China in the Information Era: Can it Maintain Controls Over the Market Sector, Appease the Globally Connected Social Networking Community and Still Attract Foreign Direct Investment?

By Samantha M. Novick and C. Roe Goddard, Ph.D.
Thunderbird School of Global Management

Abstract:

China has more than 513 million Internet users\(^1\) nearly twice the amount of the United States and representing about a quarter of all Internet users on earth. But the Internet that Chinese users, or “netizens,” access is vastly different from the one that most of the world is familiar with—shrouded in a strict censorship policy called the Golden Shield. This censorship architecture limits freedom of speech and blocks many international web pages, including some of the world’s most popular social networking sites. As a result, a powerful indigenous online environment has developed, protected from foreign competition yet financed with foreign investment. But these innovative homegrown Internet firms and the socially engaged audiences they serve directly threaten the authoritarian government policies that have made them possible. This paper argues that if China wants to continue attracting foreign direct investment in the online sector, it will have to give up its high control over the flow of information.

Keywords: Internet Censorship, Social Networking, Foreign Direct Investment, Political Control, China, Silicon Valley, Information Sharing, Technology, Google, Baidu, Facebook, Renren, Twitter, Sina, Yahoo!, Variable Interest Entity, Initial Public Offering

Introduction

While most of the world is enjoying the freedom of limitless knowledge in the information age, China absolutely is not. It is a paradox of modernity; with 98 percent broadband penetration,\(^2\) quickly sprouting 4G networks and the largest amount of Internet users by country, but with a severely limited sphere of information to access. After all, it is most likely the only country in the world where the actual number of web pages decreases year over year.\(^3\)

The Communist Party of China (CPC) has led China since 1949, and as a one-party authoritarian state, control over the dissemination of information is considered essential for stability. Because the Internet offers multiple ways to connect, share knowledge and broadcast messages, it threatens this monopoly over the dissemination of information. As a result, the government has a heavy hand in Internet functionality in China. Not only is it highly regulated, but it is also

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\(^1\) Gao Qihui “China’s Internet population hits 513 million.” *China Daily*, Jan. 16, 2012. [http://www.chinadaily.com.cn/china/2012-01/16/content_14453469.htm](http://www.chinadaily.com.cn/china/2012-01/16/content_14453469.htm)


policed by an incredibly sophisticated censorship architecture that monitors citizens’ online usage and ensures they only see only what is deemed acceptable.  

So far this censorship combination has worked largely as it should. It has maintained CPC’s authority, and its protectionist side effects have even contributed to investment growth in the indigenous online industry. But fissures are beginning to develop. International investors and global firms that have done business with China in the past are tiring over the unpredictability of an antiquated and fearful government. Younger, more globalized and increasingly socially connected youth are starting to challenge or sidestep government policies. And increasing international pressure are contributing towards a tipping point that will make the country’s “great firewall” too unpopular to uphold.

This paper will first examine China’s unique censorship policy, focusing on motivations and technological attributes specifically in Internet communications. Part II will look at some of the economic effects of those policies, concentrating on international investment in the online sector. The conclusion explores cracks in the system and hypothesizes the future of online censorship and its implications for political and commercial stability.

China Online and the Birth of the Golden Shield

Leninist governments such as China’s CPC thrive on a top-down communication model where the state controls information, and dangerous consequences can occur if this is disrupted. China’s first online censorship policies began swiftly in 1993, when the technology was new to the country and only available to a handful of academic researchers. In January of that year, the Temporary Regulation for the Management of Computer Information Network International Connection was passed, giving the state total control over the development of the Internet. It also set forth strict measures for users, and required that anyone seeking to access the Internet had to register before use and abide by approved policies. The Ministry of Public Security, China’s main body for preventing and investigating criminal activity, was also given the authority to supervise, inspect and prosecute illegal activities online.

