examine in particular the extent of economic loss and the loss of rents in an industrial monopoly. The present thesis is in part an extension of this work.

Ting Gong supplements the Principal-Agent model of corruption in China in his research. He argues that there are multiple agents, SOE officials and executives, all willing to collude to pursue their individual interests while betraying the government.

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their principal. They may commit collective corruption even while rent-seeking for personal benefits. Corruption would no longer be an isolated action, but a network of interactions and exchanges among corrupt individuals.\(^8\) He gives the example of the Minjiang Engineering Bureau of Fujian Province corruption case that implicated 70 percent of its bureau-level officials, including the bureau director and the Party chief. Each of them accepted bribes of at least hundreds of thousands yuan. Between 2001 and 2005, there were 14 major corruption cases in the financial sector, with up to US $1 billion of embezzled funds.\(^9\) Collective corruption cases involve bigger sums of money than individual corruption. Ting Gong identifies a vicious circle: the involvement of more people requires bigger sums to be divided; big sums make it necessary to involve more people. As the sum of money increases, the risk of being caught increases, and the need for protection grows. Collective corruption thus involves the support and protection of officials “above.” A corrupt official can create a safety network against detection by engaging superiors or superiors' superiors in collaboration.\(^10\) Ting Gong also suggests that the participants in collective corruption may form temporary collaborative relationships for specific ventures only. Once a venture is completed, the partnership between rent-seekers may dissolve. Or a new partnership may form once another venture attracts government investment.\(^11\)

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\(^10\) Gong, Ting. "Dangerous collusion: corruption as a collective venture in contemporary China." *Communist and Post-Communist Studies* 35, no. 1 (2002): 85-103. For example, if the bribed individual shares his gifts, either material or monetary, with his boss, thereby making the latter a bribe taker as well, the chance for him to be caught may diminish since the boss, compelled by the need for self-protection, would make an effort to protect him.

\(^11\) Ibid.
This collusion, long-term as well as venture-based, occurs often in the context of SOEs, as further detailed in Chapter II.

The recent high-profile corruption cases of Minister of Railways Liu Zhijun and deputy vice chairman of China Mobile Zhang Chunjiang can help us understand these collaborative relationships. Case studies in this thesis confirm Ting Gong’s theories on corrupt individuals’ need for protection as well as the existence of temporary relationships in the form of joint ventures. Yet a case study of the railway industry and one of its key figures, businesswoman Ding Shumiao, also shows that while the ventures names may change (to avoid public exposure of patronage), the benefactor of the venture can remain the same. When the public scrutinizes a current venture, rent-seekers can still embezzle money by changing the names of ventures.

Economists Wu Jinglian and Huang Shaoqing argue that reform measures have given SOE managers two ways to utilize control rights and rent-seek: first, to transfer benefits out of the national treasury to into their own control or, second, to funnel money through closely-connected, authorized subsidiaries.  

12 The principal, the Party, authorizes the agent, a manager, to run an SOE. The rent-seeking manager creates a subsidiary and delegates full authority to manage the subsidiary and its assets to an associate, who may create another subsidiary. This hierarchy of subsidiaries, known as the “multi-tier legal person system,” is also mentioned by

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The profits would flow into their own small cashboxes (xiaojinku) while the losses would be left for the state to bear. For example, in recent years, state owned securities and futures companies have accumulated billions of non-performing assets for which the government will have to “pay the bill.”
Ting Gong’s research of layers of supervisors. In such structures, the principal, has no effective control over collusion between agents, leading to rent-seeking and loss of public assets. Lu Xiaobo uses the concept of organizational corruption to explain department-based rent-seeking conducted in the name of an official unit equipped with legitimate discretion. This thesis will focus on two main departments as case studies of unit-based rent-seeking. This thesis will build on Wu Jinglian and Huang Shaoqing’s model of agent-subsidiary relationships and Lu’s concept of “department-based” rent-seeking.

This thesis adds a new dimension to the understanding of corruption by suggesting that collusive rent-seeking centers around an individual that holds centralized power in the state-owned enterprise (SOE). The central figure of the SOE, authorized as an agent of the Party, can establish complicit subsidiaries for the purposes of collective corruption. Even though officials within the department commit “organizational corruption,” they rely on their ties with that specific person. The central agent then extends the administrative power to his network of family and friends. This thesis will focus on two recent cases of corruption in the telecommunications and railway industries to show the extent of patronage networks in SOEs. I will discuss examples of networks comprising ex-officials and their subsidiaries in China Mobile Group and the Ministry of Railway (MOR).

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13 Ibid. These tiers could amount to ten tiers or more.
14 Ibid.
Chunjiang networks in the telecom industry in chapter IV, and the Liu Zhijun, Zhang Shuguang and Ding Shumiao networks in the railway industry in chapter V.\(^\text{16}\)

China Mobile Group and the MOR are comparable because the state still controls economic activities of both and uses them to benefit ruling elites. While the MOR, China Mobile and other telecom firms have sold minority stakes to private investors, they operate more or less like government ministries.\(^\text{17}\) Huang argues that although these reform measures copy the superficial forms of a capitalistic market economy, none of them has anything to do with changing the owners of the firms. Rather than transferring corporate control from state to private investors, reform was directed at ensuring the state's holdings of the SOEs.\(^\text{18}\) While some economists might have assumed that legal-person shareholding implies that China has a *keiretsu* arrangement similar to that in Japan where firms own each other's stocks, they are not as privately-owned in China's case. Huang Yasheng clarifies that the difference with Japan is that “in China much of the legal-person share capital originates in the state sector, via SOEs establishing or holding significant equity stakes in other firms. These firms then become affiliates or subsidiaries of the SOEs,” and thus are still SOEs by account of control.\(^\text{19}\) The history of telecom reform in chapter III will show that the "corporatization" of the state-owned telecom assets and the transition from a

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\(^{16}\) One hindrance to this study is limited the number of case studies available. Finances of unlisted state-owned enterprises' assets are not disclosed. One can read conjectures about high-level corruption from sources such as Boxun News and Mingjing News, which are not always reliable. However, researchers and analysts can scrutinize patronage connections when corruption cases emerge. When the Party decides to crack down on a faction, official, or executive, it indicates the loss of political protection. The crackdown serves as a "pass" for serious Chinese media to conduct investigations and publish findings of that faction.


\(^{19}\) Ibid. 16.
monopoly (a single SOE) to an oligopoly (several SOEs) has not altered the nature of state control.

By comparing the two cases in chapter VI, this thesis observes that partial privatization from gaizhi cannot reduce and may exacerbate the presence of rent-seeking in SOEs. Without public disclosure of accounts, external auditing, better anti-monopoly laws, and independent media, gradual privatization will only create more rent-seeking opportunities for the well-connected people. In my case studies, corruption campaigns are informed by people who covet the powerful spots within industries. Informers are motivated out of self-interest rather than creating a better system. The timing of Zhang Chunjiang and Liu Zhijun’s downfall are also part of the 18th Party Congress’s power reshuffle. While much of the explanations for power alignments are speculative, people expect dramatic changes in high leadership before Party congresses. Although much critical political action occurs behind closed doors, the calls for anti-corruption reforms from State Council planning commissions are mere formality. Economic reforms alone thus cannot reduce the ruling elites’ ability to allocate rents to critical economic sectors. Reform measures taken to improve the efficiency of these sectors are compromised by elite interest.\(^{20}\)

II. The Problem of Corruption in State-Owned Enterprises

SOEs have generated much criticism as an inefficient model. About 40 percent of SOEs are still operating at a loss, and there's no evidence that SOEs are good at innovation or efficiency. Relative to the private sector, SOEs consume a large proportion of capital, raw materials and intermediate inputs to produce relatively small shares of gross output and value added. SOEs that monopolize sectors are critiqued for paralyzing China’s technological innovation despite its rich pool of scientific talent. SOEs also fail to profit when adjusted for the many subsidies and benefits received from government policies, such as cheap loans. While private enterprises encountered difficulties in accessing bank loans, SOEs received most bank loans. The tax rate for SOEs stands at 10 percent, while private companies get a tax rate of 24 percent. Many local governments even encouraged local SOEs to dodge their repayment obligations to state-owned commercial banks through various kinds of tricks, such as declaring bankruptcy. The Unirule Institute of Economics, a Chinese think tank, released a study in 2011 of the central SOEs as well as their large provincial and municipal subdivisions. SOEs reported profits of RMB 5.8 trillion (US $920 billion) from 2001 to 2009. After accounting for RMB 7.5 trillion (US $1.19 trillion) in expenses, SOEs reported a loss.

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trillion) in subsidies and costs, Unirule showed that SOEs’ real average return on equity in those years was negative 6.29 percent.\textsuperscript{26}

The Chinese Communist Party supported state-owned firms in old priority sectors while encouraging the development of private enterprises under a trial-by-error exploration scheme in the 1990s.\textsuperscript{27} Since the last SOE reform in 2003, many large state enterprises have been “corporatized.” Some of the biggest, including those directly monitored by the central government, are now listed on stock exchanges with improved governance structure, managerial professionalism, and profitability. But the profitability of state enterprises still remains well below non-state and pure private firms, partly due to the rate of corruption.\textsuperscript{28} Partial reform or \textit{gai\textsuperscript{zh}i} has allowed the politically connected groups to double-dip by taking advantage of both the new opportunities offered by the market and the rents provided by the old unreformed state-planned system. These groups rely on their administrative power to create new monopolies and barriers to trade, resulting in lower output, efficiency losses, and fragmented markets.\textsuperscript{29}

The Party leadership hoped that Chinese SOEs could compete globally with other Fortune 500s. They believed that “corporatizing” SOEs by selling small stakes to the stock markets would not only raise money but also make them more competitive. The

\textsuperscript{28} Ibid.
majority of the shares stayed under government ownership. Some SOEs ventured outside mainland China. In 1997, China Mobile Group turbocharged the process with a dual listing in New York and Hong Kong, raising US $4.2 billion. Yet corruption is a key obstacle limiting the efficiency and innovation of these SOEs down.

In May 2012, Party leaders revived a reform package known as the “Thirty-Six Clauses” that was buried in 2005. James McGregor suggests that the outlines could be “the largest opening for the private economy since Deng Xiaoping launched reforms in 1979.” Included are ideas for allowing private investment in SOEs such as electricity, telecommunications, railway, aviation and oil. October 24th 2012, the Chinese Communist Party vowed to reform state-dominated industries and aid them in market entry again. The government aims to push for large state-owned enterprises to go public or list their main businesses if conditions allow. The Party plans to speed up reforms for the railway industry so that companies in that sector can relinquish their roles as supervisors and stakeholders. The Party plans to encourage companies that are not fit to be listed to hasten restructuring, as well as introduce corporate governance for companies solely held by the state. Guo Shuqing, the chairman of the China Securities Regulatory Commission, even suggested the government to put state-owned assets into the social security system.

