

PLA Divestiture and Civil-Military Relations:
Implications for the Sixteenth Party Congress Leadership

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December 2001

More than three years have passed since the December 1998 announcement that the Chinese People's Liberation Army (PLA) had formally divested itself from commercial operations. The intervening period has witnessed the expected "mop-up" campaigns on the part of the central leadership and significant resistance and foot-dragging on the part of local military officials, repeating the pattern of rectifications in the system since the late 1980s.² Given Hu Jintao's role as official head of the central leading group overseeing divestiture and his widely expected ascension to the central leadership core at the Sixteenth Party Congress, the time seems ripe for a re-examination of the civil-military features of divestiture and their implications for the future party-army relationship.

Civil-Military Relations and the 1998 Divestiture Decision

On 22 July 1998, at an enlarged session of the Central Military Commission, CMC Chairman Jiang Zemin gave a speech in which he 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.³

Jiang then sought to consolidate the decree by publicizing the announcement through the party's extensive propaganda apparatus. That night, Jiang's speech at the meeting was broadcast on the CCTV *Evening News*, which has the highest rating in China and is closely watched by other Chinese media for cues about important stories. Observers took special note of the fact that the Chinese leader was shown flanked by the top brass of the PLA, projecting at least tacit consent to the decision by the military.

The next day, the Party's official newspaper, *People's Daily*, ran a banner headline, declaring "PLA Four General Departments Convened in Beijing to Carry Out the Decision of the Anti-Smuggling Meeting," with the subtitle "Chairman Jiang Talked Seriously About Divestiture."⁴ The announcement was then publicly seconded in subsequent days by key members of the military and civilian leadership, including the *de facto* head of the PLA, General Zhang Wannian, Chief of the General Staff General Fu Quanyou (23 July),⁵ General Logistics Department Director Wang Ke (24 July),⁶ General Political

Department Director General Yu Yongbo (25 July),⁷ and General Armament Department Director General Cao Gangchuan (26 July),⁸ as well as Politburo Standing Committee member and Jiang Zemin's heir apparent, Hu Jintao.⁹

Contrary to the conflictual civil-military scenario put forward by many observers in the Hong Kong media, interviews in Beijing strongly suggest that divestiture in principle was largely supported by a corruption-weary military leadership. They generally agreed with the political, military and economic rationales for divestiture. On the political front, divestiture was aimed at curtailing corruption within the ranks, which had been publicly criticized at the very highest levels of the PLA leadership as early as 1993, though never explicitly linked to commercial activity.¹⁰ Painfully aware of the bureaucratic and fiscal "catch-22" created by inadequate defense budgets and increasing dependence on production revenue, the civilian leadership nonetheless summoned the political courage to publicly argue that as long as the military operated in the commercial economy, it was subject to "negative influences." Jiang Zemin even reportedly spoke of the preventing the military from "changing color" and of keeping the military "pure." At a military level, divestiture was designed to return the PLA to its primary mission of preparing for war, which was the principal aspiration of an increasingly professional officer corps.¹¹ Finally, from an economic perspective, there was recognition that the military had never proven adept at running commercial operations and that the failed experiment should end.

Nor did there appear to have been any major cleavages in the top civilian leadership over divestiture.¹² One well-informed observer relates that Jiang and Zhu were closely united on the issue, with Jiang providing the political clout and Zhu providing economic instructions to his subordinates at the State Economic and Trade Commission as to the specifics of the separation.²⁴ A top-level, civilian-led leading group was quickly established, with Jiang Zemin's chosen successor Hu Jintao as the head, and other party, government, and military leaders, including Zhang Wannian, and Luo Gan, as members.¹³ Hu's appointment served an important prelude to his official appointment as vice-chairman of the Central Military Commission at end of October 1999.¹⁴ Over the next few weeks, corresponding leadership small groups at lower levels of the system, including military units and State Economic and Trade Commission branches, were also established.

A key condition for military acquiescence to divestiture, however, was an assurance from the civilian leadership that the PLA would receive a sufficiently generous compensation package for handing over its businesses. Indeed, sources in Beijing confirm that the fault lines in the divestiture process could be drawn between supporters, including the senior military leadership and the combat units, and those who have resisted the ban, especially members of the logistics and enterprise management structure, military region commands, and military district commands that stood to lose their primary source of legal and illegal income.¹⁵

The heart of the bargain between the PLA and the civilian leadership centered on 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 annual budget increases to make up for lost enterprise revenues, with the goal of consolidating Jiang's earlier decree to the military to "eat imperial grain" rather than rely on business for revenue. 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.¹⁶ Two months later, the same author reported that the PLA would receive RMB50 billion as compensation for its lost enterprises.¹⁷ The *Wall Street Journal* quoted U.S. diplomats as saying the government offered about \$1.2 billion but the military demanded \$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.¹⁸

