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## Soldiers of Fortune:

*The Rise and the Fall of the Chinese Military-Business Complex, 1978–1999*

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## **Soldiers of Fortune: The Rise and Fall of the Chinese Military-Business Complex, 1978-1999**

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### **Introduction**

Between 1978 and 1998, the Chinese People's Liberation Army (PLA) underwent a dramatic transformation. Faced with the contradictory forces of a declining military budget and pressures to modernize at the end of the Maoist era, the army reluctantly agreed to join the Chinese economic reform drive. It converted and expanded its existing internal military economy to market-oriented civilian production, in the hope that the resulting profits could replace lost expenditures and help to finance the long-needed modernization of weaponry and forces. Over the course of twenty years, the PLA became one of the most important actors in the Chinese economy, controlling a multi-billion dollar international business empire that ran the gamut from large farms to world-class hotels and transnational corporations. This amalgam of military and commercial interests resulted in an entirely new organizational form for a Leninist system, the military-business complex.<sup>1</sup>

Until now, this subject has not received serious scholarly attention. Previous examinations have been primarily journalistic in nature, providing telling anecdotes but not examining the subject in a comprehensive, analytical, or conceptually-grounded fashion. Given the importance of the PLA to post-Deng Xiaoping domestic politics in China and its role as one of the most important security actors in the Asia-Pacific region, these dramatic changes deserve serious examination. Informed by thousands of pages of newly available internal military (*junnei*) primary source material, a decade of issues of the theoretical journal of the Military Economics Institute in Wuhan and the author's own detailed database of 1000 PLA enterprises, this study attempts to understand and explain this new organizational development. To this end, the tasks of this study are to:

- Examine the historical antecedents of the Chinese military-business complex, especially the imperial, pre-1949 and Maoist periods, focusing on the similarities and differences between these earlier systems and the current system.
- Identify the circumstances, political constraints, key players, and critical decisions involved in the decision to expand the PLA's role in the post-Mao economy, as well as the course of its development over the last 20 years.
- Analyze the evolution of structure and process in the Chinese military-business complex, focusing specifically on changes in hierarchy, regulation, and decision-making procedures.
- Explore the potential and actual consequences of increased military participation in the economy, analyzing the various organizational, legal, financial, normative and coercive countermeasures undertaken by the political and military leaderships to mitigate the

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<sup>1</sup> The exact origins of the term military-business complex are unknown, but like "PLA, Inc.," it has become a staple of journalistic reportage on the subject.

observed and putative negative effects, such as the increased incidence of military corruption.

- Assess the origins and relative success of the divestiture of the Chinese military economy initiated in July 1998.

To deal with each of these issues, this study is divided into five sections: Historical Antecedents (1929-78), Origins (1978-98), Structure and Process, Consequences, and Divestiture (1998).

## **Historical Antecedents**

Militaries throughout history have, to varying degrees, been forced to feed and arm themselves.<sup>2</sup> In pre-modern societies, individual warriors or soldiers were responsible for supplying their own armor and weapons, and in fact socio-economic status was one of the most important determinants of warrior status.<sup>3</sup> In the field, the lack of an effective supply system often led to pillaging and looting of the surrounding battlefield, living off the land regardless of whether it was enemy or friendly territory. Only the modern nation-state has sought to provide complete financial support for the military, largely to buttress corresponding notions of apolitical civil-military relations.<sup>4</sup> In only a few Western nations, such as United States, has the goal of complete financing been fully realized. In many other cases, militaries are funded by a combination of central fiscal contributions and internal military production and commerce. Notable examples of historical militaries that were heavily involved in economic production include the Byzantine “theme armies,” Elizabethan privateering/joint stock companies, and Russian military settlements.<sup>5</sup>

Similarly, militaries in imperial China were expected to be partially, if not fully, self-supporting.<sup>6</sup> In fact, it was quite unusual for the military to receive full fiscal support from

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<sup>2</sup> This discussion of pre-modern and modern logistics is drawn from Martin van Creveld, *Supplying War: Logistics from Wallenstein to Patton*, (Cambridge: Cambridge University Press, 1977); and John A. Lynn, ed., *Feeding Mars: Logistics in Western Warfare from the Middle Ages to the Present*, (Boulder, CO: Westview Press, 1993).

<sup>3</sup> See Richard Preston, Alex Roland, and Sydney Wise, *Men In Arms: A History of Warfare and its Interrelationships With Western Society*, (Fort Worth: Holt, Rinehart, and Winston, Inc., 1991), p.16.

<sup>4</sup> The relationship between civilian allocation of defense budget funds and civilian control of the military is discussed in Samuel Huntington, *The Soldier and the State: The Theory and Politics of Civil-Military Relations*, (Cambridge, MA: The Belknap Press of Harvard University Press, 1957), p.15. For a summary of Weber's views on the subject, see Stanislav Andreski, *Military Organization and Society*, (Berkeley: University of California Press, 1968), pp.85-88.

<sup>5</sup> Information on the Byzantine themata can be found in John Haldon, *State, Army, and Society in Byzantium: Approaches to Military, Social and Administrative History, 6th-12th Centuries*, (Hampshire, England: Variorum, 1995). For information about the Russian military settlements, see John L.H. Keep, *Soldiers of the Tsar: Army and Society in Russia, 1462-1874*, (Oxford: Clarendon Press, 1985), pp.275-295; Richard Pipes, “The Russian Military Colonies, 1810-31”, *Journal of Modern History* 22 (1950), pp.205-19; and Alan D. Ferguson, “The Russian Military Settlements, 1825-66”, in Alan D. Ferguson and Alfred Levin, eds., *Essays in Russian History: A Collection Dedicated to G. Vernadsky* (Hamden, Connecticut: Archon Books, 1964), pp.109-28. For analysis of Elizabethan privateering, see Kenneth Andrews, “Elizabethan Privateering: The Harte Lecture 1985”, in Joyce Youings, ed., *Raleigh in Exeter 1985: Privateering and Colonization in the Reign of Elizabeth I*, Exeter Studies in History 10, (Exeter: University of Exeter, 1985), pp.5-6; and Kenneth Andrews, *Elizabethan Privateering: English Privateering During the Spanish Civil War, 1585-1603*, (Cambridge: Cambridge University Press, 1964), p.10.

<sup>6</sup> Ch'i Ch'ing-hsiao, *The Military Establishment of the Yuan Dynasty*, (Cambridge, MA: Harvard University Press, 1978), pp.3-11.

the government, and this state financing often resulted in economic disaster for the state, primarily due to the inability of the imperial system to consistently extract revenues from the populace. For example, a reigning emperor of the Northern Sung blamed the impoverishment of his country on the enormous amount of state funds required to support his largely mercenary army, which approached 80% of central revenue in the 1060s.<sup>7</sup>

Dynasties responded to this resource problem by adopting one of two self-sufficiency policies for military support. The first, which draws inspiration from the writings of Legalist philosophers, placed the burden of production for military consumption on the backs of the civilian populace. The Legalists, particularly Lord Shang (255-206BC), proposed an authoritarian state organized for military conquest, and agricultural production controlled by the military to support that conquest.<sup>8</sup> To Shang, an effective merger of military and production functions guaranteed national supremacy. Shang's theory of the economic role of the military was first applied during the Qin Dynasty (221-209BC).<sup>9</sup> From the beginning, the economy of the Qin was basically a military economy, based on Legalist principles. In the early years, Emperor Qinshihuangdi placed great emphasis on agriculture, taxing two-thirds of output for military use. These policies were repeated in a more elaborate fashion during the Sui-Tang period (589-907AD), when the central government distributed land to peasants under the "equal-field" system. In return, the peasants were required not only to serve in the armed forces, but also equip themselves from the profits generated by their own agricultural production.

The second and more common self-sufficiency policy used by imperial dynasties to fund the armed forces called for the military itself to engage in production to supplement governmental expenditures. The most advanced version of this policy was the *tuntian*, or "military habitation", system, which first appeared during the Han Dynasty (202BC-220AD), and served as the dominant paradigm for Chinese imperial military economics for almost two millennia. It was particularly important during the Yuan (1279-1368), Ming (1368-1644), and Qing (1644-1911) periods, though it reached its most advanced form during the Ming.<sup>10</sup> As in the Yuan, the military under the Ming had a dedicated farming role in the areas under its control. At the beginning of the dynasty, these areas did not include co-located peasant lands, since the military was not allowed to confiscate land for farming. Instead, units were only allowed to develop allocated government-owned land and wilderness (*huang*) in the northern sections of the country, which totaled nearly 620,000 *qing*, or 41.3 million hectares. On this land, total output was supposed to be given to the government, but over time the military was able to negotiate a more equitable bargain, retaining at least 50% of the output. Later, the government share was reduced even further

<sup>7</sup> Ibid., p.7.

