



NEWS

Google clash highlights how China does business ; Foreign companies have jumped through China's hoops for years

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BEIJING -- Zhang Nanting enjoys text messaging acquaintances while he's at the Golden Fortune Internet cafe here. Lately, the 28-year-old insurance salesman has been meticulous about keeping his texts squeaky clean.

"I rarely send rude, short messages," says Zhang, citing the government's recent crackdown on pornographic texting. "I think it's excessive management, as I don't know how they judge what is dirty or not."

Zhang, like most Chinese citizens and most multinational companies doing business in China, grudgingly accepts government surveillance and censorship as a way of life. But things may be changing.

Google's recent threat to pull out of China has brought into sharp relief China's longstanding clampdown on personal freedoms and foreign companies' access to its vast consumer market. It has continued these practices even as it revs up the capitalist-style advance of the world's fastest-growing economy.

In China, domestic "stability" is paramount. That means zero tolerance for political dissent at a time when Chinese consumers are being encouraged to embrace technologies that let them communicate and socialize much like their Western counterparts. Similarly, China has invited major tech players, such as Google, Microsoft and Yahoo, to help nurture its economic growth. Yet it imposes censorship and other restrictions and has paid little heed to intellectual-property rights.

Analysts say this is all part of China's drive to develop -- and become the dominant supplier to -- the world's most populous consumer-driven economy, with information technology as a major component. "The government in China is determined to exercise some control over mass media and the Internet," says Harvard law professor Jonathan Zittrain. "The aim is to keep the average Internet user pointed away from controversial content and towards approved content."

Until Google dug its heels in, China Inc. seemed to have all the cards stacked in its favor. On Jan. 11, the search giant issued a statement complaining about invasive cyberattacks and demanding that China back off on censorship of Google's search results. "This is the first time a big company like Google has stood up and said, 'I have had enough of this,'" says Hu Yong, a Beijing-based new-media expert.

China hasn't budged -- and no one expects it to. Doing business in China has never been easy. Foreign-owned companies face a thicket of censorship, trade restrictions and tariffs, says Oded Shenkar, a business management professor at Ohio State University and author of *The Chinese Century*.

What's more -- not unlike many other nations engaged in multinational commerce -- China uses the Internet for industrial spying, says Jody Westby, CEO of consulting firm Global Cyber Risk.

China "lies in a class by itself" in the "scope and scale of its cyberespionage operations," says **Usha Haley**, analyst at the Economic Policy Institute and co-author of *The Chinese Tao of Business*.

Multinational tech companies, in particular, bemoan China's insistence on controlling encryption protocols that companies use to protect sensitive data. It withholds certifications until companies conform, gaining control of the decryption codes for everyone doing business within its borders, says Shenkar.

The sum of this approach: China's economy is roaring. Its Bureau of Statistics reported gross domestic product, the key measure of a nation's growth, rose 10.7% in the fourth quarter and 8.7% overall in 2009. Its banking sector issued \$1.2 trillion in new loans last year. By the end of October, China held \$798.9 billion in U.S. Treasury notes, making the U.S. its biggest borrower.

Yet the growth comes as reforms that arose from the government's 30-year "opening up" campaign are stalling out, says Joerg Wuttke, president of the European Union Chamber of Commerce in China. A September 2009 chamber report recounts a three-year rise in "industrial-policy interventions." It found protectionism woven into standardization policies on products from cellphones to medical equipment, subjective enforcement of environmental rules favoring Chinese firms, and intellectual-property theft becoming a major concern.

In this backdrop, Google's push-back could coalesce a broader shift in sentiment already underway. Many companies sense that access to Chinese markets is actually shrinking, Wuttke says. "The investment atmosphere has shifted," he says. "It's an indication that foreign companies are struggling."

That's because "China doesn't believe in survival of the fittest. It believes in 'survival of whomever we say survives,'" says Anthony Migyanka, an economist and managing partner at Texas-based Mobile Money Minute.

Energizing activists

But China may be reaching the limits to that approach. On Thursday, Secretary of State Hillary Rodham Clinton proposed policies to quell censorship and ingrain freedom of expression on the Internet as a global standard. Clinton called on China to be transparent about responding to Google. She also threw down a gauntlet for U.S. corporations. "Censorship should not be in any way accepted by any company from anywhere," said Clinton. "This needs to be part of our national brand."