The government had been quick to learn from past mistakes. In 1989, Tiananmen Square protesters took hold of a new communications tool- the fax machine- to get around the government and communicate with international media. This technology brought worldwide scrutiny to the student democratic protests and nearly caused the collapse of the CPC. The Internet had the potential to be even more powerful, because it would give individuals access to unfettered knowledge resources and allow them to connect with one another more easily than ever before. Geoffrey Taubman argues it is possibly the best incubator for “ideational
pluralism”--- where multiple sources of ideas, images and news are widely accessible to the public.8

These policies were just the beginning. In 1995 when the Internet became commercially available, further regulations began to target individual users, Internet Service Providers (ISPs), firms that set up webpages and online businesses, and even the owners of Internet cafes. A slippery slope developed; users could be prosecuted if they had been found to use the Internet to spread harmful data against the state, or participate in activities injurious to the security of the computer information network.9 Internet cafes were forced to register with the government, monitor all computer usage, and provide detailed reports on their customers’ online activity.10 Web firms also became liable for the content that was created or shared on their servers, putting another layer of responsibility on the companies themselves. Individuals and firms that do not comply with regulation and engage in political discourse and other banned topics can be prosecuted, fined and have their online rights revoked. Spreading a state secret online could warrant an Internet user the death penalty. Meant encourage netizens to self-policing their activity, China’s Internet regulations constantly shift and evolve to keep up with new technologies.11

The Golden Shield

The Chinese Internet is also heavily monitored and censored, in a project widely known as the “Great Firewall” or “Golden Shield.” Begun in 2003, the Golden Shield uses automated technology to control all gateways between China’s cyberspace and the rest of the world, and block specific content from being accessed. There are two levels of this censorship- one that monitors domestic webpages, and another that monitors foreign content. With regard to level of sophistication and effectiveness, it is considered to be the most advanced Internet censorship apparatus in the world.12

As the overarching goal of China’s censorship policy is to maintain state security, a wide range of political, cultural, economic and foreign data is eligible to deletion. Officially censored topics include anything that could be considered damaging to the state, state entities or personalities, as well as crime, falsehoods or sexually suggestive material. Other subjects that can fall foul of the censors include international news, current affairs and religion. Most times when an Internet user attempts to access a webpage that is being censored, the user will encounter a “404 Error --- page not found,” or “The connection was reset.” Only in rare circumstances does the government make external remarks about its reasoning, usually labeling the censored content “obscene” or

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9 Ibid, pg. 260
10 These rules are strictly enforced; in 2004, more than 47,000 unlicensed Internet cafes were shut down by the government. Michelle Lau, U.S. Department of State, “Internet Development and Information Control in the People’s Republic of China,” November 22, 2005 CRS-4 http://fpc.state.gov/documents/organization/57515.pdf
“subversive.” The government employs more than 30,000 people to watch over and delete web pages, blogs, chat rooms and social networks that discuss offensive content.13

To put this in perspective, Chinese censors purged upwards of 350 million pieces of content in 2010, including web pages, images, photos, commentary and videos, according to Wang Chen, the Chinese Director of Information.14 Similar technology is employed in monitoring mobile communications, such as text messaging and mobile web browsing. At least nine state agencies are responsible for censorship in China: the General Administration of Press and Publication [新闻出版总署], the State Administration of Radio, Film and Television [广播电影电视总局], the Ministry for Information Industry [信息产业部], the State Council Information Office [国务院信息办公室], the Central Propaganda Department [中共中央宣传部], the Ministry of Public Security [公安部], the General Administration for Customs [海关总署], the State Secrecy Bureau [国家保密局], and China’s judiciary system, which prosecutes those who break the rules.15

In order to be successful, Internet firms and media outlets doing business in China quietly self-censor their content. The government even issues patriotism awards each year to companies that are the most effective in removing or censoring damaging content online.16 All firms sign the “Public Pledge on Self-Discipline for the Chinese Internet Industry,” an agreement that makes them liable for anything that is contained or disseminated on their servers. The pledge sets forth principles of self-discipline for the Internet industry, such as patriotism, observance of the law, fairness and trustworthiness.17

But the rules are incredibly murky for foreign online companies trying to compete for a slice of the Chinese audience, of which some of the most popular are blocked. Chinese netizens can’t search freely on Google or read most articles on Wikipedia, The New York Times, or any Wordpress blog. And they can’t join the global conversation on trendy social networking sites such as Facebook and Twitter, or participate in media sharing portals like Flickr or YouTube. Key online conversation platforms, such as Skype are also prohibited. The protectionist restrictions inhibit or completely prevent many U.S. Internet firms from being able to do business in the country, according to Gilbert Kaplan, president of the Committee to Support U.S. Trade Laws and Former Deputy Assistant and Acting Assistant Secretary of the U. S. Department of Commerce. According to Kaplan’s testimony before a joint U.S. congressional-executive commission in 2011:

“China’s blocking and filtering measures, and the fog of uncertainty surrounding what China’s censors will and will not permit, violate numerous of China’s international

obligations. The negative impact of these violations on America’s premier Internet companies is profound.”