<sup>8</sup> For more on Lord Shang's views on agriculture and war, see *The Book of Lord Shang*, translated by J.J.L. Duyvendak, (London: Arthur Probsthain, 1928); and "Lord Shang and Han Fei Tzu" in Hsiao Kung-ch'üan, ed., *History of Chinese Political Thought*, (Princeton: Princeton University Press, 1979), pp.368-424.

<sup>9</sup> The following discussion of Qin Dynasty military economics is taken from Cao Zhiying, "Cong junshi jingji de jiaodu kan Qin Wang de xing? [The rise and fall of the Qin Dynasty: a military economic review]", *Junshi jingji yanjiu* [Military Economic Studies], No.4 (1996), pp.75-80.

<sup>10</sup> This discussion of the *tuntian* system during the Ming is drawn largely from Fu Wanlu, "Mingdai juntun zhidu yange [Evolution of garrison troops engaging in agricultural production in the Ming Dynasty]," *Junshi jingji yanjiu*, No.4 (1996), pp.87-88; and "Mingchao de junshi jingji" [Ming Dynasty military economics], in *Zhongguo junshi jingjishi* [Chinese military economic history], (Beijing: Jiefangjun chubanshe, 1991), pp.312-377.

to 25%, due to the increasing needs of the military and their relatively advantageous political position vis-a-vis the government under wartime conditions.

Together, this record of Chinese imperial military economics suggests that the PLA's enterprise system has deep historical roots. Indeed, one scholar has persuasively shown that the imperial systems were an explicit model used by Mao and the Communist leadership to implement the PLA's enterprise system.<sup>11</sup> This was especially true of production activities carried out by Wang Zhen and the 359<sup>th</sup> Brigade in the Yan'an base area in the late 1930s and early 1940s, which are still held up for emulation by the current Chinese military leadership. Similarly, the campaigns to expand military production during the Great Leap Forward and the Cultural Revolution reveal many links to the past, especially the integration of military units and an internal agricultural system.

Like the imperial system, the primary motivation for the development of PLA's military economy before 1978 was self-sufficiency, necessitated by the sometimes dire economic circumstance of the Communist forces. During the guerrilla period, Red Army self-sufficiency was a key factor in the survival of the Communist movement, especially during the precarious years of the Fifth Encirclement, the Long March, and the base area at Yan'an.<sup>12</sup> During the Maoist era, the PLA's dependence on military production remained, especially during the difficult economic periods of the Great Leap Forward and Cultural Revolution.<sup>13</sup>

A secondary motivating factor for PLA production was the Party's desire to hold up the military as an object of political and ideological emulation. During the pre-Liberation period, for example, the Red Army was well-known for helping the peasantry bring in the harvest, and this reputation helped differentiate the Communist forces from their looting counterparts in the KMT army.<sup>14</sup> Likewise, the active participation of the PLA in production during mass campaigns like the Great Leap Forward positioned the military as an ideological vanguard and its soldiers as model workers.<sup>15</sup> At the same time, this political use of the PLA as an economic vanguard appeared to oscillate significantly with the CCP's cycles of mobilization and consolidation. Specifically, economic difficulty in the civilian realm often led to a temporary mobilizational surges of the PLA's production activities. The most important mobilizational periods were the Great Leap Forward and the Cultural Revolution.

After the Cultural Revolution, however, the PLA's nascent military economic capability lay dormant, as the nation recovered from the "ten years of chaos". The rise of Deng Xiaoping and the rehabilitated cadres, however, signaled a new, reformist era for the

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<sup>11</sup> Although he clearly labels as "simplistic" the notion that PLA enterprises are simply a continuation of traditional Chinese military organization, Thomas Bickford suggests that the imperial military economics model served as sources of ideas for the CCP leadership, which they consciously drew upon and adapted to the needs of the Red Army in the guerrilla period. See Thomas Bickford, "March of the Entrepreneurs: Military-Owned Enterprises and the Marketization of the Chinese Economy," (unpublished paper presented at the 1998 National Association for Asian Studies conference, 26-29 March 1998, Washington, DC), p.4.

<sup>12</sup> See David Bernard Bobrow, "The Political and Economic Role of the Military in the Chinese Communist Movement, 1927-1959," Ph.D. dissertation, Massachusetts Institute of Technology, 1962, especially vol.I.

<sup>13</sup> Ibid., vol.II.

<sup>14</sup> Peter Williams Donovan, "The Red Army in Kiangsi, 1931-34" (unpublished manuscript), p.38.

<sup>15</sup> Jonathan Adelman, *The Revolutionary Armies: The Historical Development of the Soviet and Chinese People's Liberation Armies*, (Westport, CT: Greenwood Press, 1980), pp.168-69.

Communist regime and its military organizations, one in which the patterns of past military production and the ethos of marketization would be combined in a volatile new mixture.

### Origins of PLA, Inc. (1978-98)

To understand the commercialization of the PLA after 1978, it is first necessary to understand the fiscal relationship between the state and military. To begin with, there is strong evidence to suggest that the PLA during the Maoist era enjoyed virtually unlimited access to funds from the national budget. According to Jonathan Pollack, “few within the leadership ever challenged the army’s entitlements”, and, as a consequence, “the army grew by accretion and inertia.”<sup>16</sup> The best example of the high budgetary priority placed on defense during this period was the Third Front industrialization campaign of the early 1960s, which was personally directed by Deng Xiaoping.<sup>17</sup> Predicated on Mao Zedong’s fear of foreign invasion, one-fourth of the entire national defense-industrial complex was rebuilt in the mountainous regions of ten provinces. Chinese officials estimate that the financial costs of these enterprises was RMB200 billion over a twenty year period ending in 1984, equivalent to two-thirds of the defense budget over the same period.<sup>18</sup>

For Deng Xiaoping and the reformers in the late 1970s, however, the stagnation of the Chinese economy from the Great Leap Forward (1958-61) through the Cultural Revolution (1966-76) meant that the civilian government could not meet the budgetary needs of the PLA and provide the large capital investments necessary for an ambitious and costly program of post-Mao economic reforms.<sup>19</sup> At a 12 March 1980 enlarged meeting of the Standing Committee of the Central Military Commission, Deng Xiaoping drew a direct link between reducing the defense budget and strengthening economic reform, stating:

...our current military expenditures are rather high, to the detriment of national construction...During this time, we should try our best to cut down military spending so as to strengthen national construction. In short, it is necessary to reduce “bloatedness” [in the army] if we want to carry out the Four Modernizations [industry, agriculture, national defense, and science and technology]...<sup>20</sup>

Soon afterwards, appropriations for other parts of the state budget, including the defense budget, were slashed to pay for increased investment in civilian economic projects. Between 1979 and 1981, the military budget was cut by more than 24%.

While the military was told that its defense budgets would eventually increase as China's economy became more developed, additional short-term measures were taken to

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<sup>16</sup> Jonathan Pollack, “Structure and Process in the Chinese Military System,” in David Lampton and Kenneth Lieberthal, eds., *Bureaucratic and Elite Decision-Making in China*, (Berkeley, CA: University of California Press, 1991), p.154.

<sup>17</sup> Barry Naughton, “The Third Front: Defense Industrialization in the Chinese Interior,” *China Quarterly* 115, September 1988, pp.351-86.

<sup>18</sup> Zhou Changqing, deputy director of the Third Front Office of the State Council, “*Yi ge judadi jingji wutai*” [A giant economic stage], *Renmin ribao*, 8 June 1987, p.3.

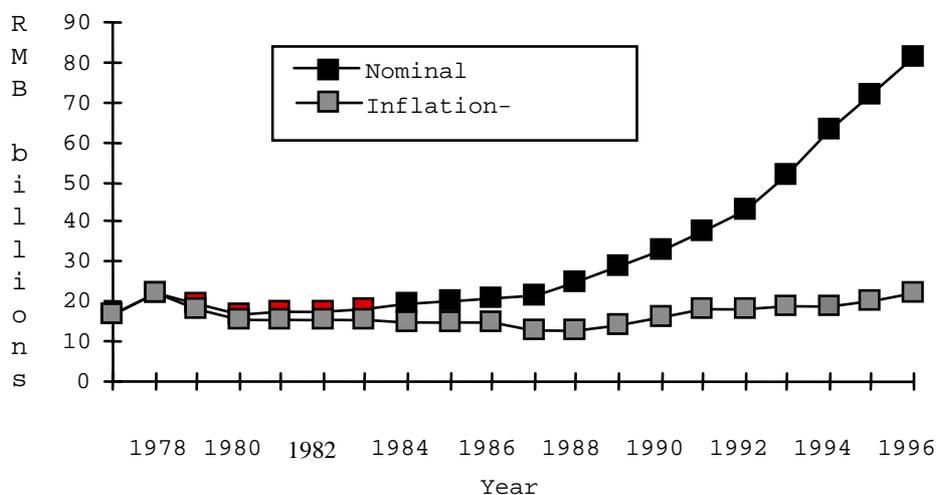
<sup>19</sup> As an example of the economic stagnation of the Maoist period, it is estimated that wages in China were frozen for nearly twenty years from 1958 to 1978.