For local units, however, the prospects of a lucrative budget deal must have been bittersweet, since it required them to buy into what might be called "the trickle-down theory of PLA economics." Whereas units previously had relatively direct control over enterprise finances, they now had to place their faith in the notion that the budget funds would trickle down through the system from Beijing to their level. Previous experience with the Chinese military bureaucracy did not inspire confidence that this would come to pass. To ameliorate these concerns and boost morale, the military leadership took steps in the fall of 1998 to improve the standard of living for the rank and file. The principal measure was an increase in the salaries of servicemen by an average of an additional ten to twenty-five percent, depending on rank and location.¹⁹ One lieutenant general in Beijing reportedly received a raise of RMB400 per month, while two senior colonels claimed twenty percent increases, from 1700RMB to 2040RMB.²⁰ Overall, the average soldier in the PLA reportedly expected to receive an additional RMB100 per month.²¹

Not surprisingly, the divestiture process still encountered resistance among military units reluctant to part with their enterprises. Some departments reportedly attempted to fold their enterprises under subordinate institutions that were not being screened by the central authorities.²² Others tried to shield their profitable enterprises while willingly sacrificing their bankrupt enterprises. In cases where an enterprise was using the label "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 it reclassified as a non-military enterprise. A significant number of enterprises were reportedly transferred to the control of relatives of military officers or de-frocked military officers, thus retaining their unofficial links to their former units. Some of this backsliding was considered so serious that the office of the military leading small group in the first half of December 1998 was forced to dispatch four work groups of thirty members each to inspect the larger units.

As the divestiture entered 1999, additional serious bureaucratic and political conflicts began to surface. Overall, they can be divided into two categories: resource allocation and discipline. In terms of resource allocation, the PLA's expected boost in the 1999 official budget was 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 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)²³

Outside observers immediately noticed the meagerness of the figure, both in relative and absolute terms. At a relative level, the 12.7 percent increase was not significantly higher than the twelve percent 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.

Initial interviews, bolstered by a loud chorus of PLA grumbling and complaining in official media, suggested that the military had been “duped” by the civilian leadership, which had implicitly promised a higher level of compensation. The actual figure of RMB 3 billion in compensation was instead 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. Thus, it appeared that the PLA was hoisted by its own petard. Ironically, interviews suggest that a genuine civil-military split over inadequate levels of budget compensation was averted thanks to the accidental bombing of the Chinese embassy in Yugoslavia in May 1999, which happened to occur during the programming phase of the Ninth Five Year Plan and resulted in a much more generous long-term budget trajectory than had previously been planned.²⁴

Apart from budgets, additional resource allocation disputes arose over distribution of enterprise assets in the post-divestiture environment. According to one well-informed observer, there were serious differences over levels of asset compensation because of the escalating costs of debts and liabilities incurred by enterprises.²⁵ Many firms were poorly managed with incomplete accounting records and borrowed from multiple creditors. The firms’ relationships with banks needed to be clarified, and licenses needed to be re-registered. Another problem involved personnel. When military officers and workers were transferred to the localities, their healthcare and insurance had to be transferred as well, creating unwanted social welfare burdens for the new owners.

The second major set of problems resulting from divestiture involved discipline issues, mainly corruption and profiteering. There is some evidence to suggest that the civilian leadership aggressively pursued discipline investigations involving corruption in PLA enterprises, much to chagrin of PLA officers who felt that the effort was gratuitous and harmful to the public reputation of the military.²⁶ Susan Lawrence and Bruce Gilley of the *Far Eastern Economic Review* reported from well-placed

Chinese sources that the SETC Receiving Office maintained a list of 23 company executives at the rank of major-general or above who had fled the country since 1998.²⁷ Seven of these officers were from the Guangzhou Military Region, which handed over more than 300 enterprises, and another five were from PLA headquarters units in Beijing. 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.

In sum, the divestiture process was a mixed bag for Chinese civil-military relations. On the one hand, the PLA complied with the civilian leadership's order to divest themselves, even permitting the process to be run by a civilian leading group with a non-military enforcement unit. Bolstering the conditional compliance hypothesis, the PLA complied with the difficult order with the proviso that the civilians meet certain conditions, especially adequate compensation for the PLA's lost revenue. On the other hand, the implementation of the divestiture order had many adversarial features, as PLA and civilians fought over the level of compensation, the value of the PLA's various assets, and the criminal pursuit of high-ranking military officers accused of corruption. Mini-crises over the budget were only resolved by the NATO war in the Balkans, which greatly strengthened the hand of the PLA in key long-term budget programming meetings in the spring of 1999 and reduced the temperature of the conflict surrounding divestiture from that point forward.