It wasn’t always this way. Many of these firms began to experience moderate success in China up until the late 2000s, when the government began to shut off access one at a time. YouTube was the first to go: it was completely blocked by the Chinese in March 2009, with no explanation given. Next, Twitter and Flickr were censored in June, before the 20-year anniversary of the Tiananmen demonstrations. Facebook went dark in July, just after deadly ethnic riots embroiled Muslims and Han Chinese in the far Western province of Xinjiang. Skype was next, when the Chinese government forbade all Internet phone calls except those made over the two state-owned networks, China Unicom and China Telecom. Google + was still in its beta field trial before the Chinese government took hold of it, not blocking it entirely but slowing its transmission in the country so severely that it is impossible to use.

Previously the Chinese government had been notoriously fickle with censoring these types of foreign sites, blocking them for a few weeks or months and then eventually bringing them back online. However by 2009, and without elucidation, the sentiment had changed- they were blocked indefinitely. Motivation for this update gained clarity in July 2010 when the Chinese Academy of Social Sciences, a government think tank, published a report alleging that Western governments could be using Facebook and other social networking sites to "destabilize" China's government and society.

C2C “Copy to China”

The loss of these sites forced Chinese netizens to embrace alternative homegrown online firms to fill the gap. Many of these companies had better government connections and were more willing to adapt to censorship guidelines and changing regulation. Among the most popular sites in China are social networking sites currently are modeled after foreign counterparts, such as Baidu (百度一下, online search), QQ (腾讯首页, instant messaging), Renren (人人网, social profiles and friend building), Youku (优酷-中国第, video sharing) and Sina Weibo (新浪微博, microblogging). Analyzing performance data, a correlation can be seen between the censorship of a foreign site and upward growth or development in a domestic alternative. Key examples include the connections between Google and Baidu, Twitter and Weibo, and Facebook and

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19 “China blocks Skype: other websites the country has blocked,” The Telegraph, 30 December 2010 http://www.telegraph.co.uk/technology/internet/8231459/China-blocks-Skype-other-websites-the-country-has-blocked.html
Renren.

**Google and Baidu.** Google.cn, the Chinese version of Mountain View-based search engine Google, went live on January 27, 2006. The company self-censored the site to meet government rules, however it faced several obstacles, including difficulties with government relations and unexplained outages. By Q4 2009, Google China had managed to capture 35.6 percent of the market, becoming the only real competitor to domestic search firm Baidu, which had 58.4 percent. Things unraveled in December 2009, when Google decided to stop censoring its search results after being hit by cyber-attacks from hackers operating within China. This act caused an about face on the practice of self-censoring the firm’s search results, which executives said went against the firm’s corporate values. David Drummond, Google SVP, Corporate Development and Chief Legal Officer wrote on Google’s blog at the time:

> “These attacks and the surveillance they have uncovered--combined with the attempts over the past year to further limit free speech on the web--have led us to conclude that we should review the feasibility of our business operations in China. We have decided we are no longer willing to continue censoring our results on Google.cn, and so over the next few weeks we will be discussing with the Chinese government the basis on which we could operate an unfiltered search engine within the law, if at all.”

Deciding not to abide by government regulated censorship requirements was the death knell for Google in China. The company eventually shut its censored search platform and most of its China operations a few months later and now redirects users on the mainland to the Hong Kong version of Google. This decision only emboldened Baidu. During the time Google first hinted that it might leave China in January 2010 to the day when it officially left in April, Baidu’s stock price had grown by 80 percent, to a high of $709.87 a share. In Q2 2010, Baidu took up 70 percent of the Chinese search market, a record high that has not fallen.