<sup>20</sup> See Deng Xiaoping, “Streamline the Army to Increase its Combat Effectiveness (12 March 1980),” *Deng Xiaoping wensuan*.

supplement defense revenue. The most important of these involved the exploitation of the PLA's latent economic capacity, which derived from three sources: (1) fifty years of PLA experience with various types of economic production, (2) a well-developed and exploitable military logistics infrastructure, ranging from transportation to factories and farms, and (3) the deeply-ingrained socialization among the ranks and the top-level civilian leadership that production was an acceptable military task. From later Chinese writings, it is clear that this internal military economy was expected to generate sufficient revenue to "make up for insufficient spending."<sup>21</sup>

Much to the chagrin of the military, the importance of the PLA's internal economy as supplement to the defense budget only grew over time, as declining defense budgets forced the military to become increasingly dependent on the rising extra-budgetary revenue from its enterprises. In terms of budgets, for example, there is a consensus among Chinese and Western analysts that, as a consequence of redirected fiscal priorities and the regime's diminishing capacity to extract rents from the economy,<sup>22</sup> the official defense budget between 1979 and 1989 declined considerably in real terms, while only increasing marginally in nominal terms (see Figure 1).

Figure 1. Nominal and Inflation-Adjusted Defense Budget, 1978-1997



Even the double-digit budget increases since 1989, which averaged rate of 14 percent per year, were largely absorbed by a 13 percent average rate of inflation. Any attempts by the

<sup>21</sup> Lu Tianyi, p.52.

<sup>22</sup> Huang Yasheng, *Inflation And Investment Controls In China: The Political Economy Of Central-Local Relations During The Reform Era*, (Cambridge: Cambridge University Press, 1996); Christine Wong, *Central-Local Relations in an Era of Fiscal Decline: The Paradox of Fiscal Decentralization in Post-Mao China*, (Santa Cruz, Calif.: Group for International and Comparative Economic Studies, Dept. of Economics, University of California, Santa Cruz, 1990); and Jia Hao and Lin Zhimin, eds., *Changing Central-Local Relations in China: Reform and State Capacity*, (Boulder: Westview Press, 1994).

government to arrest this decline in real defense budgets were offset by rapidly increasing budget deficits, reaching almost RMB60 billion in 1996.

At the same time, the profits from the military's enterprises by the late 1980s and early 1990s were providing a significant percentage of local unit operating funds, especially subsidies for wages, food, and facilities. Furthermore, these enterprises employed soldier's dependents and demobilized soldiers, supplementing the meager wages of active-duty personnel. Over time, the profits and revenue from these military enterprises became essential components of military financial management.

These two trends (the combination of decreasing government capacity to fund the military from central coffers and the increasing dependence of military units on profits from military enterprises) combined to create a sense of bureaucratic "lock-in" for the military-business complex. As a result, the military leadership found it increasingly difficult to contemplate an end to the military-business complex, despite the troubling rise in rampant corruption within the ranks. The PLA's level of dependency also made it impossible for the civilian leadership to wean the military away from commercial activity. The political leadership, ever cognizant of the central role of the PLA in the post-Deng transition, was understandably reluctant to separate the PLA from its businesses, unless it could replace the lost funds with increased budgetary allocation.<sup>23</sup>

### **Structure, Process, Consequences and Countermeasures**

The commercialization of the PLA's internal economy can be divided into three rough phases. In the first, which lasted from 1978 to 1984, the PLA leveraged its internal assets and infrastructural privileges in limited ways. Military farms were encouraged to sell in the new local markets and the PLA began to "civilianize" some of its underused ports, wharves, airfields, trucks, and rail space.<sup>24</sup>

Between 1984 and 1989, the military-business complex experienced its most intensive period of growth, by some estimates doubling the number of enterprises.<sup>25</sup> Profits reportedly grew by 700%, as the PLA moved from primarily agricultural production to manufacture of light consumer goods, such as pianos, refrigerators, TV sets, washing machines, baby carriages, and hunting rifles. By 1989, the sales of goods made by PLA factories had reached RMB20 billion in the Chinese market, and more than RMB140 million in export revenue. The PLA economy had grown to over 20,000 enterprises, employing several million workers and generating significant profits. A snapshot of the PLA economy at its height is displayed in Table 1 below.

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<sup>23</sup> The Hong Kong press has published reports in which Jiang Zemin laments the situation, claiming that if he had an additional US\$5 billion, he would give it to the PLA in exchange for a clean break from the economy.

<sup>24</sup> For example, see Liu Huinian and Xu Jingyao, "PLA Releases Airfields, Ports for Civilian Use," *Xinhua Domestic Service*, 17 February 1985, in *JPRS-CPS-85-020*, 13 March 1985.

<sup>25</sup> Tai Ming Cheung, "The Chinese Army's New Marching Orders: Winning on the Economic Battlefield," in Jörn Brommelhörster and John Frankenstein, eds., *Mixed Motives, Uncertain Outcomes: Defense Conversion in China*, (London: Lynne Rienner, 1997), pp.181-204.

**Table 1. PLA Production and Business Statistics, 1987**

Type	Output Value (RMBmil)	Profit (%total)	Profits (RMBmil)	Units	Workers
Farms	NA	14.6%	316	591	155,000
Numbered Factories	4291	26%	656	242	300,000
Army-Owned Enterprise	3682	34.4%	830	3700	170,000
Tertiary <sup>26</sup>	2380	25%	612	6870	45,000
Total	10.353	100	2414 (pre) 1988 (post)	11403	670,000

**Source:** Tai Ming Cheung, unpublished manuscript

The significant area of growth was service enterprises, which had exploded in number since 1984 and by 1987 made up more than half of all PLA enterprises. More than 90% of these enterprises were small-scale ventures with little capital investment and with workforces of no more than several dozen employees. They were similar to township and village enterprises (TVEs) that had also proliferated in huge numbers in rural areas during this same period of time. These military businesses, like the TVEs, had wide-ranging autonomy, received little government assistance, produced low-cost labor-intensive goods and enjoyed profit margins of 20-30% per year.

At the same time, the late 1980s was also the period in which serious problems began to emerge in the ranks, especially corruption and illegal economic behavior among officers and enlisted men. Towards the end of 1988 and the beginning of 1989, corruption and illegal economic behavior began to grow more worrisome to the central military leadership. A series of specific discipline regulations related to both legal and illegal business activities were promulgated, and some tentative rectification campaigns were initiated. Scholars at the Military Economic Institute in Wuhan began to write in earnest about the concept of “one army, two systems,” which was meant to provide an organizational template for reform.<sup>27</sup> For the most part, however, these efforts were unsuccessful, confirming the fears of the political leadership that military commercialism was a necessary and unavoidable evil.

The third phase of military commercialism followed in the wake of Tiananmen Square in 1989. After the crackdown on demonstrators in Beijing, the People’s Liberation Army was primarily concerned with rooting out officers and soldiers who had not responded to the orders from the leadership, and in some cases, openly sided with the protesters.<sup>28</sup> By the fall, however, the situation had stabilized enough to call an All-Army

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<sup>26</sup> Tertiary enterprises are generally service enterprises, such as hospitals or hotels.

<sup>27</sup> See Hao Si, “The Idea of Implementing the Practice of ‘One Army, Two Systems’ in Building China’s National Defense,” *Zhongguo tongxun she*, 2 August 1988, in FBIS-CHI-88-152, 8 August 1988, pp.32-33. The idea of “one army, two systems” is generally attributed to Chen Fang.