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31 Ibid. Kindle Locations 371-381. These clauses are called “三十六条” in Chinese.
32 Ibid. In April, the Ministry of Transport outlined private investment possibilities in transportation infrastructure, services, and related emerging industries
34 Ibid.
The Ministry of Railway (MOR) plans to set up a railway development fund, allowing for private capital to participate in investment through a quasi-stock platform arrangement. Chinese officials believe that this forms a critical section for the undergoing railway “reform.” This move supposedly could help the government meet its objective for increased railway investment and quadruple the length of high speed railway by 2020. Yet without checks and balances, private funds could potentially be channeled elsewhere and used as an off-budget spending source. The ministry is so large that bureaucrats create fictional departments and run up expenses for them. Another example was when US $78 million that had been set aside to compensate people whose homes had been demolished to make way for railroad tracks disappeared.

Support for stock listings originate decades earlier, proponents that include China’s then-leader Deng Xiaoping. He once famously encouraged for SOE stock listing under a banner of “Socialism.”

“Are such things as securities and stocks good, do they cause danger, are they things unique to capitalism, can socialism make use of them? It is permissible to judge, but we must be resolute in having a try. If it proves right, then we put it into

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November 29, 2012).
China's NDRC, approved infrastructure projects valued at 75 billion yuan ($12 billion), in an effort to stabilize China's slowing economic growth. The projects include a city railway in Fuzhou, the capital of Fujian province, a railway between Fuzhou and Pingtan, an island off the coast about 130 kilometers from Fuzhou, and the 2012-2019 city railway planning of Urumqi, the capital of Xinjiang Uyghur autonomous region. China City Railway Transportation Association said by 2015 total investment in China's city railways would amount to 1.2 trillion yuan and 4.3 times the current level of railway length.
38  Ibid.
practice for one or two years, if again it proves right, then we should open it; if it proves wrong, we will correct it and close it.”

This attitude shows that the government retains control over the course of “socialist” stock listings. While specific stock arrangements changed over time, the initial rationale reveals the government’s intention to control. Different forms of private investment, such as public listing or development funds, have not and will not change the fundamental power relations between the government and an SOE or the MOR and a provincial railway branch.

A common misperception suggests that a significant portion of these SOE shares are publicly traded. In reality, the state controls the majority of the shares. This is the case with all the Fortune 500 Chinese SOEs. In my other example, China Mobile Group, only 30 percent of it is publicly listed under the title of its sub-company China Mobile Co. Even if a sub-company is publicly listed, the checks on corruption are not strong. A typical I.P.O. process rarely uncovers the ultimate identity of shareholders, who could hide behind investment vehicles by using unrecognizable names. Opaqueness offers opportunities for rent-seeking agent-subsidiary relationships to form.

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Calls for provincial or subdivision railway companies to act like market players are also unrealistic. China's railway authorities have traditionally relied on centralized management. “Bureaus cannot provide complete transportation services, and they have no means of directly acquiring revenue from the market,” Beijing Jiaotong University Professor Rong Chao said. "They have no full command and control rights on their operations, and cannot be called true companies.”

As long as the government official maintains control over capital, human resources, and other resources such as user rights, the subdivisions or SOEs will not function as market players despite formalities of privatization.

The strategic importance of SOEs will become one major argument against future reforms. The Chinese government justified state ownership despite dismal profit for certain industries because they have strategic importance or have the features of “a natural monopoly.” The government often cites strategic concerns for blocking private or foreign capital investment. Contrary to the hopes of the World Trade Organization, these industries in China increased in 2006, when then-Chairman Hu Jintao and Premier Wen Jiabao issued a directive titled “Guiding Opinion on Promoting the Adjustment of State-Owned Capital and the Reconstruction of State-Owned Enterprises.” The document authorized that SOE dominance would be suitable for “major infrastructure and important mineral resources.” The leading SOEs in 2011 revenue are China Petroleum and Chemical Corp. (or Sinopec), earning

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US $273 billion, State Grid Corp. of China (US $226 billion), Industrial and Commercial Bank of China (US $80 billion), China Mobile Group (US $76 billion), and China Railway Group (US $69 billion). At the end of 2011, China had 117 central SOEs that held assets worth 28 trillion yuan, mainly operating in the energy, telecommunications, transportation and defense industries. The monopoly of these industries gives the government the control of resource, or else shocks to the sector can threaten the regime's hold on power.

More importantly, China’s Communist Party also uses SOEs to provide good jobs for its members. More than five million Party members hold executive positions in state-owned or affiliated firms. Some heads of state-owned enterprise are Central Committee members. While in America there are revolving doors between official and corporate positions, China further eliminates the revolving door and created many opportunities for administrative rent-seeking. Cheng Li argues that state monopoly is the main cause of corruption. Hu Xingdong shares similar fears: “Since the central government announced limits to official expenditures on purchasing cars, a lot of leading officials have in fact asked state-owned enterprises to buy cars for them …

The SOEs have become like private ATM machines for local government officials.”
Furthermore, the government’s 2008 stimulus in reaction to the financial crisis also overflowed unsupervised infrastructure SOEs with cash.

Another nexus for rent-seeking and resistance against control lies within the administrative power granted to China’s major national SOEs by government ministries. Ministries or SOEs, depending on their relative administrative power, often regulate and control many subsidiaries while also benefitting from these regulations. Literature shows that rent-seeking through abusing administrative power was the main source of rampant corruption during China’s transition. For example, by 2007, nearly half of all Chinese provinces had sent their chief of transportation to jail for corruption. The widespread graft phenomenon caused by lack of an independent regulator holds true for the railway industry. 80 percent of all high speed rail projects were awarded to two SOE contractors: China Railway Group and China Railway Construction Corp. Executives at two suppliers of high-speed rail equipment said that until 2011, the MOR used an “expert review” system for choosing contractors. Brokers, often subsidiaries connected to the Minister, paved the way for contracts.

These brokers often perform favors for other sources. As a result, every project is

contracted, subcontracted and subcontracted again for kickbacks. The Beijing-Shanghai high-speed railway was initially estimated at US $1.96 billion. In the end, it cost US $3.4 billion. Cost of the Guangzhou South Station escalated to RMB 14.8 billion from an initial estimate of a couple billion RMB.\(^{56}\) A Fujian Province rail contractor also said that bribes to government officials erase profits.\(^{57}\) Many contractors have to modify their plans over and over. Some even cut back on material’s quality in order to profit.\(^{58}\) In many cases workers hired for the subcontract jobs are cheap and unskilled.\(^{59}\)

Literature shows that rent-seeking through abusing administrative power was the main source of rampant corruption during China’s transition. In 2000, the Central Commission on Discipline Inspection (CCDI) of the Party put forward the notion of “fighting corruption at the roots,” demanding a reduction in administrative licensing and approval.\(^{60}\) Yet the government lacks oversight because too many illicit subcontractors emerge through these arrangements. Further privatization of key industries will create more licensing systems and layers of subsidiaries. Officials and executives continue to place factional interests or rent-seeking interests over increasing SOE market profit. These acts of rent-seeking through distributing licenses

\(^{56}\) Ibid. Kindle Locations 929-940.
\(^{57}\) Ibid. Kindle Locations 929-940.
\(^{58}\) Ibid. The People’s Daily reported that the contractor had cut costs by packing dirt instead of gravel under the tracks. “You are constantly being forced to cut corners, or else you cannot make a profit,” a contractor told the New York Times. “Everyone does this.”
\(^{59}\) Osnos, Evan. “How a High-Speed Rail Disaster Exposed China’s Corruption : The New Yorker.” The New Yorker. http://www.newyorker.com/reporting/2012/10/22/121022fa_fact_osnos#ixzz2DAn1Tiy (accessed November 24, 2012). “In 2010, a rookie welder employed by an illegal subcontractor was working on a dormitory in Shanghai when he dropped his torch and set the building on fire; 58 people died. In November, 2011, a former cook with no engineering experience was found to be building a high-speed railway bridge using a crew of unskilled migrant laborers who substituted crushed stones for cement in the foundation.”
and projects in the infrastructure projects will be further explored in the following chapters.
III. The History of Economic Reform of Telecom State-Owned Enterprises

Telecom had been the classical case of an industry with “natural monopoly” features. The economies of scale theory argued against any potential firms to compete against the monopoly. Many developing countries have or had state-owned telecom industries, including China. One representative from the MPT view is that a state-planned monopoly and central planning could build up basic telecom infrastructure and raise teledensity rapidly for the population. Current literature suggests that telecommunications services begin to contribute significantly to overall economic development when phones are available to 40 or more people per 100. The developmental vision of the Chinese government hopes to make telecommunications service available to residents in rural areas and in the less economically developed regions of central and western China. Cross-subsidization between profitable and unprofitable market segments was regarded as necessary in order to provide universal service to the public. Irene Wu shows that a higher rate for urban users helps cross-subsidize for rural usage.

Still, rent-seeking often occurs in China in the name of development since the Party devotes enormous amounts of investment for development and modernization. A closer examination and evaluation of the history of telecom’s economic path will...

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64 Wu, Irene S. From Iron Fist to Invisible Hand: the Uneven Path of Telecommunications Reform in China. Stanford, Calif.: Stanford University Press, 2009. 100. However, as scholar Huizhong Zhou argues, government adjustments fail to make subsidization transparent and competition neutral. In particular lower revenue prospects in rural areas will make it more difficult for competitive carriers to expand their networks there.
help us understand the political logic of the SOE and possibly benefit future ministry reforms. This chapter will show the consequences of obsolete anti-monopoly laws and regulations, such as the existence of shadow companies and money laundering in the form of stock holdings. This chapter will also explain why the state restricted foreign capital from the telecom industry at first and how foreign capital was introduced despite the regulations. Many telecom SOEs’ actions aim to expand power for inter-jurisdictional power struggles with the State Administration of Radio, Film, and Television rather than increase profits. As a result, telecom carriers engage in mutually destructive practices. Finally, the powerful Organization Department’s role in telecom restructuring shows how the Party continues to dominate the sector through personnel appointments.

China's telecom service sector has been one of the fastest-growing industries since the reform, measured both by the expansion of capacity and growth in revenues. Yet the telecom service sector remains one of the most closed industries in China, with the state-owned firms dominating the market through monopolies or duopolies. Private firms have been banned from providing fixed-line and mobile services. Under Ministry of Post and Telecommunications’ (MPT) monopoly, telecom services were both expensive and low quality. Cross-national comparison of the performance and competition in the telecom service industry indicates that China lagged behind most transition economies and other large developing countries.