29 As one of China’s Special Administrative Regions (SARs), Hong Kong has different economic, political and legal rights from mainland China under the “one country, two systems” policy. The Hong Kong version of Google is censored in a different way not by Google itself but by China’s government monitors. Elizabeth M. Lynch, “Google and China: Full of Sound and Fury, Signifying Nothing?” *China Law and Policy*, March 24, 2010 [http://chinalawandpolicy.com/2010/03/24/google-china-full-of-sound-fury-signifying-nothing/](http://chinalawandpolicy.com/2010/03/24/google-china-full-of-sound-fury-signifying-nothing/)


Twitter and Sina Weibo Chinese firm Sina launched Weibo in August 2009; roughly a month after Twitter was censored in the country. It has quickly become a success story—the platform boasts more than 250 million registered users, more than Twitter, and about half of all Internet users in China. It has also picked up celebrity support from actor Tom Cruise and NBA basketball star Jeremy Lin.\(^\text{32}\) Like Twitter, Weibo allows users to post very short messages and multimedia, which can be shared or forwarded on to other members. It is about expression and news dissemination as much as networking, and has become popular through its ability to transfer information quickly and relatively anonymously. Sina took out a billboard in Times Square in 2011 to flaunt that its Weibo platform had grown to 200 million users in half the time it took Twitter.\(^\text{33}\)

According to Hung Huang, a Chinese writer and publisher, Weibo has brought the power of communication back to the people. “Freedom of speech was repressed for so long, Weibo is an...”

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\(^\text{32}\) “China’s microblog user population tops 300 million,” Xinhua, November 21, 2011

\(^\text{33}\) Robert Andrews, “A Free Twitter has Lost in China,” Paid Content UK, September 19, 2011
http://paidcontent.co.uk/article/419-a-free-twitter-has-lost-in-china-to-a-booming-censored-weibo/
outburst.” Twitter has plans to claw its way back into the country, and in January 2012 launched a censored Chinese language version of its platform.

**Fig. 2 NASDAQ Performance Chart, Sina.com (SINA) from April 1, 2009 through January 14, 2010**

Facebook and Renren (Xiaonei) When Renren launched in China in 2005 (then known as Xiaonei - “on campus”) it was already a thinly veiled Facebook clone, attracting the same college-aged audience and featuring an incredibly similar design, colors and features. The service allows users to create individual profiles, add friends and share content. A month after the U.S.-based popular social networking site was censored in China in 2009, Xiaonei launched a radical growth plan and re-branded as Renren, meaning “everybody.”

At the time of its re-branding, Renren had 70 million users, which has risen to more than 137 million users in 2012. It is considered the country’s leading “real name” site, as it complies with regulations that prevent a user from masking his or her identity. Share value performance

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data could not be used in this example because Renren did not go public until 2011. It is important to note that Renren is not the only Facebook clone that is popular in China—other competitors include Tencent’s Pengyou (朋友网) and Kaixin001 (开心网).38

Infrastructure development and future market share

These domestic firms have another advantage over the protectionist benefits of the Golden Shield: a growing consumer base within a huge local market, aided by rising rates of broadband and Wireless Application Protocol (WAP) mobile Internet access. Things were much different a decade ago. In 2000, Internet access was woefully inadequate and hardly befitting a global superpower. Connections were slow, and nationwide penetration was minimal---less than two percent.39 But the Chinese government aggressively pushed policies to support the digital revolution, making it imperative for overall development and essential to compete with savvy neighbors South Korea and Japan.40 By 2011, vast nationwide infrastructure improvements helped boost the number of Internet users by an astonishing 2.055 percent, a higher rate than any other BRIC nation. Despite this, still less than 40 percent of the country’s population has Internet access, making it an industry with enormous growth potential.41 Today it is no wonder that China is one of the most attractive online markets on earth.