<sup>28</sup> According to Baum: “...there had been at least 111 serious breaches of military discipline by PLA officers at or above the level of company commander. In some cases, divisional and regimental commanders had

Production and Business Operations Discussion Meeting to discuss the impact of Tiananmen on the military enterprise system.<sup>29</sup> At this conference, a clean-up campaign targeting PLA companies was launched. The campaign was led by the new Leading Group of the Rectification of Army Firms was established in October 1989 under the leadership of General Logistics Department Director Hong Xuezhong. This rectification continued throughout 1990, and by the end of the year the number of army-owned companies [*junban gongsi*] had reportedly been trimmed by 88 percent.<sup>30</sup> At the same time, the CMC soon issued instructions that military units' attention "should be aimed mainly at promoting farm production", which continued to be perceived as less vulnerable to illegal economic behavior because of the smaller scale of profits involved.<sup>31</sup> This push was also aimed at developing large-scale intensive farming operations producing crops that could be sold for profit.<sup>32</sup>

The post-Tiananmen slowdown in both the military and civilian economic sphere was briefly reversed by Deng Xiaoping's dramatic February 1992 "Southern Tour" [*nansun*] of China's special economic zones (SEZs), during which he called for rapid and bold economic reforms, such as privatized factory ownership and the introduction of stock markets. Borrowing one of Mao's favorite metaphors, Deng declared that the reforms "must not be like a woman with bound feet", but must "stride boldly forward" for thirty or forty more years.<sup>33</sup> The military was a belated supporter of this Dengist reform offensive, as were many other conservative groups within the Chinese system. Eventually, General Yang Baibing, the half-brother of party elder Yang Shangkun and one of the most powerful officers in the Chinese military, jumped on the bandwagon, announcing that the PLA would be the "escort and protector" [*baojia hufu*] of the reforms.<sup>34</sup> Within a few months, more than one hundred of the PLA's most senior generals visited the SEZs. In the month of June alone, the CMC dispatched four high-level military groups to Shenzhen and other locations for briefings.<sup>35</sup>

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refused to bring their troops into the city; in other cases, unit commanders had balked at carrying out orders to discharge their weapons against civilians. In addition, some 1,400 ordinary soldiers had reportedly 'shed their weapons and run away' during the crackdown." As a result, a thorough shake-up of the military command structure was eventually carried out, followed by the court-martial or imprisonment of a few high-ranking officers and transfers of many others, including six of China's seven regional military commanders and five regional political commissars. In total, 1,500-3,000 officers were investigated for possible breaches of discipline during the martial law period. See Richard D. Baum, *Burying Mao: Chinese Politics in the Age of Deng Xiaoping*, (Princeton: Princeton University Press, 1994), pp.304-306.

<sup>29</sup> *Zhongguo renmin jiefangjun dasbidian* (hereafter *Dashidian*), (Tianjin: Tianjin renmin chubanshe, 1992), p.2037.

<sup>30</sup> It is important to note that military companies [*junban gongsi*] are a subset of military enterprises [*jundui qiye*]. From accounts of the clean-up, it appears that most of these companies were "briefcase companies" [*pibao gongsi*], some of which existed only on business cards. These can be directly contrasted to military factories [*jundui gongchang*] or farms, which possess significant tangible assets. Interview with knowledgeable PLA official, February 1997.

<sup>31</sup> "Army Farms Achieve Summer Grain Bumper Harvest", *Xinhua Domestic Service*, 13 July 1990, in FBIS, 17 July 1990, p.35. This move did not affect the PLA's industrial enterprises, most of which were run directly by the GLD.

<sup>32</sup> "Military Forum States That Developing Agricultural and Sideline Production is a Long-Term Policy of the Army", *Jiefangjun bao*, 13 April 1990, in FBIS, 8 May 1990, p.27.

<sup>33</sup> For an excellent account of this episode, see Baum, *Burying Mao*, pp.341-368.

<sup>34</sup> See *Xinhua*, 31 March 1992, in FBIS, 1 April 1992, p.17; and *South China Morning Post*, 1 April 1992.

<sup>35</sup> *Hsin wan pao*, 11 June 1992, in FBIS-CHI-92-116, 16 June 1992, pp.32-33.

The military's public support for Deng's reform had a predictably positive effect upon growth in the military economy. The remainder of 1992 and the first half of 1993 witnessed a significant expansion of the military economy, matching the dramatic increases among civilian enterprises during the same period. Production among military enterprises rose 16.68 percent in the second half of 1992, and profits jumped 19.88 percent. Because the new policies allowed them to accept civilian customers, the biggest beneficiaries of the new policy were the service enterprises like hospitals and hotels, which registered turnover rates of more than 30 percent. The PLA began to enter the international market in earnest, raising capital abroad and establishing subsidiary companies in foreign countries and Hong Kong.<sup>36</sup> In the beginning months of 1993, the Chinese military press could confidently report that income from production was now covering one-fifth of the PLA's budgetary shortfalls, the highest point ever.<sup>37</sup>

By the summer of 1993, however, it was clear that the old problems of illegal economic behavior and corruption had returned. Smuggling was on the rise,<sup>38</sup> bribery of officers was a continuing problem,<sup>39</sup> military license plates were still being sold or leased to civilians wishing to avoid road tolls and customs charges,<sup>40</sup> military transport and warehouses were being used to transport and store illegal goods,<sup>41</sup> and enterprises continued to hide or launder money through unauthorized bank accounts. For example, an eight month army-wide audit in late 1992 of more than three quarters of all military units uncovered RMB1.05 billion in funds that owed to the General Logistics Department from production and other activities.

By the fall, a backlash against economic misbehavior had gained momentum. It culminated in the November 1993 All-Army Production and Management Work Conference, which launched the most ambitious rectification campaign in the history of the military enterprise system. The meeting's participants asserted that the PLA's most important role was that of a professional fighting force, and its participation in economic activities was only of secondary importance. Chief of the General Staff Zhang Wannian told the conference that "production and management, in essence, are not fundamental tasks assigned to armed forces by society".<sup>42</sup> He also declared that "over the past few years, the army has managed to make up for the deficiency in military spending, ensure normal

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<sup>36</sup> For more information on the Chinese military's international activities, see James Mulvenon, "Chinese Military Commerce and U.S. National Security," MR-907.0-CAPP, (Santa Monica, CA: RAND, 1997).

<sup>37</sup> "Civilian Production Bolsters Budget", *Jiefangjun bao*, 23 July 1992, FBIS-CHI, 14 August 1992, p.1.

<sup>38</sup> Willy Wo-Lap Lam, "Beijing Said to Crack Down on Army, Police Corruption", *South China Morning Post*, 10 September 1993, p.8, in FBIS-CHI-93-174, 10 September 1993, p.35; "Military Commission Takes Low-Key Approach to Income Disparities Between Servicemen and Civilians to Avoid Provoking Discontent", *Ming pao*, 16 July 1993, p.10, in FBIS-CHI-93-147, 3 August 1993, pp.16-17; and Li Chu, "Chi Haotian Personally Handles Smuggling Cases in the Military", *Zheng ming*, No.191, 1 September 1993, pp.20-21, in FBIS-CHI-93-174, 10 September 1993, pp.35-36.

<sup>39</sup> "Lieutenant Commander He Yunchuan Arrested for Accepting Bribes Amounting to 370,000 Yuan", *Ming pao*, 6 September 1991, p.9, in FBIS, 11 September 1991, pp.31-32. "Tiger" is a common nickname attributed to major organized crime figures.

<sup>40</sup> John Kohut, "Military License Plate Change Under Way", *South China Morning Post*, 24 June 1993, p.6, in FBIS, 24 June 1993, p.33.

<sup>41</sup> Lin Chung-hsing, "Regularization of Military Legislative System: Legal Bureau of Central Military Commission Starts Functioning", *Junshi jingji yanjiu*, January 1993, pp.34-36; and Christian Virant, "Corruption in the PLA", *Eastern Express*, Hong Kong, 1 May 1996, p.1, in FBIS-CHI-96-025, 1 May 1996, pp.35-36.

<sup>42</sup> *Renmin ribao*, 10 December 1993, p.3, in BBC/SWB/FE/1879/G/4, 23 December 1993.

military training and operations against war, and improve its own material conditions by engaging in production and business, but such a practice also gave rise to some problems.”<sup>43</sup> Jiang Zemin himself appeared at the conference to lend his personal support for the campaign, reminding the conference participants that “army comrades should clearly bear in mind historic responsibilities they shoulder”, and that they will “always be combat troops.”<sup>44</sup> As a result, he insisted that the armed forces should primarily rely on eating “imperial grain” [*chi huangliang*], implying that they should regard the annual defense budget allocation as the primary source of their operating revenue.