66 Ibid. 108.
One reason for explaining China’s lag is the role of the MPT as a captive regulator that suppressed competition. Among ministries under the State Council, the MPT was the only ministry that combined the functions of policy regulation and public telecom service provision. 67 Japan’s telecom operator is also owned by the government and regulated by Japan’s Ministry of Internal Affairs and Communications. 68 “There is little formal separation between regulatory and political decisions and between the interests of the government as operator and overseer of the industry.” 69 Like Japan, China’s telecommunication system also has little separation between the operators and the regulators. MPT’s growing oversight of industrial development planning and its monopoly over the public service market conflicted with the interests other ministries. Dissatisfied with the MPT monopoly, large users and local governments also favored more liberal policy towards public service. 70

Since the 1990s, the government introduced new firms to enter the market by two means: by issuing a license to a new firm or by restructuring an existing operator into several parts. 71 Competition has brought improved interconnection frameworks, more services, and cheaper prices. In turn, telecommunication subscribers increased

69 Ibid. 28. However, in Japan, the customary absence of a revolving door between industry and government, except at the most senior levels of Japanese bureaucracy, does create an informal separation of these interests.
71 This has inspired the restructuring of other SOEs facing insolvency from inefficiency such as Ping An Insurance. “Now, Ping An’s life insurance is in a loss, and property insurance and the trust company have thin margins,” Chairman Ma Mingzhe wrote in the Sept. 29, 1999, letter to then-Premier Wen Jiabao.
rapidly. \textsuperscript{72} However, this process has involved much political pressure and inter-jurisdictional competition.\textsuperscript{73} While the government knew that competition can improve efficiency, it also fears diminished revenues from state enterprises due to competition.\textsuperscript{74} Certain state actors’ especially wished to maintain its control of the telecom sector despite international pressure, namely then-MPT minister Wu Jichuan.\textsuperscript{75}

Government intervention and interest parties bargaining are pervasive.\textsuperscript{76} The Central Organization Department treated the heads of state telecom companies as “apparatchiks” of the Party. The emergence of China Unicom and other new players in the industry was a product of high-level politicking. A political coalition formed by then-Ministry of Electronic Industries, then-Ministry of Electric Power, the Ministry of Railways, and thirteen major state-owned companies conceived the idea for Unicom as early as in 1988.\textsuperscript{77} The State Council finally awarded China United Telecommunications Corporation (Unicom) a basic telecom license in 1993.\textsuperscript{78} Unicom received much opposition from the former MPT minister Wu Jichuan.\textsuperscript{79} Wu welded much power: He regulated the phone system, the cable TV, and the

\textsuperscript{72} Wu, Irene S., \textit{From Iron Fist to Invisible Hand: the Uneven Path of Telecommunications Reform in China.} Stanford, Calif.: Stanford University Press, 2009. 3. Only a few countries in the world, U.S. and Brazil; have been as vigorous as China in divesting incumbent telecom operators
\textsuperscript{74} Ibid. 74. When China refused to cede foreign telecom operators majority control almost caused its World Trade Organization negotiations in 2002 to collapse.

Wu Jichuan once said, “I want not only to strangle Unicom, but also to bury it deep.”
manufacture of computers and phones. The telecom industry moved so fast that Wu made up new regulations by the week. Wu did not want to lose his power from regulating Unicom. He attempted to block its market entry or from gaining competitive advantage. Under his lead, the MPT continued to make policy decisions that favored the Directorate General of Telecommunications, which ran the network.

A similar conflict of interest has occurred between the later government body Minister of Ministry of Information Industry (MII) and other telecom firms: state ownership of firms conflicts with the MII’s interest to promote competition, since it may reduce state firms’ state revenues. The MII served as a “captive regulator,” where it acted in its interest as a major shareholder of the monopoly incumbent China Telecom during the 1990s. MII regulated the market in ways that favor the incumbent and impede competition and telecommunications policy legislation remains weak.

The State Council Informatization Office serves as a weak and small regulator. The antimonopoly law did not exist until August 2008, which remains relatively obsolete.

One example of the obsolete regulations was the rule that prohibited foreign investment to the telecom industry. In order to introduce foreign investment, Chinese firms established China-China-Foreign (“CCF”) structures. A Chinese company was

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81 The Hu-Wen administration possibly foresaw another power struggle from Liu Zhijun if they reformed MOR. Liu Zhijun’s downfall thus preceded any substantial reform of the MOR.
used as an intermediary between SOEs and the foreign company to circumvent the rules. Former president of the China United Telecommunications (Unicom) Zhao Weichen first used the structure in 1998 for obtaining Bell Canada investment. Foreign companies would form a joint venture with a Chinese company. That entity, now a Chinese legal person, would then form a joint venture with a local Unicom branch. The foreign investor would provide telecom equipment, build the network, and teach Unicom how to operate it. In return, the foreign entity would collect a share of the revenue. Around twenty-one foreign investors, including Deustche Telekom, France Telecom, and Sprint, invested around US $1.3 billion in Unicom through their joint ventures in China. Through this method, the MII attracted foreign company’s telecom equipment sales to China and raised money for domestic equipment purchases by maintaining high phone hookup and calling rates.

But in late 1999, the MII accused the joint ventures of reaping profits at the expense of government programs designed to subsidize telephone service in poor and remote regions. Under government pressure, China Unicom unilaterally forced these investors to withdraw their equities at a very low rate of return of investments.

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86 Ibid. 245.
The government resisted ceding profits or management control to foreigners, which also explains its push toward listing companies on foreign stock exchanges to bring in foreign capital without foreign management influence. China Telecom, as the incumbent and former monopoly, particularly wished to maintain its dominance and stop foreign direct investment that would help its competitors. Unless an equity-investment-based foreign competition occurred under a full open market, China Telecom would prefer a growth strategy over a profit strategy to increase its political status. SOEs’ political logic constantly prioritizes inter-jurisdictional power struggle over profit-making.

Since neither telecommunications laws nor anti-corruption laws were in effect, the option for legal resolution of disputes have not been available. The policy clearly leaves entrants at the mercy of the incumbent for access and interconnection and puts the Ministry in charge of determining where and entrant can operate. The first entries into many markets in China in the past were mostly the result of intergovernmental competition. The first entry into the telecommunications market, the foundation of Unicom in 1994, was a result of several years of power struggle between the MPT and a coalition of several government agencies.

Without procedures for resolving disputes, acts of sabotage, patronage, and

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94 Ibid. 70. Other examples include home appliances and electronics, tobacco, cable TV networks, automobiles, and airlines.
95 Ibid. 70. A detailed account can be found in Zhang Yuyan’s “Deregulation: A case Study of the China United Communications Corporation.”
politicking have been rampant within the telecom industry. According to a State Council think tank, state ownership and control encouraged telecom SOEs to “expand investment, seek market power, and increase insiders' income ... these firms have distorted competitive behavior, such as excess debt and price wars.” Disagreements between the incumbent monopoly and entrants have led to vicious practices such as sabotage of rival’s facilities. For example, Gansu Province’s Lanzhou Telecom and Lanzhou Mobile failed to reach an agreement on interconnection in 2000. Lanzhou Telecom chose to block access of mobile phones to its fixed-line network, resulting in disruptions of communications. On August 2nd, 2000, 260 thousand users of mobile phones in Lanzhou City were blocked from access to local fixed line network. Lanzhou Mobile subscribers nationwide couldn’t call through to customers of “Little Smart,” or xiaolingtong, a personal handy-phone system product. Then people calling from their home and office phones in Lanzhou could not get through to friends on the China Mobile system. The interconnection was restored on the evening of August 3rd, and this incident made the headlines of People’s Daily. Similarly, in Suining county of Sichuan Province, Unicom’s communication cable was severed by its rival carrier in 2002. These incidents unsettled then-minister Wu Jichuan who wished to contain competition. From the Party’s perspective, if these conflicts happen on a larger

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96 China Netcom, a joint venture of the Chinese Academy of Sciences, the Shanghai Municipal Government, the State Administration of Radio, Film, and Television, and the Ministry of Railway, had backing from Jiang Mianheng, the eldest son of China's president Jiang Zemin.
97 Li, Zhong, "Woguo dianxin tizhi gaige de huigu yu zhanwang" (A Review and Prospective Look at Reforming China's Telecom System), Jingji yanjiu cankao 43 (2000): 5
100 Ibid. 243.
scale, it could lead to mass social discontent or exposed national security. Some Party members thus use this reason to argue against reforms of SOEs in strategic industries.

Another feature of political control behind private formalities would be frequent top SOE management changes and state restructuring. The Party’s Organization Department decides these changes and implements them within short notice. Concerned that the bosses of the three biggest publicly listed telecom companies became too powerful, the Organization Department reshuffled the top executives in 2004. The third restructuring in the telecom industry in 2008 brought the Zhang Chunjiang from China Netcom to serve as the deputy general manager of China Mobile, whose influence will be discussed in the following case study (See Figure 1). Overnight, China Mobile had become the world’s biggest mobile company in a booming sector. Power was accruing to the companies’ CEOs in a strategic industry with important national security implications. The Party wishes to control SOEs but also produce competitive and efficient SOEs.


105 McGregor, Richard. "The Keeper of the Files." In The Party: the secret world of China's communist rulers. New York, NY: Harper, 2010. 86. “The view was that we have to keep these ones in the box; we are better off running these companies with politicians and not entrepreneurs,” said an adviser to the companies. “The idea was to break emerging centers of power.”
One should not mistake these restructuring with “mergers.” There had been no discussion of telecom operators making decisions on their own based on commercial interests nor have any carriers entered or exited the industry without the backing of the MII and the State Council. Journalist Richard McGregor suggests that the deliberate element of surprise in many of these moves, much as it might enrage executives and investors, serves the Party’s purposes to remind them of their subordinate status. The Party appoints and removes top personnel of ministerial departments as well as state-owned enterprises through the Organization Department, despite introducing the corporate governance for telecom firms. The Party strove to professionalize the selection of top officials, while undermining the process at the same time by fixing appointments in favor of loyalists and relatives.