To meet demand, Chinese firms have actively courted foreign direct investment to develop Internet technologies, e-commerce enterprises, social networking sites and other online ventures. In 2011, venture capital and private equity firms invested $5.8 billion into Chinese Internet companies, a 124 percent year-over-year increase.42 The growth of homegrown web companies especially has been aided by an influx of cash from Silicon Valley, home to many of the firms which are blocked from China in the first place.43 Silicon Valley institution Sequoia Capital, which put early money into Apple, Cisco Systems and Google, has a $1 billion China Fund that has seeded dozens of Chinese Internet firms.44 Foreign Internet companies are also snapping up their Chinese counterparts when they can afford it; in November 2011 U.S. travel site Expedia.com spent $72.4 million for stake of eLong, a Chinese travel site.45

Initial public offerings are the main way that venture capital and private equity investors exit companies they have invested in, and the number of Chinese Internet firms going public is also on the rise. Between July 1999 and July 2000, many were surprised when IPOs of Chinese Internet firms on NASDAQ raised more than $400 million;46 in 2011, Chinese companies raised

38 Venturebeat profiles: Renren http://venturebeatprofiles.com/company/profile/renren/competitors
44 China Internet Firms Early Seed- Sequoia Capital Current Document http://www.sequoiacap.com/china/internet
$61.5 billion on global stock exchanges. More than 60 percent of all firms that filed for an IPO in 2011 came from China; one was Facebook clone Renren Inc., which completed an $855 million IPO in May.  

Mark Natkin, managing director of Marbridge Consulting in Beijing likens the current investing atmosphere in China’s Internet sector to a ‘gold rush’ or ‘land grab’ mentality. In a recent article with Knowledge at Wharton he explains:

“We consult for a variety of hedge funds and venture capital firms and we are constantly highlighting the various risks involved - which is not meant to deter them from coming into the market, but just to make them aware of what may happen. The potential rewards are just too high. They can't bear not to participate.”

But this seemingly sure bet, which has made investors worldwide delirious on its market potential, may be beginning to sour. Overzealous government censorship and surveillance goals, and growing uncertainty on how foreign investors can invest in Chinese Internet firms going forward are hurting business. The possibility for instability between the public and the government also represents another threat to future investment in the sector. This next section will examine a few of the risks foreign investors will have to weigh when deciding to do business with China’s Internet industry. At the crux of all of these examples is an unyielding state censorship obligation.

**International doubt over the future of China’s Internet VIEs**

The Internet industry, like telecommunications and energy, is a banned sector in China, which restricts foreign investors from outwardly acquiring stakes in or managing individual firms. But web companies such as Sina and Renren have been able to get around this and raise billions of dollars in investment capital by setting up offshore variable interest entities (VIEs). Located in the Cayman Islands or other tax havens, these VIEs can collect assets from foreign investors without problems and channel it back to the main company in China.

The VIE structure is risky from the offset, and does not give the investor many protections. Researcher Fredrik Öqvist found that 42 percent of US-listed Chinese companies are set up as a VIE, and that a majority do not disclose this structure in their annual reports. Dr. Paul Gillis, at the Peking University Guanghua School of Management finds two main concerns with the VIE structure - the Chinese government has the ability to abolish them all, and VIE owners have more

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power to get around shareholders. So far, investors have largely overlooked these considerations because the potential gains appear too great.  

It’s a regulatory loophole that has been quietly tolerated by the Chinese government, but attitudes may be beginning to change. A report issued in July 2011 by the Chinese Academy of Social Sciences (CASS) issued a tough rebuke against foreign investors in China’s Internet, who said these arrangements threaten state sovereignty. According to the report:

“The combination of capital and the Internet is a mighty controlling power. The Internet is a special industry—once it is controlled by foreign capital, the impact could be severe. So far the issue of control has not been given sufficient attention.”

The Chinese Commerce Ministry and other departments are currently researching how to regulate the VIE workaround, which could possibly have an enormous effect on the country’s top Internet firms. According to the CASS report, China’s leading Internet companies are all listed overseas, use the VIE structure and have an aggregate market capitalization of about $160 billion. Professor Roselyn Hsueh argues that this behavior is fitting to China’s “open the door, then close the door” approach to sectors where there is much foreign investment; using market liberalization to gain funding and intelligence, followed by re-regulation to enhance Communist leadership and its power over the flow of information.

The high cost of new regulations: the case of China’s microblogs

China’s censorship needs mean that the Internet is incredibly susceptible to state control, and firms must comply with spontaneous, frequent regulation updates meant to keep the government ahead of the technology. Meeting new mandates usually throws planned business goals out of joint, creates uncertainty and sometimes comes with high costs that can damage a firm’s bottom line. Recently new regulations have targeted China’s enormously popular microblog websites.