The subsequent organizational reforms would last for almost two years, and they completely changed the structure of the Chinese military-business complex. By the time the campaign ended in September 1995, the total number of PLA enterprises [*jundui qiye*] had been cut in half from 20,000 to 10,000.<sup>45</sup> Nearly 1000 military-run companies [*junban gongs*] had been closed down, and several hundred enterprises had been forced to sever their business ties with local civilian companies.<sup>46</sup> A massive audit of more than 9000 enterprises and 1100 production and management departments conducted between June and September 1995 had yielded more than RMB700 million in undeclared profits, RMB150 million of which was turned over to the state.<sup>47</sup>

When the 1993-95 rectification came to a close, the resulting PLA enterprise system bore little resemblance to the primitive system of 1978 or the “go-go” economy of the late 1980s. Enterprises that had once been attached to units at all levels of the system were now centralized under newly-formed national, regional, and sectoral conglomerates [*jituan*]. The purpose of these conglomerates was two-fold. On the one hand, they were designed to exploit greater economies of scale through the centralization of previously disparate enterprises run by individual units, often in competition with each other. On the other hand, the conglomerates were to serve a disciplinary purpose by removing a significant source of corruption from the purview of military commanders and placing them in the hands of centrally-directed logistics officers.<sup>48</sup> As soon as they were established, however, rumors had already begun to surface in Beijing suggesting these conglomerates were themselves transitional organizational forms, eventually becoming autonomous economic units completely separate from the military structure altogether.<sup>49</sup>

Despite these changes in the structure of the system, however, the military was not any less reliant on the revenue of its enterprises than it had been at any time in the previous twenty years. The potential gains from double-digit increases in the Chinese defense budget had largely been absorbed by inflation rates averaging 13.1% between 1988 and 1995, and

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<sup>43</sup> Ibid.

<sup>44</sup> Jiang’s comments can be found in Guo Jia, Luo Yuwen, and Zhang Dongbo, “Jiang Zemin Addresses PLA Production Activities”, *Xinhua Domestic Service*, 8 November 1993, in FBIS-CHI-93-216, 10 November 1993, p.35.

<sup>45</sup> Interview with knowledgeable PLA official, February 1997.

<sup>46</sup> Meng Minlin, “The Army Has Achieved Significant Results in Reforming and Rectifying Its Production and Business”, *Jiefangjun bao*, 10 February 1995, p.1.

<sup>47</sup> Zhang Dongbo, “All-Army Auditing Brings About 1 Billion Yuan in Economic Benefits”, *Xinhua Domestic Service*, 16 December 1995, in FBIS-CHI-95-246, 22 December 1995, p.54.

<sup>48</sup> This is not to say that logistics officers are less susceptible to corruption than combat commanders. The leadership was probably prioritizing, knowing that corruption could not be stamped out altogether until the PLA was removed from the economy entirely but wanting to have a minimal impact on the operational effectiveness of line units.

<sup>49</sup> Interview with knowledgeable PLA official, February 1998.

yet the demands on the PLA to modernize had been given an even greater sense of urgency by the growing prospect of a military conflict with Taiwan and possibly the United States. This precarious budget situation made the military leadership reluctant to limit the expansion of the military-business complex, despite the rampant corruption that had accompanied the commercialization of the military economy. The PLA's level of dependency also made it impossible for the civilian leadership to wean the military away from commercial activity.

The political leadership, ever cognizant of the central role of the PLA in the post-Deng transition, was understandably reluctant to separate the PLA from its businesses, unless it could replace the lost funds with increased budgetary allocation.<sup>50</sup> For the nearly twenty years, therefore, the PLA was trapped in a catch-22: it could not fully professionalize without abandoning its economic enterprises, nor could it sustain the current professionalization process without them. Even Jiang Zemin allegedly said: "if we were given an additional RMB30 billion in a short time, there would be no need for the armed forces to engage in trade".<sup>51</sup> Since he did not have the extra funds, however, he publicly maintained the position that "...the Army can play an active role in reducing the burdens on the state...when it engages in production".<sup>52</sup> As the PLA approached the 21<sup>st</sup> century, most observers seemed convinced that the civilian leadership and the PLA would be forced to maintain this uncomfortable arrangement for the foreseeable future.

### **Divestiture (1998)**

On 22 July 1998, at an enlarged session of the Central Military Commission, CMC Chairman Jiang Zemin publicly called for the dissolution of the military-business complex, asserting:

To make concerted efforts to properly develop the army in an all-around manner, the central authorities decided: The army and the armed police [*wu jing*] should earnestly screen and rectify [*qingli*] various commercial companies operated by their subordinate units, and shall not carry out any commercial activities in the future... Military and armed police units should resolutely implement the central authorities' resolution and fulfill as soon as possible the requirements that their subordinate units shall not carry out any commercial activities in the future.<sup>53</sup>

This announcement, which was unprecedented in its public airing and the severity of the language used, was seconded in subsequent days by key members of the military and civilian leadership, including the *de facto* head of the PLA, General Zhang Wannian, as well as Politburo Standing Committee member Hu Jintao,<sup>54</sup> Chief of the General Staff General

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<sup>50</sup> See Footnote 23.

<sup>51</sup> "Central Military Commission Holds an Enlarged Meeting Before the Spring Festival to Discuss the Key Issues of Unity and Anti-Corruption in the Army," *Ming pao*, 3 February 1993.

<sup>52</sup> Guo Jia, *et al*, p.35.

<sup>53</sup> See fn 888.

<sup>54</sup> Wu Hengquan, Liu Zhenying, and Wang Jinfu, "Hu Jintao Speaks on Banning PLA Businesses", *Xinhua Domestic Service*, 28 July 1998, in FBIS-CHI-98-209, 28 July 1998.

Fu Quanyou,<sup>55</sup> General Political Department Director General Yu Yongbo,<sup>56</sup> and General Armament Department Director General Cao Gangchuan.<sup>57</sup>

While the divestiture was immediately touted by Western and Chinese media as a dramatic reversal of policy, it should instead be seen as the logical culmination of over six years of rectification and consolidation campaigns in the military enterprise system. Indeed, it was not even the first divestiture announcement. A decision to divest had actually been made over a year earlier in May 1997, though the major transfers were not set to begin until three years later in May 2000. The reasons behind the acceleration of the divestiture timetable are not entirely known, but there are at least two competing stories. One rumor claims that divestiture was initiated by an angry Jiang Zemin upon receiving an account of the excessively corrupt activities of six PLA and People's Armed Police companies, the most egregious of which involved oil smuggling that was bankrupting the country's two geographical oil monopolies.<sup>58</sup>

A second version of the story actually begins with Zhu Rongji.<sup>59</sup> According to cited U.S. intelligence sources, Zhu Rongji angered the PLA at the 17 July 1998 meeting of the anti-smuggling work conference by accusing the General Political Department's Tiancheng Group of rampant corruption. In particular, he singled out a case in which the company had avoided paying RMB50 million in import and sales taxes after purchasing a shipment of partially processed iron ore from Australia. "Every time our customs officials tried to snare these bastards, some powerful military person appeared to speak on their behalf", Zhu allegedly charged at the closed-door meeting. As anger and resentment spread through the PLA leadership, Jiang Zemin appeared at the conference four days later to lend his support to Zhu, confirming that "some units and individuals" in the PLA were involved in smuggling. According to this account, Jiang thereupon announced the divestiture order.

Before acting, however, Jiang Zemin allegedly discussed the divestiture announcement with at least the two most senior officers in the PLA, Generals Zhang Wannian and Chi Haotian, but did not reportedly disseminate his decision to the rank and file. To support this account of events, military officers in Beijing pointed to the fact that the investigation and work team phase of the divestiture was not initiated until after the anti-smuggling meeting. By contrast, previously military rectification campaigns were initiated long before the announcement, so that the kick-off meeting can be closely followed by the heralding of preliminary results. In this case, however, the investigation and work team phase of the divestiture lasted well into the fall of 1998, with official press releases of results beginning to appear in late November/early December. Second, some of the PLA's largest corporations claimed to have not been informed prior to the announcement. An official of PLA pharmaceuticals manufacturer Sanjiu (999), for instance, claimed two days after the anti-smuggling meeting that the company had not been

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<sup>55</sup> "Fu Quanyou on Supporting Jiang's Anti-Smuggling Drive," *Xinhua Domestic Service*, 23 July 1998, in FBIS-CHI-98-206, 25 July 1998.

<sup>56</sup> "Yu Yongbo Calls on Army to Cease Business Operations", *Xinhua Domestic Service*, 26 July 1998, in FBIS-CHI-98-208, 27 July 1998.

<sup>57</sup> "General Armament Department to Fight Smuggling", *Xinhua Domestic Service*, 26 July 1998, in FBIS-CHI-98-209, 28 July 1998.

<sup>58</sup> Personal communication with Tai Ming Cheung, 12 November 1998.

<sup>59</sup> This account is taken from Susan Lawrence's excellent article "Bitter Harvest", which can be found in the 29 April 1999 issue of *Far Eastern Economic Review*, pp.22-26.

informed “officially”.<sup>60</sup> Third, some of the PLA’s most notorious and corrupt enterprises, such as the *Redian* (“Hot Spot”) disco in the compound of a Beijing military unit, were operating in the first few days after the announcement as if it were business as usual, and continued to do so throughout the summer.<sup>61</sup>

These accounts of the decision to divest the PLA of its enterprises raise a fundamental analytical question: how did the PLA and the CCP work their way out of what could only be described as the fiscal and political Catch-22 of military commercialism? An answer would speak volumes about the current nature of the PLA as a military organization, in particular its relationship to the civilian apparatus. If, in the end, civilian intervention was sufficient to extract the PLA from its businesses, then perhaps a “balance” or “bargaining” model of Chinese civil-military relations is overstated. If, however, the civilian leadership’s decision to extract the PLA from business met strong and possibly insurmountable military resistance, then perhaps the PLA’s institutional power vis-à-vis the civilian apparatus was greater than commonly thought.