The Beijing-based Xinhua News Agency on Friday issued an official response. Chinese Foreign Ministry spokesman Ma Zhaoxu called on the United States to "respect facts and stop unreasonable accusations on China in the name of so-called Internet freedom."

Clinton's speech energized privacy and human rights activists, who've been tilting with Internet censors and hackers in China, Vietnam, Iran, North Korea and Tunisia. Clinton pledged \$15 million to support "Internet freedom" projects, including helping non-profit organizations plot "circumvention strategies."

"New technology demands new thinking about how companies and governments can each work to protect freedom," says Elisa Massimino, CEO of Human Rights First.

China's leaders aren't completely immune to criticism. But for China, nothing counts more than domestic stability, which government leaders achieve by squelching dissent. Go along and you're left alone to consume like a Westerner; resist and pay the consequences.

For the past six months, China has sent a vast region, larger than Alaska, back to the pre-Internet age. Last week, residents of Xinjiang, the nation's Muslim northwest, were permitted to send text messages again. But international telephone calls are limited, and Internet use remains greatly proscribed, after ethnic riots in July.

Such actions remind Chinese citizens who is in control. Underground, in the dimly lit Golden Fortune Internet cafe and pool bar in Beijing's Chongwen District, Zhang must register his ID card before logging on to one of 80 computers. Then he faces the "Great Firewall of China," an array of official censorship tools designed to curb his surfing.

"Of course I wish I could read whatever I want," he says, but he rarely bothers "climbing the wall" to bypass the censor's blocks. "It's too complicated."

Playing along

Historically, tech giants Microsoft, Yahoo and even Google have played along to get along in China. To gain approval to launch google.cn and open a high-rise office in Beijing in 2006, the search giant accepted censorship of search queries and results, such as references to the Tiananmen Square massacre. In a speech to Houston oil executives on Thursday, Microsoft CEO Steve Ballmer said that Microsoft intends to obey China's specific censorship requests just as it follows laws in every country.

Yahoo has done that, too. The portal company infamously forked over data to Chinese officials that in 2004 helped convict journalist Shi Tao for leaking a propaganda directive. Shi was sent to prison for 10 years.

The kowtowing hasn't exactly paid huge dividends. Yahoo sold its China business, also in 2004, to Chinese company Alibaba, giving up day-to-day management of its China operations. Yahoo retained a 39% stake in Alibaba.

Microsoft in 2002 began investing \$750 million to help seed an indigenous Chinese tech sector, including opening a major research- and-development center in Shanghai. But the software giant has no illusions about dominating the Chinese PC software market, says Matt Rosoff, tech industry analyst at Directions on Microsoft. Windows PCs already are widely used in China, but 90% run pirated copies of Windows, says Rosoff.

Microsoft figures investing in the maturation of the Chinese tech industry will help drive down the piracy rate. Over time, Microsoft hopes, millions of Chinese will begin paying for their copy of Windows, Rosoff says.

For its part, Google has quickly become a mainstay with young professionals. It has a 20% share of the Chinese search market compared with search leader Baidu's 70%, according to China IntelliConsulting.

Chinese tech firms, such as Baidu, "are extremely scrappy," says Kaiser Kuo, a Beijing-based tech consultant. "They've managed to get the notoriously frugal Chinese consumer to part with money."

Whether Google leaves China or stays remains to be seen. "The environment in which we are operating in terms of an open Internet is not improving in China," says David Drummond, Google's chief legal officer. "We're no longer comfortable censoring our search results in China, and we are reviewing the feasibility of our operations there."

Noting Google's respect for the Chinese people, Drummond said it will keep a Chinese-language option on its global service if it shuts down google.cn.

Meanwhile, James McGregor, a Beijing-based consultant at APCO Worldwide, says complaints about mounting restrictions -- he describes it as a lot of "little things at every level ... by every ministry" -- are reaching a crescendo. He says there is a high level of "clandestine support" for Google in the multinational business community. Google's protest "has the possibility of stirring up a lot of people here who depend on Google and don't want to lose it," says McGregor.

Much could be riding on the resolution. Will Western values factor in or will China's tactics prevail? "The 21st century is about whether and where a converging balance will be found. Google is just the beginning," says international lawyer Jeanne-Marie Gescher.

MacLeod reported from Beijing, Chu from Hong Kong and Acohido from Seattle. Contributing: Jon Swartz in San Francisco

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