There are two main microblogs in China- Tencent Weibo and Sina Weibo. Users sign up with a screen name, and have a profile where they broadcast “weibos” or short statements, pictures, links or other multimedia. Users can subscribe to others’ weibos, and then can forward their messages to others. When juicy news hits Weibo it spreads like wildfire. For this reason the medium has drawn the CPC’s ire- enterprising anonymous Weibo users have organized protests, shared news about government corruption and cover-ups and have even contributed to diplomatic flare-ups. To demonstrate its reach, in February 2012 a single Sina Weibo user with

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52 Paul Gillis, Ph.D., “Are VIEs a going concern?” China Accounting, March 25, 2011 [http://www.chinaaccountingblog.com/weblog/are-vies-a-going-concern.html](http://www.chinaaccountingblog.com/weblog/are-vies-a-going-concern.html) In May 2011 it should be noted that the second part of Gillis’ argument held true in a major way. VIE structured firm Alibaba group spun off Alipay, a profitable online payment division, without sharing this information or profits to major shareholder Yahoo. More about this arrangement can be referenced at Joy Shaw and Lisa Chow, “China VIE structure may hold hidden risks,” Financial Times, November 11, 2011 [http://www.ft.com/intl/cms/s/0a1e4d78-0bf6-11e1-9310-00144feabdc0.html#axzz1q96IJe00](http://www.ft.com/intl/cms/s/0a1e4d78-0bf6-11e1-9310-00144feabdc0.html#axzz1q96IJe00)


less than 200 followers falsely announced the death of North Korean leader Kim Jong Un, which was forwarded more than 10,000 times and made headlines around the world.\(^{56}\)

In order to crack down on free speech and discourage weibo users from spreading harmful information, the government stepped in with new rules mandating that all microblog sites must authenticate individual users.\(^{57}\) From March 16, 2012 onward, all weibo screen names must be attached with an individual’s full real name and identification number. The regulations began in trial form in December 2011 with tests in several Chinese cities. Online firms have struggled to meet the new mandate—it costs about 2 RMB (US$0.20) for an outside provider to independently verify each user, which adds up quickly for firms that each have more than 200 million users each.\(^{58}\)

Chinese netizens have not reacted favorably to the new restrictions, and the strict real name criterion could turn away some users and make the platform less popular. Shuoba, a weibo site launched by Baidu in 2010 was closed in just about a year after it failed to gain traction—many critics blamed the platform’s stringent real name verification requirement.\(^{59}\) After the new universal rules come into effect, anonymous posting will no longer be possible, and users who make political comments risk being caught and disciplined.\(^{60}\) For Sina Weibo’s CEO, Charles Chao, it’s an unenviable position to be in. “We believe the requirement to convert existing users into verified users [...] will have a negative impact on user activity in the short term,” he said during the Sina 2011 Q4 quarterly earnings call, also forecasting lower than expected 2012 Q1 earnings as a result.\(^{61}\) By the March 16 deadline, only 19 million of Sina Weibo’s 250 million had registered for a real name profile.\(^{62}\)

This new regulation is an example of what researcher Elizabeth C. Economy terms of the type of “schizophrenic” behavior the Chinese government has towards censorship- trying to balance the needs of the economy and public with state security.\(^{63}\) If censorship rules like this become too stringent or difficult to implement, eventually this equilibrium will prove untenable and the online firms and their customers will rebel. The multiple state agencies that have a hand in the censorship matrix are the wildcard in this equation, and lack of transparency in their motivations is what could keep foreign investors wary.