The Party maintains the illusion that it does not involve in resource allocation decisions. Public announcements of new appointments are made by formal government bodies, such as the State Council, or the State-Owned Assets Supervision

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109 Ibid. 75. Powerful officials presiding over local regions have even established market places in which government positions are bought and sold for huge financial gain.
and Administration Commission (SASAC), the ministries themselves or the parent company.\footnote{Ibid. 86.} In 2003, the government created the SASAC as the official shareholder of the state’s SOE shares and the government body which regulates SOEs. SASAC was designated to be the state shareholder of 196 central SOEs. Local SASACs also would hold the controlling shares of provincial and municipal SOEs.\footnote{McGregor, James. No Ancient Wisdom, No Followers: The Challenges of Chinese Authoritarian Capitalism. Perseus Books Group. 2012. Kindle Edition. Kindle Location 451-462.} On paper, SASAC is the shareholder. In reality, the Party manages important personnel appointments and significant policy decisions.\footnote{Ibid. Kindle Locations 389-394.} The reshuffling announcements are heralded in newspaper headlines as “job changes.” Yet from a party perspective, the officials who move between enterprises or in and out of the government are being shuffled within the same system.\footnote{McGregor, Richard. “The Keeper of the Files.” In The Party: the secret world of China's communist rulers. New York, NY: Harper, 2010. 86.}

Another example would be over the government’s halfhearted efforts to run China Netcom in a more accountable fashion. Then party secretary and general manager of Netcom, Zhang Chunjiang, recruited John Thornton, the former president of Goldman Sachs and McKinsey and Company, the management consultancy, to advise him about how the internal processes should be run.\footnote{Yongqiang, Gu, and Cao Haili. "All the Wrong Signals for China's Fast Trains." Caixin Online News and Analysis on China's Markets, Chinese Businesses and Economics. http://english.caixin.com/2011-09-01/100297517.html (accessed November 24, 2012).} Netcom eventually agreed that the board would approve senior executive appointments. The committee which recommended the appointments to the board had to have a majority of its members appointed by the

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\begin{enumerate}
\item Ibid. 86.
\item Ibid. Kindle Locations 389-394.
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Party. The board’s role in evaluating and appointing was strengthened in theory, but in practice the board only saw candidates authorized and promoted through the party system. The efforts to open up the company’s personnel system that lasted for months ended without much effect.  

The "corporatization" of the state-owned telecom assets and the transition from a monopoly (a single SOE) to an oligopoly (several SOEs) has not altered the nature of state control. The Central Organization Department treated the heads of state companies in China as “apparatchiks” of the Party. The Department shifted them around despite potential commercial conflicts. An anonymous banker suggested, Richard McGregor argues that “The idea that the boards really run companies… does not happen in reality.” Major state companies hold Party meetings regularly before the board meetings. Board meetings discuss operating costs and capital commitments, but personnel remains in the Party’s hands. “No matter how many independent directors there are and what oversight they provide, at the end of the day, if all management are appointed by the Party, nothing will change,” Richard McGregor concludes. The tension between economic reform and political control in the strategically important telecom industry continues to trouble the Party.

Pei Minxin also argues that the underlying dominance and exclusive control by the state over the telecom service sector has hardly changed despite liberalizing

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115 Ibid.
116 McGregor, Richard. "The Keeper of the Files." In The Party: the secret world of China's communist rulers. New York, NY: Harper, 2010. At a time when the executives at state enterprises had been ordered to behave more like entrepreneurs than politicians, it was inevitable a new set of conflicts would rise to the surface. 84.
117 Ibid. 85.
Entrenched interests have succeeded in protecting their rents. The telecom sector is an enormous patronage machine and a source of rent generation because it employs a large number of employees, invests massive capital, and collects monopoly rents. Even the introduction of minority foreign ownership since China’s WTO membership could only change in corporate governance on the margins, but could not lessen state dominance in telecom SOEs. The economic reform history of the telecom industry will enlighten our understanding of the railway industry, which its ministry retains the power and monopoly resembling the unitary ministry of MPT. But before we compare the two, first we shall examine a case study to show the patronage networks prevalent in the “reformed” telecom industry and the limits of gaizhi.

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119 Ibid. 108.
120 Ibid. 109. Overseas listings increase monopoly value of the state's telecom assets, reflected in the share prices of the state-owned telecom firms. "Perversely, this explicit link between capital market valuation and state monopoly becomes another obstacle to reform. Under the pretense of protecting the state's investments, the government can justify its monopoly because stock markets value monopolies." Pei argues.
IV. The Case Study of China Mobile’s Value-Added Services

The China Mobile case studies of officials and executives, Zhang Chunjiang, Li Xiangdong, and Lu Xiangdong, show the extent of rent-seeking in the supposedly reformed but still state-dominated telecom industry. The telecommunication industry has more competition than the railway industry, including price wars, but rent-seeking still exists and centralized state control is rarely absent from market formalities.\textsuperscript{121} Gradual economic reform without political reform leads to more outlets subject to rent-seeking.

In 2009, the party’s anti-graft unit detained the deputy general manager and Communist Party secretary of China Mobile, Zhang Chunjiang, on unspecified corruption allegations. Ironically, Zhang was an official who once heralded as a champion of Chinese-style corporate governance.\textsuperscript{122} After his court hearings in 2009, Zhang was arrested by Hebei provincial authorities. A Hebei intermediate court found Zhang guilty of accepting 7.46 million yuan (US $1.15 million) in bribes from middlemen Song Shicun and Zhang Rui.\textsuperscript{123} Song owned Antong Mobile Satellite Positioning and Communication Company, founded in 1999 with registered capital of 10 million yuan. Antong Co. focused on location-based services, and at one time collaborated with China Unicom and Qualcomm Inc.\textsuperscript{124} Song-Zhang transactions were discovered while Song was seeking to invest in Ultrapower Software Co., a company whose primary client is China Mobile, at a time when

\textsuperscript{121} A cycle in developing countries have been noted in the political study of resources: privatization of monopoly $\rightarrow$ rent-seeking among competitors $\rightarrow$ centralization of control $\rightarrow$ industry suffers stagnation $\rightarrow$ privatization.
\textsuperscript{123} Zhao, Hejuan, and Yongchun Li. "China Mobile Vice President Detained." Caixin. english.caixin.com/2012-03-05/100364079.html (accessed November 23, 2012).
\textsuperscript{124} Ibid.
Ultrapower was preparing to list on China's Growth Enterprise Markets (GEM) trading board.\footnote{Ibid. GEM was launched last year on the Shenzhen stock exchange.} Zhang Chunjiang’s other cronies Zhang Rui, Li Xinze, and Tan Chunling also benefitted from their relationship. These three people’s patronage conenctions allowed them to reach into major value-added services (VAS), as well as consulting, sales representation, and IT services. A two-year long investigation uprooted many of these networks and shook up China Mobile.\footnote{Ning, Yu. “Shutdown for a Gatekeeper of Telecom Gold.” Caixin Online News and Analysis on China's Markets, Chinese Businesses and Economics. http://english.caixin.com/2010-07-30/100165466_2.html (accessed November 30, 2012).} The average revenue per China Mobile user, a key industry barometer to determine the long-term growth rate of telecommunications companies, slid to 71 yuan in 2011 compared with 73 yuan in 2010.\footnote{Mozur, Paul, and Chester Yung. “China Mobile Executive Resigns - WSJ.com.” Business News & Financial News - The Wall Street Journal. http://online.wsj.com/article/SB100014240527023044459804057782703849983864.html (accessed November 25, 2012).} This section will use China Mobile as a case study to explain in-depth the limits to gradual reform.

China Mobile’s value-added services “were an essential driver of total revenue growth,” accounting for 31 percent of operating revenue in 2010, the new chairman of China Mobile Wang Jianzhou said in March 2011.\footnote{Zhao, Hejuan. “Sichuan Mobile Head Put Under Probe.” Caixin. english.caixin.com/2010-06-30/100157088.html (accessed November 24, 2012).} The VAS industry only started less than a decade ago. As the number of mobile subscribers grew rapidly, regulators and telecom operators also had to expand networks on a massive scale. Paying for this growth required investment for equipment and service providers. Foreign telecom equipment manufacturers could find local suppliers eager for contracts. But without Chinese agents who have close ties to telecom executives and officials to smooth the
process, foreigners found themselves caught between regulatory constraints.\textsuperscript{129} Zhang Rui acted as a middleman and signed up numerous telecom equipment and software companies who hired him as a consultant. Authorities say he functioned as a third-party representative by transferring payments from contractors to telecom company insiders. Zhang called the bribes "consulting fees." His brokering activity has been common in the industry, especially when foreign companies are involved.\textsuperscript{130} Zhang Rui also owned a side company that handled computer communication network technology and project integration, but also sold telecom equipment.\textsuperscript{131}

Monternet, the prospective online platform for distributing innovative applications, became the corrupt version of Apple’s App Store under the rent-seeking influence of another agent-subsidiary relationship. The executive director and vice-president of China Mobile, Lu Xiangdong, unveiled the Monternet program in 2000, which attracted participation from numerous Internet and software companies.\textsuperscript{132} China Mobile launched its multimedia messaging service (MMS) in 2002. The MMS provided another huge opportunity for service providers (SPs) as well as rent-seekers. Lu and his subordinate Su Jinsheng, then director general of the Telecommunications Administration Bureau at the MII engaged in graft activity after this launch. Lu oversaw the Beijing-based carrier’s development strategy, planning, construction, and procurement. Lu and Su determined any VAS’s chance at getting

\textsuperscript{129} Ibid.  
\textsuperscript{130} Ibid.  
\textsuperscript{131} Ibid.  
listed, as well as its profitability and share price.\textsuperscript{133} For a long time, Lu and his subordinates managed China Mobile’s value-added services: they set the rules of the game and initiated the controversial Monternet program. Later, they tried to amend the rules (for example, they adjusted their profit-sharing plan and prohibited free WAP), so as to eliminate rampant illegal activities in the multi-billion dollar industry they created, but to no avail.\textsuperscript{134}

At the end of 2011, Su was sentenced to 13 years in prison by Cangzhou Intermediate People’s Court in Hebei Province for accepting nearly 7.12 million yuan in bribes. The majority of the bribes were for assisting several companies in profiting from VAS and telecom engineering projects. Companies that bribed him came from information technology, engineering, and advertising industries. In addition, Su took 200 thousand yuan in exchange for recommending others for promotion. After being sentenced, he did not appeal his case to a higher authority. The investigation case after Su’s downfall showed that he also had connections with providers of VAS.\textsuperscript{135} Lu Xiangdong resigned after the judicial investigation of his financial issues in 2012.\textsuperscript{136}

Zhang Rui and Su Jinsheng shared an element in common: the middlemen tried to steal a slice of pie from the value-added services (VAS). These are often new services, including SPs, content providers (CP), and wireless data service (WDS). The State Council issued regulations that allowed Chinese companies other than the monopoly

\textsuperscript{134} Ibid.
\textsuperscript{135} Ibid.
to provide VAS, such as paging services and music downloading. In contrast, basic services in telecom are more controlled. While these definitions evolve along with changing technologies, current basic services include local and long distance wire line, and mobile phone rates. The state view believes that markets for plural and advanced services should be made open for competition gradually. The government sets tariffs for basic services and places more strategic importance. Due to its constantly-updating nature and lesser political importance, value-added services can obtain licenses from the state for procuring private investment. The official in charge of this growing sector or well-connected middleman can use these licenses to rent-seek. For example, Zhang Rui and his wife’s side companies Beijing Ruizhi and Raynetwork were valuable for holding a telecom business license. Such a license requires approvals from multiple government departments and applications are tightly controlled.