Since the announcement, two major schools of thought have emerged. There is compelling evidence in support of both perspectives, making any conclusion premature at this time, though some preliminary assessments can be found in the concluding section of this chapter. The first asserts that the decision to divest the PLA of its businesses reflects an attempt at reassertion of civilian authority over the PLA by Jiang Zemin. For evidence, some point to General Zhang Wannian’s use of the phrase “supreme leader” for Jiang Zemin as a new attempt by the party leader and his supporters to cultivate a Mao-like cult of power within the PLA.<sup>62</sup> Advocates of this position also point to the fact that only a few top military leaders were informed of the announcement ahead of time, effectively presenting the PLA with an unpopular *fait accompli*. Some even questioned the logic of upsetting the PLA at a time of economic downturn and great potential social upheaval in China, concluding that Jiang felt he had to expend precious political capital to rein in the PLA no matter what the potential costs.

The argument that the divestiture was the signal of a looming civil-military clash was further supported by the high-profile investigation of Hong Kong-based J&A Securities in late July 1998, whose main shareholders were the Guangzhou Military Region and the Ministry of State Security.<sup>63</sup> Reportedly, the probe focused on corruption allegations against the chairman of the company, Zhang Guoqing, who was Shenzhen’s former chief securities regulator, and the its president, Yang Jun.<sup>64</sup> Within days, clients who had sought to invest with J&A because of its top-level connections to the military and security leadership in Beijing abandoned the company and moved their money elsewhere.<sup>65</sup> Eventually, the true political nature of the probe was exposed, as the investigation was taken over by Politburo member and secretary of the Central Discipline Inspection Commission Wei Jianxing.<sup>66</sup> It was later revealed that rumors of irregularities had been circulating for months, but

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<sup>60</sup> Mark O’Neill, “Beijing Spikes Business Guns of PLA Power”, *South China Morning Post*, 24 July 1998.

<sup>61</sup> Author’s personal observations in Beijing, July 1998.

<sup>62</sup> Sun Maoqing and Jia Chaoquan, “Zhang Wannian Praises Jiang’s Leadership”, *Xinhua Domestic Service*, 3 September 1998, in FBIS-CHI-98-250, 7 September 1998.

<sup>63</sup> O’Neill, “Beijing Spikes Business Guns”. See also Christine Chan, “Markets Fall as Regulators Grill J&A Chiefs”, *South China Morning Post*, 15 July 1998.

<sup>64</sup> Christine Chan, “More Staff Quizzed at J&A”, *South China Morning Post*, 16 July 1998.

<sup>65</sup> Christine Chan, “Nervous J&A Clients Bail Out”, *South China Morning Post*, 17 July 1998.

<sup>66</sup> Foo Choy Peng, “J&A Probe Becomes Political”, *South China Morning Post*, 18 July 1998.

investigations into the company accounts by the State Auditing Administration were often obstructed by Zhang Guoqing, who had powerful backers in the PLA. As a result, the move against J&A Securities seemed to signal that Jiang was willing to confront even the most protected military enterprise operations.

A second school of thought on the civil-military implications of divestiture argues that the divestiture was largely supported by a corruption-weary military leadership, provided that they received a sufficiently generous compensation package. If true, the heart of the bargain between the PLA and the civilian leadership would center on financial compensation, in this case two separate financial deals. The first was the one-time transfer of the PLA's divested enterprises. Reportedly, the financial burden for these enterprises, including their weighty social welfare costs and debts, was to be placed upon local and provincial governments rather than the central government, though no money was to change hands. This devolution of responsibility from the center to the localities was seen by many as yet another attempt by Zhu Rongji to restore some measure of macro-level economic authority in China by forcing the lower levels of the system to assume greater financial responsibility for the economic units in their area.

The second negotiation focused on the annual budget increases to make up for lost enterprise revenues. Before the divestiture was completed, Hong Kong sources reported that the PLA would receive between RMB15-30 billion per year, with the exact time frame subject to negotiation.<sup>67</sup> Two months later, the same author reported that the PLA would receive RMB50 billion as compensation for its lost enterprises.<sup>68</sup> The *Wall Street Journal* quoted U.S. diplomats as saying the government offered about US \$1.2 billion but the military demanded US \$24 billion. Sources at the GLD claimed in December 1998 that the PLA would receive between RMB4-5 billion in additional annual compensation, complementing continued double-digit budget increases.<sup>69</sup>

### Managing the Divestiture

To oversee the divestiture, a leading group was reportedly established, with Jiang Zemin as the head and party, government, and military leaders, including Zhu Rongji, Hu Jintao, Zhang Wannian, and Luo Gan, as members.<sup>70</sup> To actually carry out the divestiture, a new organization was created, known as the "National Office for the Handover of Enterprises Under the Army, the Armed Police Force, and the Political and Judicial Organs."<sup>71</sup> This leading group was staffed primarily by personnel from the State Economic and Trade Commission, with support from the four General Departments, the People's Armed Police Headquarters, officials from the Politics and Law Department of the State Development and Planning Commission, the Commission on Science, Technology and Industry for National Defense (COSTIND), the Ministry of Public Security, and the Ministry of State

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<sup>67</sup> Willy Lo-Lap Lam, "PLA to Get HK28 Billion for Businesses", *South China Morning Post*, 3 August 1998.

<sup>68</sup> The RMB15 billion number comes from Kuang Tung-chou, "Premier Promises to Increase Military Funding to Make Up For 'Losses' After Armed Forces Close Down All Its Businesses", *Sing Tao Jib Pao*, 24 July 1998, p.A5, in FBIS-CHI-98-205, 24 July 1998. For the RMB30 billion figure, see Willy Wo-Lap Lam, "PLA Chief Accepts HK47 Billion Payout", *South China Morning Post*, 9 October 1998.

<sup>69</sup> The author would like to thank Dennis Blasko for this information.

<sup>70</sup> "Military Meets Resistance in Enforcing Ban on Business", *Ming Pao*, 9 September 1998, p.A16, in FBIS-CHI-98-253, 10 September 1998.

<sup>71</sup> Han Zhenjun, "Military Business Said 'Disconnected' By 15 December", *Xinhua Domestic Service*, 28 December 1998, in FBIS-CHI-98-362, 28 December 1998.

Security. This office was tasked with the promulgation of detailed regulations governing the handover and takeover of military enterprises, the organization and coordination of divestiture, and oversight over lower-level offices. The national office was also given responsibility for the divestiture of ministry-level enterprises.<sup>72</sup> Similar offices were also been set up by the Economic and Trade Commissions of provinces and autonomous regions to take charge of the takeover of enterprises based within their geographic purview.

The guiding principle of these offices, as defined by the Central Committee, was: “turning over enterprises first, consolidating them later.”<sup>73</sup> Accordingly, the work teams were sent to the units to get a proper accounting of the units’ legal and illegal commercial activities. Information on illegal activities was used to prepare cases for the military’s discipline inspection commission, while data on the legal enterprises were used to give the military leadership a clear picture of the extent and financial viability of the military-business complex. Specifically, the work teams sought to assess the number of enterprises that required transfer, the number of enterprise employees involved in the process, and the asset/debt values of the enterprises. This first phase was completed in October 1998. One official government assessment of the asset value of enterprises owned by the military was roughly RMB50 billion (US \$6.02 billion).<sup>74</sup>

The second phase of the divestiture involved the formal registration and assessment of assets of the enterprises, followed by the expected official transfer of these enterprises to the local governments, provincial governments, and Economic and Trade Commission Receiving Offices at all levels of the system.<sup>75</sup> In general, stable enterprises were to be transferred to the governments, while profitable companies were to be placed underneath the commissions. In addition, a considerable number of banking, security, and trading companies that were poorly managed and operated, together with those industrial enterprises that have suffered serious losses were expected to be reorganized or closed down altogether.<sup>76</sup>

Not surprisingly, the divestiture encountered some resistance among military units reluctant to part with their enterprises during this second phase. Some departments reportedly attempted to fold their enterprises under subordinate institutions that were not being screened by the central authorities.<sup>77</sup> Others tried to shield their profitable enterprises while willingly sacrificing their bankrupt enterprises. In cases where the enterprise was using the label of “military enterprise” (*jundui qiye*) as a convenient cover for tax reductions and privileged access to transport or raw materials, individuals or units tried to have the enterprises re-classified as non-military enterprises.