Moral concerns with investing in censored China

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\(^{57}\) “China tightens microblog supervision as real-name registration expands to more cities,” *Xinhuanet* (English version) December 22, 2011

\(^{58}\) Steven Millward, “Real Name Checks on Weibo Won’t Come Cheap for Sina, Tencent,” Penn Olson, January 5, 2012

\(^{59}\) “Baidu Sheds ‘Shuoba,” Sina Surges,” Zacks Equity Research, August 12, 2011

\(^{60}\) David Feng, “Chinese Academy of Social Sciences: ‘Real Name’ Weibo isn’t a Viable Solution,” Penn Olson, February 16 2012


\(^{62}\) Malcom Moore, “China moves to control Sina Weibo social network with real names,” *The Telegraph*, March 16, 2012

\(^{63}\) Isabella Bennett, “Media Censorship in China,” The Council on Foreign Relations, March 7, 2011
It is also becoming more unpopular at home for foreign investors to participate in an industry that does not allow its users the freedom of speech that is enjoyed elsewhere. Those that turn a blind eye to China’s aggressive censorship rules in order to business there are “selling their souls,” according T. Kumar, Amnesty International’s advocacy director for the Asia Pacific region. In testimony before the U.S. congressional human rights caucus, he states:

“In the pursuit of new and lucrative markets, these [firms] are contributing to human rights violations. Unless strong action is taken, this type of practice will not only increase, but is likely to move into other areas, which will lead to disastrous impacts on the Chinese people.”

Human Rights Watch has publicized evidence of corporate complicity in Chinese Internet censorship by firms such as Yahoo!, Microsoft and Cisco, creating an enormous public relations headache. Yahoo! specifically has enabled Chinese authorities to imprison dissidents and political activists, while Cisco has been accused of providing surveillance technology. The United States has come out on the record against China’s censorship policies, and this will be a tough stance for any U.S. firm to ignore. As a result, several U.S. firms and investors have started work on a code of conduct for doing business in countries that limit freedom of expression, a new frontier in ethical investing.

A time for possible change

In late February and early March 2012, an unidentified glitch enabled millions of Chinese Internet users to access foreign social networks and web content that is normally forbidden. During a period of about three and a half days, Chinese netizens curiously flooded forbidden sites such as YouTube, Facebook, Twitter and Google+. More terrifying for the CPC, thousands of Chinese flooded U.S. President Barack Obama’s Google+ page with comments, some urging him to fight for greater freedom in China. “Chinese people are suffering, and we are looking forward to your rescue!” user Yuan Liu commented March 1. “A lot of Chinese people [have] gathered here to celebrate that they have the [opportunity] to leave a message for Obama,” user Cico CN posted March 2.

The CPC didn’t lose control of the country when the Internet was uncensored. But as comments on President Obama’s Google+ page show, the Chinese public recognizes the limits on their

64 Speech excerpted in Steve Maich’s “Yes, Master,” Macleans, February 20, 2006 http://www.macleans.ca/business/companies/article.jsp?content=20060220_121814_121814
Internet freedoms. As Chinese netizens become more rights conscious, ⁷⁰ this could eventually become a source of friction between the government and the public. Investors will need to weigh this accordingly.

The next few years will be a crucial time for China. Low economic growth in the West has cooled the country’s export market, and domestic pressures such as economic inequality, environmental problems and isolationist political tactics have put the CPC in fragile standing. ⁷¹ A new generation of political leaders will inherit these concerns when they take power in October 2012- the first leadership change in a decade and only the fourth transition since Mao Zedong seized power in 1949. ⁷² This leadership shift has brought a critical eye to the need for political reform from within the country, and possibly a change to the authoritarian censorship needs of the past. If historical indicators provide any insight toward the future, an era of sociopolitical change in China is likely to occur shortly after the leadership transition. ⁷³

Grave uncertainties over censorship and lack of transparency have already caused many foreign investors to lose faith in the system, and some believe China’s web bubble has already burst. ⁷⁴ But the Internet can be a growth sector and possibly even a strengthening pillar of the economy if restrictions and surveillance are eased. I’ve examined how opaque CPC government censorship policies have created a risky position for investors, despite the tantalizing thought of an untapped large potential market. Going forward, China will need to give netizens and investors more confidence if it is to attract the investment needed for future growth.

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⁷⁰ “Rights consciousness,” is the growing understanding and realization of an individual’s rights and power under the rule of law in a society. It has been argued in China that rising income levels over the past two decades has contributed towards more rights consciousness nationwide, which has also led toward an increase in civil unrest. This phenomenon has been referenced in several reports, but I’d like to reference Mike Monteleone, “Knocking from Within: Contemporary Social Unrest and its Consequences for a Stable China,” The University of Chicago, Spring 2006 http://humanrights.uchicago.edu/Baro/mcmhr1.pdf