Investing in advertising companies has been another rent-seeking method for telecom middlemen. Some shares of these agencies can be half-owned by a telecom company chief or his family, despite the conflict of interest. Zhang Rui’s agency won a national contract from China Netcom in 2004, the year after Zhang Chunjiang took a job as Netcom's president. Zhang Rui eventually sold the company in 2007 for 7.2 million yuan. Zhang Rui’s “career” path shows a common theme in the Chinese

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139 Ibid. 102.
141 Ibid.
telecom industry. His friendship with Zhang Chunjiang and the participation of his wife are important elements that exemplify the importance of personal networks in collective rent-seeking (See Figure 2).

Figure 2: Patronage Networks in China Mobile

Another feature of VAS rent-seeking is its centralization of power and outsourcing capabilities. The notorious case would be former chief of China Mobile’s Digital Music and Data Department general manager Li Xiangdong’s dealings with

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music VAS. Li Xiangdong studied ringtone technology in Korea in 2003. Then in 2004, he introduced the technology to establish the mobile music base for China Mobile in Chengdu, capital of Sichuan Province. Sichuan Mobile thus became more competitive than other music bases and Li Xiangdong used this opportunity to introduce a Central Platform business plan. Sichuan Mobile’s Mobile Music Product Base started officially in August 2006 and revived China’s dwindling music industry. It basically functioned as an independent department within China Mobile by the end of 2009. Even though Li Xiangdong’s title remained as the manager of Sichuan Mobile Data Department, he worked mostly on the national wireless music service.\textsuperscript{143} Interest grew among officials after they witnessed this moneymaking business and began courting Li Xiangdong.

Initially, big service providers, including China Mobile, provided and managed their services through their provincial branches. Then China Mobile published the “Notice on Starting the Concentration of Wireless music Content Management” in June 2009 that required all ringtones and VAS content to be introduced and distributed by the official 12530.com web portal or the Central Music Platform. Service and content providers who wanted business on China Mobile's network platform had to go through the Sichuan Mobile Data Department and Mobile Music Base.\textsuperscript{144} China Mobile intended to concentrate purchase and management to improve efficiency. But in reality, power and internal resources were increasingly centralized in the hands of


\textsuperscript{144} Ibid.
one man and one bureau, which created the environment for rent-seeking. Li Xiangdong controlled the music application function for 400 million customers of 31 provinces and municipalities.\(^{145}\) He also gave the Central Music Platform the power to collect a percentage of profit from direct sales of each province’s music services, despite the platform’s conflict of interest with the provincial mobile companies. On paper, supposedly, profit allocation differs among service providers and different companies can negotiate the ratio. In reality, Li’s approval is crucial because he is the central agent authorized by the Party. Even though Sichuan Mobile’s Legal Department has to approve each contract with the official stamp of the vice manager, many industry insiders have said that these approvals are merely a formality.\(^{146}\)

Reporter Zhao Hejuan analyzes that despite the competitiveness of the VAS industry, the competition is geared towards having the best relationship with the official rather than better products. An anonymous analyst interviewed by Zhao said, “This kind of business model has the basic characteristic of a monopoly. Any kind of VAS product has to be issued through its (platform).”\(^{147}\) Many friends and relatives of Li Xiangdong benefitted from their relationships. During the decade he served as the head of Sichuan Mobile Data, his friends established shadow companies in Sichuan as well as his hometown Jiangsu. For example, one of the initial investors of Chengdu Yinxin Interactive Info Technology Company, Yu Weizhong, went to university with Li Xiangdong and shared the same hometown. After the company’s establishment in


\(^{146}\) Ibid.

\(^{147}\) Ibid. Yet China Netcom and Unicom also copied this business model before the corruption exposure of Li Xiangdong.
January 2005, it mainly managed telecom VAS and consulting services and had a long history of cooperation with China Mobile’s Data Department. This company started out with three shareholders but eventually, Yu transferred his shares to someone who shared the same home address with him.148 With connections to central figure Li Xiangdong, subsidiary Yu Weizhong could use companies to rent-seek.

In 2001, the Chinese government issued new regulations that put restrictions on trading in listed shares by Party members and their families. The rules prohibited party officials in charge of a state-owned company from using their parents, children, or their children’s spouse’s relatives, to trade stocks of a listed state-owned company.149 Yet Zhao Hejuan finds that these acts still occur within the mobile VAS industry. She thus argues that patronage is present when constant changing in shareholding possession occurs. “At first the shares are dispersed among shareholders, but as the income of VAS increases, the shares are gradually centralized,” she writes.150 This observation also holds true in the case of many privatized industries in China, such as the railway industry, where the lack of regulatory institutions allows for shadow companies and money laundering in the form of stock holdings.

China Mobile’s hierarchical management and ranking system also favored the companies with patronage connections. According to company policy, the more research capabilities and higher profit growth a service provider has, the better its

148 Ibid.
150 Ibid.
ranking of reliability. The SP could be ranked as “A,” “B,” “C,” or “normal.” This ranking system in theory would allocate resources toward high-level service providers, and low-level providers would gradually be eliminated. "But in actuality, the main deciding factor was the relationship level with Li. Whoever had closer relations would get more resources and thus move a step closer to reaching a higher grade." explained Xiang Ligang, a telecom industry veteran.

A China Mobile internal report last year claimed Li had been manipulating service providers for personal gain. Government auditors followed up with a visit to the Sichuan branch in February, and later by meeting with Li. He has since escaped the country. In the Party’s deliberate yet spontaneous fashion of human resource management, positions were quickly replaced through the Organizational Department. Li Xiangdong’s case thus provides us with another example of agent-subsidiary relationship rent-seeking. Case studies of agents Zhang Chunjiang, Li Xiangdong, and Lu Xiangdong fit the aforementioned theories of collective corruption proposed by scholars Ting Gong, Lu Xiaobo, Wu Jinglian, and Huang Shaoqing. With an understanding telecom reforms, one can understand the political logic of rent-seekers in the following section on the railway industry as well.

152 Ibid.
V. The Case Study of the Ministry of Railway’s High Speed Railway Project

Minister of Railways Liu Zhijun was replaced after the ruling Communist Party said he was accused of accepting bribes and under investigation for “severe” disciplinary violations, Xinhua News Agency reported February 25, 2011. Zhang Shuguang was also removed as deputy chief engineer and placed under investigation for alleged “severe violation of discipline.” The downfall of Liu Zhijun and Zhang Shuguang cannot be explained without the context of his ambitious high speed railway project. Liu Zhijun took charge of plans to build 750 miles of high-speed railway in 2003. An earlier reform project died in 2003 with Liu's installment. Under the leadership of Liu, the Ministry of Railways (MOR) argued in favor of the monopoly structure because it can maintain efficiency and safety of the rail network through centralized command and control. Centralized command allowed for Liu and Zhang to act out their entrenched interests in developing the high speed railway and a spectacular patronage network. Dissenters such as Professor Zhao Jian, of Beijing Transportation University, publicly objected to the pace of high-speed-rail construction. He wrote in 2010 that the “blind pursuit” of high-speed rail is “highly likely to develop into a debt crisis.” Liu summoned him and advised him to keep quiet. Even the university president called Zhao to ask him to stop voicing out his

This chapter will explore problematic outcomes of Liu’s centralized power.

Even though Liu and Zhang’s acts of rent-seeking and quashing dissent had been circulating in the media outlets, the tragic high speed train accident that happened near the coastal city Wenzhou, Zhejiang Province on July 23rd, 2011 brought much more scrutiny to their patronage networks and public spending decisions. The LKD2-T1 signal control system sent a mistaken signal, which was read by the automatic control system aboard the fast-moving D301 train, which then rammed the slower D3115 train from behind. The collision killed forty people and injured a hundred and ninety-two. Five months after the accident, authorities released a detailed report that acknowledged “serious design flaws,” a “neglect of safety management,” and problems in bidding and testing. Gerald Ollivier, a senior infrastructure specialist at the World Bank in Beijing, argues that trains in China are still by far one of the safest means of transportation. “We in the U.S. are doing little to nothing and will pay a price in slower growth now and in the future,” Ollivier said. Nicholas Lardy, a senior fellow at the Peterson Institute for International Economics in Washington, also marveled at China’s large spending on railway networks. He argued that the difference between China’s spending and the U.S.’s spending on networks “is a confirmation of

158 Ibid.
160 Ibid.
161 Ibid.
162 Ibid. “If you think about it, the China high-speed railway must be transporting at least four hundred million people per year,” Ollivier said. “How many people have died on the China high-speed railway in the past four years? Forty people. This is the number of people who die in road accidents in China every five or six hours.
China’s rise and an indication of U.S. demise.”\^{163} While economists marvel at the numbers, one should also look at structural causes for the train accident and rampant corruption. Problems such as rent-seeking will not improve or self-correct without regulations. The Chinese government admonished and punished several officials including Liu and Zhang and slowed down the railway’s running speed to placate the public’s anger and concerns without fundamental reforms. This section will explore the bidding process to show how rent-seeking has affected the quality of the high speed railway project.

China has strong reasons for building a high speed railway, such as its vast geographic landscape, and mobile labor force. China has relied on diesel trains for much of its freight transport.\^{164} Coal transportation bottlenecks are another reason for the construction of high speed freight train, because many mines are located in inland provinces, such as Shanxi Province.\^{165} It is no mere coincidence that Liu Zhijun’s major subsidiary, Shanxi businesswoman Ding Shumiao, gained prominence from a background in the coal business. Rising wages and land costs in the coastal provinces that underpinned China’s industrial development for three decades are forcing manufacturers, including Ford Motor Co., Pfizer Inc. and Foxconn Technology Group, to move production inland to cut costs. Inland manufacturing strained China’s ability


to transport goods within the country. Passenger long-distance ground transportation is also extremely strained during festival seasons. The official Xinhua News Agency reported that 83.73 million people traveled by road on a single day during the 2012 Chinese New Year.

