

CHINESE MILITARY STILL EMBEDDED IN THE ECONOMY

By Mark Magnier
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BEIJING--More than a year after the Chinese military was ordered to disband its octopus-like business empire and return to the barracks, its influence over the nation's economy remains deep and widespread. Military experts, diplomats and China watchers estimate that the People's Liberation Army still owns some 10,000 companies selling everything from toilet paper to telecommunications services.

The scope of the PLA's private kingdom might be significantly smaller now if the military hadn't found an unwitting ally last year in its bid to fight off divestiture: the United States. After losing ground for months in its effort to protect its assets from state seizure, the military saw its fortunes improve May 8, when U.S.-led NATO forces mistakenly bombed the Chinese Embassy in Belgrade, the Yugoslav capital. In the weeks that followed, China rallied around the flag, and pressure to close up shop diminished.

"Things were really coming to a head when the U.S. did them a big favor," said James Mulvenon, an expert on PLA business at Rand Corp., the Santa Monica-based think tank. Now, "divestiture is not going that well."

Beijing's official line is that it has forced the military out of business. During 1999, high-profile investments, such as Beijing's five-star Palace Hotel, were handed over to central government shareholders with great public fanfare. And at least 150 large, profitable enterprises were grabbed up by the central government.

"All business except for military logistics is now disengaged," said Chu Shulong, senior fellow at the government-backed China Institute of Contemporary International Relations. "It's fully been done."

In fact, analysts believe that the deadline set a year ago was only the start of protracted negotiations on who gets what. Furthermore, the military's case for holding on to many of its assets--officially valued at \$9.7 billion but in reality worth far more, according to many independent analysts--has been strengthened by history, power politics and national budgets.

On the historical front, the PLA has a long tradition of manning the trenches and the till simultaneously. Starting with its battles against the Japanese and the Nationalists in the 1930s, the army relied on farming, factory work and other extracurricular activities to support its guerrilla operations. And the late Communist leader Mao Tse-tung reportedly cited Ming and Qing dynasty precedents going back hundreds of years in justifying the strategy.

A second factor undercutting reform efforts is inertia and the intricacies of domestic politics. While it sought to contain military freelancing for years, the Communist Party also needs the PLA as the ultimate defender of its privileged position, as seen by the army's role in the 1989 Tiananmen Square massacre. With unemployment rising amid growing fears of domestic instability, party leaders reportedly have been wary of pushing the military too far.

Finally, state budgets have limited how much pressure the government can heap on the armed forces. The biggest problem over the past year has been the dispute over how Beijing will compensate the military for the revenue lost by handing over its companies.

That includes the current value of the airlines, pharmaceutical companies, factories and chemical makers as well as the future revenue stream.

"The trade-off for getting out of the economy is supposed to be greater budgets," said Scott Snyder, Asia affairs analyst with the U.S. Institute of Peace, a Washington-based think tank.

China, however, with its growing fiscal debts, lacks the resources to support the PLA solely on "imperial wheat," or central government largess--although it has tried. Soldiers were given a raise in 1998 of between 10% and 25%. And analysts expect a far larger increase in the next PLA budget due in March than the 12.7% growth it gained last year.

That said, these steps still won't fill the gap, especially at a time when the military is trying to modernize with expensive high-tech equipment. This suggests that the PLA and its cousin organizations will maintain for years their active role in the private economy.

Moving forward, these countervailing forces are starting to forge a rather messy compromise. Private business activities by those in uniform will continue, analysts believe, but increasingly will fall within pre-1978 guidelines.

In essence, the military is closing a 20-year circle. Before 1978, its business focus was essentially limited to production for its own use. When Deng Xiaoping came to power in the late 1970s and urged people to get rich for the good of China, the military took the advice to heart. Suddenly the armed forces, with tax-exempt status, warehouses, vehicles and control over the borders, had a virtual license to print money--and used it.

Now it in theory will curb the excess and return to the earlier guidelines.

Local units will still be able to operate farms and factories that support PLA wives, children and retirees. And some of the commercial activities considered most strategic will have Beijing's blessing, including railroads, civilian aviation, postal services and telecommunications. The air force's China United Airlines has been tapped to continue, for example, as has the General Staff Department's China Electronic Systems Engineering Corp. telecom unit.

But the PLA will face growing pressure to dump its most blatant and widely criticized investments, such as discos, prostitution rings, karaoke parlors and glitzy international hotels, analysts say.

Party and military leaders seem to believe that such a move makes sense and is tenable. That follows because the military's abuse of power and position has undermined Communist Party credibility and embarrassed its senior civilian leaders, who face growing public pressure to stem rampant state corruption. From a senior military standpoint, the growth of private sector interests has undermined armed forces loyalty and left many soldiers soft and distracted.

While the direction of the new policy is clear, carrying it out is problematic. Many officers at lower levels have resisted giving up their cash cows.

"If someone gave you a choice between running through the mud with bullets overhead or learning to work in a factory, what would you do?" asked June Teufel Dreyer, a China military specialist at the University of Miami.

Various military units have used the divestiture to dump their money-losing companies on local governments, even as they try to keep the best for themselves. Some also have used political pressure to block audits that might reveal theft and corruption. Others have reportedly moved assets into umbrella companies to hide their ownership.

"The PLA initially fought" the policy, said William Triplett II, a Republican congressional staffer. "Then someone realized it was a great opportunity to keep the good stuff and dump the bad stuff in [Premier] Zhu Rongji's lap."

Many of the companies that are divested, meanwhile, have simply been taken over by departing military officers, their wives or relatives. That's about as good as you can expect in China's muddled economic state, analysts say. As with the state-owned enterprises, ownership lines are not going to be cleanly drawn any time soon. And at least this reduces the military's role as a direct economic player.

"What you need to do is gradually replace the management [of these companies] to weaken the relationship with the PLA," said Eddie Wong, economist with ABN Amro, an international banking firm.

Originally, the military had until May 2000 to get out of business, but the timetable was pushed up. One reason for the more aggressive schedule, say China watchers, might have been the greed exhibited by the military during the Asian economic crisis that started in 1997.

China's protected market allowed it to keep petroleum prices relatively high even as world prices dropped sharply. The military used its ships, warehouses, trucks, private gas pumps and storage tanks to operate a huge smuggling operation and arbitrage the price difference, in the process almost bankrupting China's two state-run oil monopolies. At some point, President Jiang Zemin and Zhu reportedly hit the roof.

"There was egregious oil smuggling by the PLA," said Rand's Mulvenon. "Tankers were lined up as far as the eye could see."

In a somewhat unusual move, Jiang's challenge to the military in mid-1998 was very public, earning him credit among some for his courageous stand. Often high-stakes campaigns between such political giants are choreographed behind the scenes.

What followed were protracted negotiations, which analysts say could continue for years.

"Getting the military out of business appears to be a mixed success," said Eric McVadon, a former U.S. defense attache in Beijing. "It's so firmly rooted in so many cases--but at least they realize it's a corrupting force."

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