The emerging details of the second phase also aroused resentment among the central, provincial, and municipal bureaucrats, who were being “forced” to take over the PLA’s many large and bankrupt enterprises.<sup>78</sup> The transfer of these enterprises to government

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<sup>72</sup> “Work of Disengaging Armed Forces and Armed Police From Their Enterprises to Be Completed in Mid-December – Over Ten High Officials Absconded With Money”, *Ming Pao*, 7 December 1998, p.A12, in FBIS-CHI-98-353, 19 December 1998.

<sup>73</sup> Yang Xinhe, “Hebei Takes Over Military Enterprises”, *Xinhua Hong Kong Service*, 12 December 1998, in FBIS-CHI-98-350, 16 December 1998.

<sup>74</sup> “Separation of Army From Business Done”, *China Daily*, 21 March 1999, p.1.

<sup>75</sup> Willy Wo-Lap Lam, “PLA Cashes In Its Assets”, *South China Morning Post*, 29 July 1998.

<sup>76</sup> “Work of Disengaging Armed Forces”.

<sup>77</sup> “Military Meets Resistance”.

<sup>78</sup> Lam, “PLA Cashes In.”

offices was seen by many as another component of Zhu Rongji's strategy to re-centralize macro-level decisionmaking authority and extract more resources from the provinces, many of which were perceived to have benefited disproportionately from reform at the expense of central coffers. For the local governments, however, these enterprises were simply another burden. The factories were particularly unattractive to the civilian governments, who would be saddled with the fiscal costs of free social services (education, housing, health care, etc) for thousands of unemployed or underemployed workers. Further, local officials would assume responsibility for finding new jobs for these workers, adding to their already weighty burden in this area.

By December 15, 1998, the government officially announced the end of the second phase. Reportedly, between 4500-5000 enterprises had been officially transferred or disbanded, with one-third at the central level and two-thirds at the local level.<sup>79</sup> A partial list of the enterprises can be found in Table 2 below.

**Table 2. Partial List of Divested PLA and PAP Enterprises**

Province	Units Divested	Workers	Output Value	Profits	Asset Values	Debt Values
Hebei <sup>80</sup>	122				1.47b	1.07b
Guangdong <sup>81</sup>	390				2.0b	
Jiangsu <sup>82</sup>	64				1.4b	830m
Beijing	68				1.4b	
Shenyang <sup>83</sup>	47	762	534m			
Hainan <sup>84</sup>	29					
Shanghai <sup>85</sup>	9	600		30m	300m	
Tianjin <sup>86</sup>	67					

<sup>79</sup> Personal communication with Tai Ming Cheung, 24 January 1999.

<sup>80</sup> Yang Xinhe, "Hebei Takes Over Military Enterprises", *Xinhua Hong Kong Service*, 12 December 1998, in FBIS-CHI-98-350, 16 December 1998.

<sup>81</sup> "Guangdong Military Hands Over Enterprises", *Zhongguo Xinwen She*, 30 November 1998, in FBIS-CHI-98-337, 3 December 1998. This number includes 22 enterprises located in Guangdong that were owned by other military regions.

<sup>82</sup> Jiangsu units also dissolved 194 enterprises, with RMB 360 million in assets. Jin Weixin, "The Jiangsu Forces in the Nanjing Military Region Turn Over All Army-Run Enterprises, Stressing Politics, Considering the Overall Order, and Acting in Line With High Standards and Strict Requirements", *Nanjing Xinhua Ribao*, 10 February 1999, pp.1,3, in FBIS-CHI-1999-0222, 10 February 1999. See also "Jiangsu Troops Hand Over Enterprises to Localities", *Xinhua Domestic Service*, 27 November 1998, in FBIS-CHI-98-337, 3 December 1998.

<sup>83</sup> "Shenyang 'Theater of Operations' Transfers Enterprises", *Beijing Central People's Radio Network*, 25 November 1998, in FBIS-CHI-98-337, 3 December 1998.

<sup>84</sup> Bu Yuntong, "Hainan Armed Forces Hand Over Enterprises", *Xinhua Domestic Service*, 29 November 1998, in FBIS-CHI-98-337, 3 December 1998.

<sup>85</sup> This number refers only to the divestiture of Yunfeng Industries. See "Shanghai Army Garrison Hands Over Military Business",

Jiangxi <sup>87</sup>	8	687			45.75m	
Lanzhou <sup>88</sup>	68					

One-third of the companies and their subsidiaries were retained by divestiture offices at the central level, while the remaining two-third were transferred to divestiture offices at the local level. The commercial elements of China's most profitable military conglomerates, such as Xinxing, Songliao, and Sanjiu, were placed directly under the control of the State Economic and Trade Commission in Beijing.<sup>89</sup> In a similar fashion, profitably regional military conglomerates, such the Jinling Pharmaceuticals Group in the Nanjing MR, were placed directly under the direction of the regional commission.<sup>90</sup>

The remaining 8000-10000 enterprises, most of which were the smaller, subsistence-oriented enterprises at the local unit level, remained in the military.<sup>91</sup> The reforms were also "suspended" in some sectors, especially civil aviation, railway and posts and telecommunications, because of the "special nature" of these industries.<sup>92</sup> For example, the Air Force's China United Airlines was permitted to continue operating<sup>93</sup>, as well as the General Staff Department Fourth Sub-Department's telecommunications company, the China Electronic Systems Engineering Company (CESEC).<sup>94</sup> At first, the State Council had decided to merge CESEC's Great Wall CDMA business with China Unicom, seemingly ending the PLA's foray in cellular service. But two months later, the decision was reversed, permitting Great Wall and PLA to provide CDMA service, though the military is actively looking for a partner to directly operate the commercial side of the business<sup>95</sup>. Nonetheless, CESEC has been forced to break its ties with other international partners, selling its 20% share in a Nanjing-based satellite joint venture holding company with KPN Royal Dutch Telecom. Other notable exceptions to divestiture included the 55 or so numbered factories previously under the control of the GLD's Xinxing Group, which remained under the administrative control of the General Logistic Department's pared down Factory Management Department (formerly the larger Production Management Department), and Poly Group, which was divided between the General Equipment Department (arms trading elements like Poly-Technologies), and COSTIND.

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<sup>86</sup> "Tianjin Hands Over All Military-Run Businesses", *Xinhua*, 8 December 1998, in FBIS-CHI-98-342, 8 December 1998.

<sup>87</sup> Liu Yi, "Jiangxi Military Hands Over Commercial Firms", *Xinhua Domestic Service*, 26 November 1998, in FBIS-CHI-980337, 3 December 1998.

<sup>88</sup> This number refers only to Lanzhou MR AF enterprises. See *Lanzhou Evening News*, 20 January 1999.

<sup>89</sup> First rumors of Songliao's transfer began to appear in late July. See Christine Chan and Foo Choy Peng, "Jiang Demand Threatens PLA Business Empire", *South China Morning Post*, 24 July 1998.

<sup>90</sup> Jin Weixin, "The Jiangsu Forces in the Nanjing Military Region Turn Over All Army-Run Enterprises, Stressing Politics, Considering the Overall Order, and Acting in Line With High Standards and Strict Requirements", *Nanjing Xinhua Ribao*, 10 February 1999, pp.1,3, in FBIS-CHI-1999-0222, 10 February 1999.

<sup>91</sup> Personal communication with Tai Ming Cheung, 24 January 1999.

<sup>92</sup> "Separation of Army From Business Done", *China Daily*, 21 March 1999, p.1.

<sup>93</sup> China United Airlines survived divestiture because many remote towns protested that the shutdown on the airline would cut them off from the rest of the country.

<sup>94</sup> There is some evidence to suggest that CESEC will retain an equity stake in the China Unicom reincarnation of Great Wall.

<sup>95</sup> Wang Chuandong, "Great Wall Gains Position CMDA Net in Full Expansion", *China Daily*, 18 July 1999, p.1.

While these moves were significant in their scale and scope, the Central Committee's guidance cited above also suggested that the opening two phases of the divestiture were only the beginning of a much longer, and more protracted process of allocating and restructuring thousands of troubled enterprises. This third phase of divestiture, which began after the 15 December 1998 transfer, is focused on the difficult task of restructuring and consolidating the former military enterprises. According to Qin Chaozheng, the director of the Economic and Trade Commission of the Hebei Provincial Government:

It will be an arduous task to turn these enterprises over to proper units for their management and to standardize their operation. More than half of these enterprises are poor in management. It is necessary to further improve their management mechanisms and turn them into legal and competitive entities that are suitable to the market economy and that are able to conduct management independently.