To meet this high demand, the MOR received much funding for better train facilities and increased train speed. Like the telecom industry, the MOR also used the China-China-Foreign (CCF) investment structure and increased number of contractors outside of the more traditional manufacturers China North Locomotive and Rolling Stock Industry Corp. (CNR) or China South Locomotive and Rolling Stock Corp. (CSR). While restrictions against foreign companies from directly supplying or manufacturing for high speed railway projects did not exist on paper like the telecom industry, the monopoly interest and underlying restriction was the same. But the supply side of the economic formula depends solely on the monopolies and oligopolies of suppliers with good connections. China’s central-commanding political system can create the momentum for rapid production of infrastructure like high-speed railway systems. Yet systemic problems have

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exposed research, bidding, and building process, as well as the post-construction operation of the trains to corruption. 169

As I have argued before, there are very few inconsistent checks and balances on railway projects approval and railway product quality. 170 The MOR employs 2.5 million people across China and commands a vast budget. 171 Commonly referred to as the *tie laoda* or “Boss Rail,” the MOR has been a historically strong ministry with its own police force, courtroom, and procuratorate, as well as a strict hierarchy. 172 (The separate railway courtroom system has been recently abolished. 173) While China’s top economic planner, the National Department and Reform Committee (NDRC), nominally approves most of the railway projects, the MOR still overruled much of their checks. The NDRC had a special offer policy, when the high speed rail met the nationalization ratio standards, the sales taxes or import custom taxes will have subsidies and rewards for the Ministry. “At the time (Railway people) thought, I don’t want NDRC rewards and therefore I won’t need to bear NDRC control,” an NDRC official suggested. Afterwards, the overseeing State Council filed a notice, requiring the MOR to introduce high speed railway, while the NDRC will “cooperate” with the

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170 Ibid.


173 Wang, Hongliang. “Liu Zhijun and Liu Zhixiang: The Political Profession and Destiny of the Two Brothers.” Lifeweek.com.cn. http://lifeweek.com.cn/2011-03-14/0005331330.shtml (accessed August 20, 2012). “The railway is a relatively closed and special system.” The reporter said. “On the train, they have rituals including wearing uniforms, standing in ordered rows, and salute. When I interviewed the railway system last year I was still very surprised at these [rituals]. They said ‘we use a partially-militarized kind of management,’ with the characteristic of ‘a clear hierarchy between leaders and workers. The orders are absolute, and in a station, the station chief is absolute authority.’”
process. Afterwards, the State Council also established a technological specialist committee, while the MOR started a Motor Unit Project United Office, headed by then Transportation Unit Bureau Chief Zhang Shuguang. The power thus shifted to the MOR, and the NDRC’s role was thus alienated. In the end, to use words by an NRDC official, “(They) didn’t even let us read and approve plans.” The last official check on the MOR diminished as central government’s demand for the high speed railway grew.

The centralized power of the MOR laid ground for corruption in an infrastructure-based industry. Liu Zhijun used the China Railway High-Speed (CRH) project to achieve high-profile political performance and illicit financial gains. A new, record-breaking high speed railway caters to the people’s need for national pride. The MOR decides which company receives bids and which factory gains access to core technology. Before the high speed railway initiative, not many new manufacturers entered the high speed railway through inside relationships. After high speed initiatives were introduced, MOR presented a uniform set of standards for all trains, and gives the bidding power to all the railway bureaus. This railway upgrading process gave a lot of business opportunities for railway suppliers. Many suppliers

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175 Ibid.
177 Ibid.
178 Ibid. When giving a speech on China’s railway industry development in 2009, Liu Zhijun exuded much pride and enthusiasm: “‘The Speed of China,’ speaks not only about our high speed railway’s speed, but also about our economy. Since New China has been established for 60 years, especially after the 30 years of Open and Reform, our country and her railway industry has experienced world-shaking changes.” Yet according to a scientist Zang Qiji, speed-up initiatives pressured scientists and engineers to design train models with unreliable safety indices. Some Chinese scientists called for moderation in railway speed and design, but Liu Zhijun quashed dissent by firing scientists who argued with him.
believe that the uniformity of bidding was good for the standardization of the railway.\textsuperscript{179} The state-owned banking system also allocated financial resources that encouraged the growth-boosting investment in high-speed railways, without evaluating the consequences of corruption.\textsuperscript{180}

But this call for standardization also increased the power of MOR’s Transportation Bureau and fueled patronage. Liu used this momentum and introduced his crony, a businesswoman Ding Shumiao from Shanxi Province. She backed a club “for international diplomats,” to gain foreign contacts. Her lavish receptions drew members of the Politburo. Her significance and ability had been well-known in the industry, and officially acknowledged in August, 2010, when the National Audit Office reviewed the books of a big state-owned company and came upon a US $16-million “commission” to Ding, the intermediary, in return for high speed rail contracts.\textsuperscript{181} Ding was detained in January, 2011, suspected of taking kickbacks worth US $67 million.

Ding’s main company, Broad Union, signed joint ventures and supplied the ministry with train wheels, sound barriers, and more. In two years, Broad Union’s assets grew tenfold, to the equivalent of US $680 million in 2010, according to China’s Xinhua news service.\textsuperscript{182} Zhibo-Lucchini Railway Equipment Co., Ltd., Broad Union’s joint venture with an Italian company, had no experience in


\textsuperscript{182} Ibid.
manufacturing wheel sets. Yet Zhibo-Lucchini won an important bid for wheel sets, despite competition from over traditional wheel set companies like Ma Steel. Ding received 800 million yuan as a commission fee for allotting programs among other manufacturers as well. The same problem of back-handed biddings also affects the quality of cement used for railway tracks. A railcar parts catalog from train manufacturer CSR lists tax-inclusive prices paid by CSR for more than 3000 parts, including countertops and toilet paper holders, installed on bullet trains. These prices far exceed those charged for similar fixtures in China’s market because prices were set not by parts companies with high-level connections at the MOR.

Bidding processes were neither procedural nor organized. In some cases, the bidding period was shortened from five days to thirteen hours. The bids were sometimes mere formality, because construction had already begun or a company won it through a backhand deal. A retired member of the Academy of Railway sciences, Zang Qiji reported that even multinational companies like Siemens would bribe him and other major scientists to gain advantage for the bidding process. Spontaneously modified bidding requirements in the favor of a patron’s company are common, sometimes a day prior to the official bid date. The most dramatic case occurred in

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2010 when the MOR established new bidding conditions for acoustic barrier industry.\(^{189}\) Ostensibly the new register capital and construction experience requirements higher thresholds are intended for better-quality bidders, but actually the requirements limit the pool down to a specific company. Excluded providers understand that backhand dealing happened after repeatedly receiving edited fax notices or internet proclamations about renewed requirements. They express their collective anger against this practice, but their demands for transparency or fair bidding are rarely met.\(^{190}\)

Shanxi Jinhande Environmental Protection Company, another rent-seeking company headed by Ding Shumiao, is a notorious case that shows the extent to which patronage within the bidding process can influence the product quality. Jinhande mostly coveted the opportunity to manufacture for products along the Beijing-Shanghai High Speed Railway line. The Beijing-Shanghai railway project started in April 18th 2008, with a total length of 1318km and 220.9 billion yuan in investment budget. In 2009, Jinhande combined its bid for the Wuhan-Guangzhou, Zhengzhou-Xi’an, Guangzhou-Shenzhen sections that comprised the Beijing-Shanghai high speed railway line with the more authoritative China Railway Electrification Bureau Group. Even though the bidding was conducted by the Ji’nan Engineering Trading Center, a sub-company of Ji’nan Railway Construction Bureau,

\(^{189}\) Wang, Chen. "Jinghu Gaotie Pingzhang Fengbo: Gongcheng Zongtouzi You 23 Yi Fanzhi 52 Yi.” Sohu News. http://business.sohu.com/20110425/n280406671.shtml (accessed November 23, 2012). The acoustic barrier is mainly used for highways, rail transportation and blocks noises and wind. The barrier construction started in August 2008, with a length of 1200km, at 6 sections each, and opened bids twice. An approximate investment of 5 billion yuan was used to attract more than 10 domestic companies for the bidding.

\(^{190}\) Ibid.
the real decision power lied in the MOR. And the bidding rights went to China Railway Electrification Bureau Group and Jinhande. An anonymous specialist of the Railway System believes that some arrangements intended for influencing the bidding result in Jinhande’s favor. He analyzes that combining distant three railway construction projects into one bid was convenient for Jinhande but problematic in terms of logistics. The specialist said, “This is very abnormal, because the railway construction transportation costs should was a very important factor, and these three lines are very far apart, which would not only increase transportation cost, but also increase the management difficulty during the construction.” Jinhande benefits from bidding arrangements despite logistical impracticalities. Given that Jinhande is a relatively small company, how does it manage to produce and install acoustic barriers for so many lines?

Companies that could win the large bid later became illicit brokers when the bid exceeded their production capacity. For example, even though Jinhande won all the bids by its connections and technology, it cannot produce all the orders. So Jinhande would then divide the work amongst other companies, while also pocketing brokerage “management fees” from them. The middleman cuts usually 3 percent to 8 percent of the entire deal for “management fee;” other reports indicate 1 to 6 percent. During the bidding process of the Beijing-Shanghai high speed railway line’s acoustic barriers, the “conquer and divide” phenomenon also occurred. For example, a Jiangsu

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191 Ibid.
192 Ibid.
193 Ibid.
corporation’s product had the label of a Chengdu company. But the contract was signed by a Xuzhou company. Investigations revealed that the Chengdu company that assigned some orders to Xuzhou company, which then transferred it to the Jiangsu company.\textsuperscript{195}

Other contracted firms benefit from being direct subsidiaries of the MOR. The signaling system that caused the tragic Wenzhou train accident was developed and assembled by Beijing-based, state-run China Railway Signal and Communication (CRSC).\textsuperscript{196} It receives government funding and designs, researches, manufactures, and sells its products within the railway system.\textsuperscript{197} One of its foreign partnerships is Nasdaq-listed Hollysys Automation Technologies Ltd. Hollysys is one of the three companies MOR had approved to do such work. Like Zhibo-Lucchini, Hollysys was relatively new to the industry.\textsuperscript{198} Hollysys became a central supplier of the signaling systems, circuits and software and received more than US $100 million in high-speed rail signaling contracts in 2010.\textsuperscript{199} State Council conducted an \textit{ex post facto} investigation on the train crash, but many railway and subway lines continue to operate on Hollysys signal equipment.\textsuperscript{200} Despite the crash and pressure to improve

its systems, investors in CRSC remain confident that the company will continue to dominate the market and will continue to win MOR contracts. In a more competitive environment, Hollysys would have suffered from its ignominy.

Head of Transportation Zhang Shuguang’s wife, Wang Xing, chose a safer path for infrastructure rent-seeking. Zhang obtained real power and enjoyed power to delegate resources after transferring to the Passenger-car Subdivision in 1994 by way of connections. Many spending choices were “all up to a nod of his head,” Zang Qiji, a retired member of the Academy of Railway Sciences said. Wang Xing thus benefitted from Zhang’s rise to power. Since the end of the 1990s, Wang represented major foreign toilet suppliers such as Micropher Rail Corp. to Monogram. Railway toilet supplies include the entire set of materials of collecting human waste in the bathrooms. Compared to other construction materials, toilet infrastructure comprises a relatively small part of the high speed railway industry. Still, there was an annual need for 30 thousand set of toilet equipment, which exceeded 1 billion yuan in market size. According to an insider in mechanics production, this sector does not involve safety issues but it has a huge market, and its low-key status works in the favor of

205 Ibid.
Wang’s delicate position as the wife of Zhang Shuguang.206 “Even though the MOR would send invitations to foreign companies, but eventually Micropher and Monogram would win the bidding at the same time, and take up the largest share of the market,” an anonymous toilet salesperson said.207 Her role is similar to that of VAS telecom middleman Zhang Rui. Both Wang Xing and Zhang Rui facilitated the entries of foreign companies, but only those that curried their favor. They both engaged in malpractice that decided market outcomes.

There are also many similarities between trend of power centralization and bid outsourcing in the railway and the telecom industry. The central government calls for uniform management, which at first seems efficient and necessary. But then the person with the decision-making power gives the large share to his friend and relatives. His friend’s companies then outsource the orders to other companies while they launder the money to their own pockets, sometimes overseas.208 Zhang Shuguang has been a notorious case of a naked official, or luo guan. He bought a US $840,000 house in the Walnut, California in 2003 when he was reportedly earning just US $365 a month.209 Worse, other companies and subsidiaries do not have a sufficient check on quality problems. Regardless of the quality, the high speed railway system was growing so fast that almost everything a supplier produced found a buyer.210 A similarly excessive need for speedy expansion also occurred in the telecom industry, though

206 Ibid.
207 Ibid.
with fewer deadly consequences.

The depressing story of infrastructure rent-seeking does not end when the government crack downs on corruption. The complicated aftermath of corruption investigations especially affects the railway industry, which has long-term construction projects with few insurance policies. Since Liu Zhijun and Zhang Shuguang’s downfall, the government ordered to stop several of these orders or even reverse infrastructure installations. Some products, including wind barriers, were scheduled to be installed on the Beijing-Shanghai high speed railway. After a fax sent by the central government to companies on March 2nd, 2011, titled “About the (Wind) Barriers Processing Installment Notice,” some of the 1.93 meter wind barriers have been cancelled. The order indicated that the installed barriers must be taken down, and the ones that are not installed will not be supplied. A day after the fax, many of the wind boards have been taken down in Tianjin City’s Wuqing District, with only vertical bars standing agape. No one knows who will pay for the costs of taking down the wind barriers.\footnote{Wang, Chen. "Jinghu Gaotie Pingzhang Fengbo: Gongcheng Zongtouzi You 23 Yi Fanzhi 52 Yi." Sohu News. http://business.sohu.com/20110425/n280406671.shtml (accessed November 23, 2012).}

Not only does the lack of checks and balances on the MOR affect the infrastructure quality and effective governance, the project’s financial health also suffers. None of the investment capital of the high speed railway comes from private sources.\footnote{Fang, Yanhong, and Zhigen Du. Liu Zhijun’s Dream of Red Chambers. Hong Kong: Mirror Books, 2011. 406.} The financing of the high speed railway project relies heavily on loans from central banks. The tax system and difficulty of market entry also lessens the

\begin{thebibliography}{9}
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possibility for competition. Due to the lack of checks and balances, the ticket pricing system has been targeted by corrupt officials as well since its implementation in 1995. MOR officials, including former Minister Liu Zhijun’s brother Liu Zhixiang, the head of the railways bureau in the city of Wuhan, profiteered by manipulating ticket prices. Large numbers of tickets end up in the hands of scalpers and ticket prices increased exponentially during times of high demand, such as the holidays. Government investigators found that Liu Zhixiang accumulated the equivalent of US $50 million in cash, real estate, jewelry, and art. In April, 2006, a court in Hubei Province gave Liu Zhixiang a suspended death sentence for hiring people to kill a man who had revealed his corrupt activities. Liu Zhixiang was also convicted of taking bribes and embezzling public funds and property worth more than US $5 million over a nine-year period. The MOR implemented reforms and improved financial accountability for the passenger railway ticketing. Yet customers remain deeply unsatisfied and published many rants about the ticketing system in September 2012. Also, the freight delivery remains as a loophole for railway officials’ price manipulation.

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213 Ibid.
215 Ibid.
219 Identification is required for each railway ticket transaction in China.
The MOR’s unchecked power also actively thwarted the scientific research progress in the subordinate factories. Many Chinese scientists in the Academy of Railway Science hoped to research and develop their own high speed train model.\textsuperscript{222} High speed train model “Star of China” came very close but could not win bidding rights.\textsuperscript{223} Liu Zhijun earned a bad reputation among domestic suppliers and scientists alike for his impatient political ambition. Some called him “Great Leap Liu,” in an allusion to Mao Zedong’s disastrous Great Leap Forward.\textsuperscript{224} Liu Zhijun ignored and even punished dissent from the science experts.\textsuperscript{225} The MOR insisted on importing technology for the assuring “foreign” name, which would guarantee quality from the public’s view. Some people criticized Liu in online forums for impatiently buying Japanese products when he knew that Chinese models could have been developed over a longer period of time. Some commentators called Liu a “traitor,” and labeled the high speed trains as “Shame” in place of the given name “Harmony” (\textit{Hexie Hao}).\textsuperscript{226}

Finally, rent-seeking has exacerbated the already debt-heavy financing of high speed railway. When the first high speed line debuted with a test run in June, 2008, the

\begin{itemize}
  \item \textsuperscript{223} Ibid.
  \item \textsuperscript{225} Wang, Chen, and Yongqiang Gu. "The Illusion of High Speed Railway Nationalization."Caixin Magazine. http://magazine.caixin.com/2012-06-29/100405437.html?p0 (accessed August 20, 2012)."Before the meeting that publically denounced Star of China, Liu once organized a specialist evaluation meeting. According to a specialist at the meeting, the participants were CNR and CSR engineers who participated in the research of Star of Zhongyuan. Liu Zhijun asked them to talk about Star of Zhongyuan’s problems from the title of a manufacturer. At the committee, many engineers spoke under the order, while CSR’s Zhuzhou department’s engineers remained silent. The resistant Zhuzhou department later bore the price for this incident.”
\end{itemize}
project exceeded over the budget by 75 percent.\(^{227}\) The amount of its outstanding bond debts by the end of October 2012 was 622 billion yuan. The ministry's overall liabilities are estimated at over 2 trillion yuan.\(^{228}\) The MOR’s liabilities were equivalent to US $198 billion at the end of 2009, with 38 percent of debt-to-asset ratio.\(^{229}\) The ministry's plan was to have revenue-generating operations come on line before loans come due in 2011. Yet lenders turned soft toward the ministry after Liu's sacking in February, and big banks are no longer offering discounted rates, narrowing the ministry's ability to raise funds.\(^{230}\) Zhang Chunjiang managed to revive Netcom from indebtedness during his time as a general manager, but in order for that type of restructuring, the railway industry would still require a centralized management system. Through bad debts in state-controlled banking systems, Party officials can conceal the information from the public and thus hide their slush funds costs of gradualist reforms of industries.\(^{231}\)

The aftermath of the accident shows the limits on media’s checks on the MOR. The Department of Propaganda ordered editors to give the crash as little attention as possible. “Do not question, do not elaborate,” it warned, on an internal notice. When newspapers came out the next morning, China’s first high-speed train wreck was not


on the front page.\(^{232}\) A day after the accident, the MOR dug a pit and buried the railcars, attempting to destroy evidence. Lawyers in the Zhejiang Province area say that the government-run bar association ordered them not to take on crash cases.\(^{233}\) The media’s coverage on the first anniversary of the Wenzhou accident was also tightly managed. China’s state press was ordered not to visit the scene, and survivors were warned to not speak to media outlets. When a man tried to visit the site that day, he was tailed and videotaped by police.\(^{234}\)

In conclusion, Liu Zhijun and Zhang Shuguang’s centralized power allowed for them to protect and benefit from rent-seeking their subsidiaries, such as Wang Xing, Liu Zhixiang, and Ding Shumiao. The railway’s ticketing, acoustic barrier, wind barrier, and toilet industry have all been entrenched with rent-seeking interests. The science research process has also compromised with central figures’ ambition to finish the high speed railway project. While the existence of high speed transportation will benefit many rural and urban economies, this centralized system has impinged the quality of railway products and customer service. While the government wishes to improve the railway system through economic reform, the lack of checks and balances is crucial factor for the thriving patronage network. Even though the Liu brothers (Liu Zhijun and Liu Zhixiang), Ding, and Zhang have been punished, the story of infrastructure rent-seeking does not end with the seasonal, irregular, and


\(^{234}\) Ibid.
politically-charged anti-corruption campaigns. Despite its bad debt, more state investment will flow into the railway industry in the next decade. Collective rent-seeking will continue without more media independence or effective legal institutions.
VI. Comparing Rent-Seeking and Reform in the Telecom and Railway Industry

Both telecommunications and railways are fundamental public infrastructure that speeds economic growth. They receive much attention from the Party for their strategic importance as well. Yet ready investment and unchecked powers of central decision-makers such as Liu Zhijun and Zhang Chunjiang has led to rent-seeking through agent-subsidiary relationships in both industries. While telecom has decreased the power of its ministry, none of these two industries have succeeded in separating the roles of policy-making and service delivery. The MOR is more integrated and thus more vulnerable to rent-seeking as well as quality issues.

From railway signal systems to toilets to VAS products, these products produced by SOEs or Ministry-affiliates are all subject to quality issues. Given the spectacle of the train crash, the consequences of quality issues caused by rent-seeking are obviously more disastrous for the public psyche. But the reasons for rent-seeking and bad infrastructure quality are similar in nature. The political protection offered by the central agent, such as Liu Zhijun or Zhang Chunjiang, for the subsidiaries allow them to lax on product quality checks. While the agent-subsidiary relationship is an efficient rent-seeking model that allows room for economic growth, too many illicit subsidiaries decrease the possibility for state supervision.