The first task for the divestiture offices in the third phase involves going through the accounts of all PLA enterprises, which must be squared before these enterprises are allowed to become fully civilianized or merged with civilian firms. It is expected that this process will take at least 2-3 years, depending on the number of major corruption cases that are generated.

Some initial results of the third phase have already been publicized. In March 1999, it was announced that 150 large enterprises formerly owned by the military and the armed police were being transformed into state-owned corporate groups.<sup>96</sup> Xinxing, for example, remains as an independent, non-military entity, controlling one of the General Logistics Department's largest construction units. The top-level management of the large enterprises is being selected and appointed by the central government, especially the Ministry of Finance, which was placed in charge of supervising the assets of these enterprises. By contrast, nearly all of the smaller enterprises have been handed over to local authorities. Regardless of size, however, all enterprises are being required to transfer their credit liabilities, as well as participate in the medicare insurance programs on behalf of their employees. Those that failed to offset their debts would be overhauled, shut down or acquired by other, viable companies.

### **Divestiture Problems: Resource Allocation and Discipline**

As the divestiture entered 1999, however, some serious bureaucratic and political conflicts began to surface. Overall, they can be divided into two categories: resource allocation and discipline. Each of these disputes has important implications for our assessment of the final success or failure of the divestiture process, as well as our view of Chinese civil-military relations. In terms of resource allocation, recent trends suggest that the PLA's compensation, especially in the area of the official budget, is going to be far less than the military expected. In March 1999, the Minister of Finance Xiang Huaicheng announced the military budget for the new fiscal year in his annual work report:

In line with the CPC Central Committee request, central finances will provide *appropriate subsidies* to the army, armed police force, and political and law organs after their severance

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<sup>96</sup> "Separation of Army From Business Done", *China Daily*, 21 March 1999, p.1.

of ties with enterprises. In this connection, this year's defense expense will be 104.65 billion yuan, up 12.7 percent from the previous year because of the provision of subsidies to the army and of regular increases. (emphasis added)<sup>97</sup>

Outside observers immediately noticed the meagerness of the figure, both in relative and absolute terms. At a relative level, the 12.7% increase was not significantly higher than the 12% increase of the previous year, calling into question the notion that the fiscal priority of the PLA had been augmented. Even in absolute terms, the increase of RMB13.65 billion between 1998 and 1999 was not that much larger than the RMB10.43 billion increase between 1997 and 1998, and reportedly included only a RMB3 billion compensation for the loss of business income. Where was the additional RMB15-50 billion reported in the Hong Kong media? Why did the military receive only RMB3 billion extra when even the official China Daily newspaper pegged the estimated annual profits and taxes of the enterprises at RMB5 billion (US \$602 million)?<sup>98</sup>

There are several plausible explanations for this budgeting outcome. The first, and most difficult to prove, is that that PLA was sufficiently compensated with off-budget funds that are not calculated into the official budget. Given the Byzantine nature of the Chinese budgeting process, we may never have a definite estimate of any off-budget compensation. The second explanation is that the PLA did not have as much as leverage in the divestiture process as it or outsiders thought, allowing the civilian leadership to get the military out of business "on the cheap". The third possibility, supported by a loud chorus of PLA grumbling and complaining, is that the military was "duped" by the civilian leadership, the latter of whom had implicitly promised a higher level of compensation. Indeed, there is some evidence to suggest that the RMB3 billion of compensation is based on the conservative profit estimate of RMB3.5 billion (on total revenue of RMB150 billion) that the PLA gave to Zhu Rongji before the divestiture announcement in July. This low estimate was very much in line with previous PLA estimates by the General Logistics Department, which consistently undervalued the profit of the military enterprise system in order to lessen the central tax burden of the commercial units. If the above story is true, then the major source of the PLA's animus may be that it was hoisted by its own petard. At the time of writing, it is difficult to judge which of these three explanations is correct, but the fact remains that vocal elements within the PLA appear to be significantly dissatisfied with the compensation package, above and beyond the usual bureaucratic rapaciousness for ever greater resources.

Apart from budgets, additional resource allocation disputes have arisen over distribution of enterprises in the post-divestiture environment. One of the most public examples of this is the dispute between the Beijing Military Region and the General Armaments Department over the fate of the Huabei Hotel in central Beijing.<sup>99</sup> Under the rules of the handover, military units at the bureaucratic rank of military region, which also covers the new GAD, are allowed to keep only one three-star hotel. Before divestiture, the Beijing Military Region controlled two three-star hotels, including the Huabei, which it agreed to hand over to the SETC Receiving Office. Since the GAD is a new organization and therefore had no hotels, it reportedly coveted the Beijing command's extra hotel. Thus

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<sup>97</sup> PRC Finance Minister Xiang Huaicheng, "Report on the Execution of the Central and Local Budgets for 1998 and on the Draft Central and Local Budgets for 1999", *Xinhua Domestic Service*, 18 March 1999, in FBIS-CHI-1999-0320, 18 March 1999.

<sup>98</sup> "Separation of Army From Business Done", *China Daily*, 21 March 1999, p.1.

<sup>99</sup> Susan Lawrence, "Bitter Harvest", *Far Eastern Economic Review*, 29 April 1999, p.24.

far, however, the military region headquarters has declined to transfer the hotel to the General Armaments Department, igniting an unresolved bureaucratic struggle within the top military and civilian leaderships.

The second major set of problems resulting from divestiture involved discipline issues, mainly corruption and profiteering. While the data in this area remains anecdotal, there is some evidence to suggest that the civilian leadership has aggressively pursued discipline investigations involving corruption in PLA enterprises, much to chagrin of PLA officers who feel that the effort is gratuitous and harmful to the public reputation of the military.<sup>100</sup> Susan Lawrence of the Far Eastern Economic Review reports from well-placed Chinese sources that the SETC Receiving Office has a list of 23 company executives at the rank of major-general or above who have fled the country since the divestiture was announced.<sup>101</sup> Seven of these officers are from the Guangzhou Military Region, which handed over more than 300 enterprises, and another five are from PLA headquarters. Among the latter is Lu Bin, former head of the General Political Department's Tiancheng Group, who was arrested overseas and extradited in January. Other arrestees include a senior colonel who was the head of one of the PLA's top hotels, the Huatian, which is located in Changsha. As the various receiving offices continue to process the assets and books of some of the shadier PLA enterprises, one can only expect the numbers of disciplinary investigations to increase.

In conclusion, the disputes between the military and the civilian leadership outlined above, as well as within the military itself, highlight the enormous difficulties inherent in the effort to de-commercialize the PLA. The appearance of alleged divisions, however, does not automatically lead to the conclusion that the decision to divest was foisted upon the PLA, since the latter could have agreed with the general thrust of the campaign but felt dissatisfied with the results. Instead, the current evidence suggests that both the PLA and political leadership agreed in principle with the goals of divestiture, but the former now feels slighted by the meager compensation and aggressiveness of the anti-corruption campaigns within its ranks. Given that divestiture is still a work in progress, the long-term implications of these developments for Chinese civil-military relations are not entirely clear at the current moment, but they certainly highlight the extent to which the political and military leaderships play a complex and nuanced game in their policy interactions with one another. On the one hand, the relatively weak political leadership could not simply order the PLA out of business without a series of side-payments. On the other hand, the civilian leadership seems willing to incur the costs of not fully meeting the compensatory demands of the military, suggesting a future course of either increasing civil-military confrontation or increasing civilian control of the military.

## **Conclusion**

In a sense, divestiture brings the PLA full circle. The pattern of the campaign, ranging from the transfers of its high-profile commercial enterprises to the retention of its lower-level farms and industrial units, suggests that the military has essentially returned to the pre-1978 "self-sustaining" economy. Thus, the widespread conclusion that the PLA has been "banned" from business is far too simplistic. The military will continue to operate a wide

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<sup>100</sup> Ibid.

<sup>101</sup> Ibid.

variety of small-scale enterprises and agricultural units, with the goal of supplementing the incomes and standards of living for active-duty personnel and their dependents at the unit level. No longer, however, will profit and international trade be critical features of the system. Moreover, the military leadership hopes that the divestiture of profitable companies will greatly reduce the incidence of corruption and profiteering in the ranks, and thereby refocus the PLA on its important professionalization tasks.

At this point, of course, it is too soon to judge the long-term impact of this divestiture on the PLA. Most likely, the next few years will witness repeated “mop-up” campaigns on the part of the central leadership and significant resistance and foot-dragging on the part of local government and military officials, repeating the pattern of earlier rectifications. Nonetheless, it is important not to downplay the importance of what has already occurred. The military-business complex of the 1980s, with its freewheeling commerce, is gone. The remaining military economy is far more circumscribed, perhaps closing one of most unique and interesting chapters of the post-Mao revolution.



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