Another shared aspect of telecom and railway subsidiaries lies in their response to state inspection and the downfall of their central agent. After some major figure in the industry is investigated, the “friends” leave the country to escape investigation. Much
of Zhang Shuguang’s assets already were transferred abroad, anticipating state inspection. There have been three bosses of railway toilet supplying companies who have been investigated, and others have been staying outside China for months.\textsuperscript{235} Similarly, those who benefited from their links with Zhang Chunjiang and Zhang Rui also escaped to foreign countries during corruption investigations.\textsuperscript{236} For example, equipment suppliers for Sichuan Mobile left China temporarily after Sichuan Mobile’s executive manager Li Hua was investigated.\textsuperscript{237} After investigating China Mobile in 2010, the Central Commission for Discipline Inspection (CCDI) of the Party sent investigation teams each to China Mobile, China Unicom and China Telecom in 2011. This anti-corruption campaign targeted middle-level managerial staff and above. In order to prevent another escapade, authorities ordered these executives to turn in their passports temporarily.\textsuperscript{238} Manufacturing corporations that had received fat orders through Zhang Shuguang’s patronage network face a double challenge: on the one hand they received no money and thus suffer from a broken capital chain, and on the other hand they are investigated for their dealings with Zhang Shuguang.

Without better anti-monopoly laws, public disclosure of accounts, external auditing, and independent media, anti-corruption campaigns in the telecom and railway industry cannot stop corruption. “They made a show of [crackdowns,] but it’s still the same rules,” an anonymous subcontractor for the railway said. “They caught

\textsuperscript{237} Ibid.
Ding Shumiao, but she’s just one person. There are many, many Ding Shumiaos.”

There will also be many Zhang Ruis and Wang Xings. Corrupt officials would be replaced with new officials tempted by the same rent-seeking opportunity. In fact, the secret informers that reported Liu Zhijun and Zhang Chunjiang’s acts to the Party most likely had ulterior motives. They wish to replace the position with another agent that would choose them as the subsidiary for rent-seeking and become agents themselves. Informers are motivated out of self-interest rather than creating a better system. The timing of then-China Mobile deputy general manager Zhang Chunjiang and then-Minister of Railways Liu Zhijun’s downfall also anticipate the 18th Party Congress’s power reshuffle. While much of the explanations for crucial position changes are speculative, people expect dramatic changes in high leadership before Party congresses. Hence the downfalls of Liu Zhijun and Zhang Chunjiang are shifts in factional power rather than a signal for institutional reform.

The future for railway reform does not look promising. Scholar John Ure once observed that there are conservative and reformist elements in all organizations, such as China’s Ministries and SOEs. Without a strong external challenge, such as “competition from a new entrant, or a strong political directive from the State Council level,” the nature of China’s Ministry-based bureaucracy “is to prolong decision making the name of ‘consensus’ or simply to put things on indefinite hold,” Ure

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He based his observations on the telecom industry that changed over time in response to technological innovations.

Even with an external challenge of the Wenzhou train crash, the MOR decidedly tabled a reform plan. According to a 1991 law, the MOR directly administers and is financially responsible for railway service delivery units, the eighteen regional rail authorities (RRAs). A reform plan suggested for allowing expanded autonomy for MOR regional bureaus, in terms of operational management and finances in 2011. Regional divisions such as the Shanghai Railway Bureau and Beijing Railway Bureau would function in some ways as independent market players. It was shelved suddenly after the Wenzhou accident that triggered a nationwide debate over the wisdom of a high speed train program. Thus, the World Bank consultants’ roadmap for the MOR’s reform (see Figure 3), while plausible, could be easily tabled as well.

![Figure 3: The Three Pillars for Reform](image-url)

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243 Amos, Paul, and Richard Bullock. “Governance and Structure of the Railway Industry: Three Pillars (pdf).” Figure. The World Bank.
Can the MOR and railway industry learn from the path of telecom SOE reform? The cautionary tale of the telecom industry shows that even with multiple providers, destructive sabotage activities, rent-seeking and incidents of unreliable service could still occur. One could easily imagine a rival railway regional bureau refusing to transport customers from another regional bureau in times of price wars. Furthermore, Wu Jichuan backed the telecom monopoly for an extensive period of time. Like Wu Jichuan’s attempt to hold onto control and thwart competition, Liu Zhijun’s influence also remains in the MOR. Zang Qiji recalled that many administrative people are obstructive to his requests since Liu’s downfall. He believes that they are retaliating for Liu’s downfall through informal resistance. Moves to open the MOR for private investments will require more changes to the bureaucracy than just removing leaders.

Suggestions for railway reforms will require further research. We should acknowledge the differences qualities between the industries before providing suggestions. The railway industry has never been as competitive as the telecom industry. The telecom industry has been challenged many times through technological innovation and popular bottom-up products. The nature of telecom technology provides an opening for unauthorized competitors. As Irene Wu summarizes, the emergence of new technologies can destabilize industry structure (See Figure 4). If technology challenges the established balance of power among ministries, government power will slow down innovation. In the case of high speed railway,

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57/Rendered/PDF/662160BR10p1250ailway0Governance0EN.pdf (accessed November 26, 2012).
this graph does not apply because its industry characteristics differ from that of telecom. While people can invent bottom-up solutions for communicating with one another, building a railway system requires much capital and resources that few people could provide on their own.

Figure 4: China’s approach to new Telecom Technology: Challenge, defense, and retrenchment²⁴⁶

Unlike the railway, telecom VAS is a non-rivalrous good, in which the marginal increase of the next person using it will not diminish the resource. Yet in China, given the enormous number of people and resources using the rivalrous good of railway transportation, MOR will require more top-down management, especially because it will have to respond in an orderly manner in times of crises. If China’s railways

²⁴⁶ Ibid. Figure. 10.
actually consisted of five regional companies of roughly equal traffic task, each one would still appear on a list of the ten busiest railway companies in the world.\textsuperscript{247} The MOR can still play a central role in regulating logistics and qualifications for personnel. But then one would ask: what if the MOR still uses its limited role to rent-seek again, as in the telecom case? Telecom officials still gave exclusive licenses to people they personally knew or curried favor to them. The MOR could also give out licenses to well-connected railway companies. In order to prevent further rent-seeking after the MOR increases competition, the Party will need more independent institutions to check and audit SOEs.

This thesis chapter compared the similarities and differences between the telecom and railway state-dominated industries and subsidiaries similar reactions to rent-seeking. The next thesis chapter will discuss the general prospects of SOE reform in the context of rent-seeking.

VII. The Future for State-Owned Enterprise Reforms

The government acknowledges the imperative for eradicating corruption but has had little success. The CCDI issues directives for fighting corruption from its plenary meeting last January 12, 2010. It stressed requirement for party organs at all levels to monitor officials' family asset declaration and the supervision of executives who are running SOEs. The CCDI has made specific regulations to prohibit government officials from, for example, banqueting and sightseeing at public expense, offering or accepting securities as gifts, building private housing with public funds, engaging in business activities, borrowing public money, and using public vehicles for private purposes. The CCDI also encouraged public participation in lodging complaints about corruption via the Internet, though the incentive programs for reporting on corrupt officials remain unclear. The person who risked his marriage to report on Liu Zhixiang had to appeal several times to receive his official compensation of 50 thousand yuan. While rules and regulations against corruption have increased in recent years, they have not been effective. Statistics show that the Party has grown softer on corruption in its punishments. While the Chinese government has expanded considerably over the last decade, the number of officials indicted for various economic crimes number has held relatively steady since 2000. This trend indicates a relative decrease in the real rate of

249 Li, Li. "Weeding Out the Corrupt." Beijing Review. www bjreview com cn nation txt 2010 01 22 content 241647 htm (accessed November 27, 2012). Shi Guangsheng (Vice-Chairman of the NPC Financial and Economic Committee) acknowledged that earlier reforms notwithstanding, the loss of state-owned assets posed serious problems.
prosecution.\textsuperscript{251} Party members “vows to work harder” after every anti-corruption campaign, yet the anti-corruption system does not change and continues to allow top officials to supervise themselves.\textsuperscript{252}

Reform of SOEs will be a hard and costly process because gradual economic reform is dictated by its political logic. The World Bank published the “China 2030: Building a Modern, Harmonious, and Creative High-Income Society,” a joint report with the Development Research Center of China’s State Council. The report suggested that for natural monopolies, the monopolist enterprise should be subject to independent and strict oversight to ensure that the lack of competition does not lead to monopoly pricing and the abuse of market power that could harm downstream industries.\textsuperscript{253} The participation of Chinese government bodies in this report lends it more credibility than other policy recommendations.

Yet China’s ruling elites’ political survival can be threatened by World Bank reforms. Pei Minxin estimates that substantial reforms recommended by the “China 2030” study could threaten five million Party jobs at SOEs and an equal number at government agencies that depend on strong state control of the economy. “World Bank-style reforms would jeopardize probably close to ten million official sinecures,” Pei writes. “There is little doubt that reducing the SOEs’ power would make the Chinese economy far more efficient and dynamic. But it is hard to imagine that a

one-party regime would be willing to destroy its political base.”  

Economic assets serve the political function of retaining patrons within the Party, yet this “loyalty” does not come cheaply. Furthermore, SOE privatization would increase layoffs. In 1995, SOE reforms caused officials to fire between 30 million and 40 million workers.  

With increases in social protests and stability maintenance budgets every year, the Chinese government will not want to increase social unrest by increasing unemployment. The new head of CCDI, Wang Qishan, has an extensive background in finance. Given his knowledge, he may learn the ways corrupt officials try to rent-seek and funnel money out of the country quickly. But potential reform efforts by the Party will most likely be thwarted by entrenched SOE interests, linked together by the rent-seeking groups, such as the ones examined in this thesis.

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VIII. Conclusion

This thesis has shown the limits of economic privatization without political reform in China. Chapter I summarized previous literature on collective rent-seeking and agent-subsidiary and applied these concepts to SOEs. Chapter II illustrated the government’s dilemma between strategic interests and self-preservation through maintaining state control, versus increasing SOE competitiveness through privatization. Chapter III explained the political logic of SOEs by examining the history of telecom reform. Then-minister Wu Jichuan wished to dominate the industry and backed the monopoly for an extensive period of time. Chapter IV and V revealed state-dominated industries’ potential for agent-subsidiary rent-seeking with case studies of China Mobile and the MOR. Chapter VI compared the railway and telecom rent-seeking cases and asked whether or not the MOR could learn from the experience from the MII’s reform. Many risks lie ahead for the gradual reform of the railway industry, which the Party intends to implement in the near future. Chapter VII analyzed the future for general SOE reforms and corruption and suggested some difficulties the “fifth-generation” Party leadership will face.
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