Conclusion: Implications for the Sixteenth Congress Party Leadership

Though it is always dangerous to predict the outcome of Chinese leadership struggles so far in advance, it is widely assumed that a troika consisting of Hu Jintao, Wen Jiabao, and Zeng Qinghong will become the leadership core after the 16th Party Congress in October 2002, with Hu as first among equals. Like nearly all of the fourth generation of civilian leaders, these three individuals have no military background or identifiable networks of supporters within the military. Their ascension will therefore deepen the long-running civil-military transition in China from the interlocking directorate system and deep military ties of men like Mao Zedong and Deng Xiaoping to the "conditional compliance" system and dearth of military ties of third generation leaders like Jiang Zemin and their fourth generation successors.

But this analysis is not entirely complete. It is important to note that Hu was appointed vice-chairman of the Central Military Commission at the end of October 1999, which has theoretically given him *ex officio* access to the senior military leadership.²⁸ It is not clear, however, if Hu regularly attends CMC meetings, especially given the fact that Jiang Zemin rarely attended the weekly meetings, preferring to act through a proxy, his military secretary, Jia Tingan. Jiang also put Hu in charge of the central-level divestiture leading small group, which provided an opportunity for interaction with PLA supremo Zhang Wannian and experience working on a bureaucratic issue with the PLA. While these positions gave Hu more recent and significant opportunities for dealing with the PLA than his fourth generation counterparts, they are unfortunately mostly ceremonial, in the case of the CMC position, or adversarial, in the case of enforcing unpopular aspects of the divestiture process.

Indeed, the conflicts between Hu and the PLA leadership during the divestiture process has likely been exacerbated by more recent conflictual issues dividing the civilian and military leaderships. As discussed in my previous submission to the *China Leadership Monitor*, the PLA's apparent control over and manipulation of the details of the EP-3 crisis further strained bonds of trust between civilian elites and the military already frayed by the difficult divestiture struggles, as did the military's dissatisfaction with the final outcome of the civilian-led negotiations with the United States.²⁹ For the military, therefore, there are reasons to be more wary of the civilian apparatus than before divestiture began in 1998. There are also reasons to be less confident that its institutional prerogatives, either involving internal matters like economic production or external matters in critical foreign policy areas, will be accepted without question, though perceptions of U.S. intentions in Operations ALLIED FORCE and ENDURING FREEDOM appear to have created more than enough justification for enhanced defense spending.

For the civilian leadership, these civil-military trends since 1998 will likely affect military personnel choices for the Sixteenth Party Congress and beyond. In a reversal of pre-1998 trends towards the institutionalization of civil-military relations, divestiture and the EP-3 crisis have likely increased the salience of personal connections between civilian and military elites, as the next generation of civilian leaders looks to promote officers with whom they have bonds of trust. They may now be more concerned about developing relationships with people who will give them the unvarnished truth, rather than officers who are institutional paragons but unknown to them. As a result, civil-military relations in the year of leadership transition may in fact take one step backward before they can move forward again.

¹ The views expressed in this paper are the author's own, and do not reflect the views of RAND or any of its clients.

² An audit in early 1999, for example, revealed that the military had kept back some fifteen percent of its businesses, necessitating extension of some deadlines until August 1999. As late as May 2000, a top-level meeting on divestiture all but admitted that the military continued to shield some assets from the process, stating that the withdrawal of the military from business activities had only been "basically completed" (emphasis added). See "Separation of Army From Business Done," *China Daily*, March 21, 1999, p.1.

³ "Jiang Orders PLA-Owned Firms to Close," *Xinhua Domestic Service*, July 22, 1998, in Foreign Broadcast Information Service, China Daily Report (hereafter FBIS-CHI), FBIS-CHI-98-204, July 23, 1998.

⁴ *People's Daily*, July 23, 1998, p.1.

⁵ "Fu Quanyou on Supporting Jiang's Anti-Smuggling Drive," *Xinhua Domestic Service*, July 23, 1998, in FBIS-CHI-98-206, July 25, 1998.

⁶ Cao Haili, "The Chinese Army Has Sailed Out of the Business Sea," *Caijing* [Finance and Economics], January 1999, pp.1-16.

⁷ "Yu Yongbo Calls on Army to Cease Business Operations," *Xinhua Domestic Service*, July 26, 1998, in FBIS-CHI-98-208, July 27, 1998.

⁸ "General Armament Department to Fight Smuggling," *Xinhua Domestic Service*, July 26, 1998, in FBIS-CHI-98-209, July 28, 1998.

⁹ Wu Hengquan, Liu Zhenying, and Wang Jinfu, "Hu Jintao Speaks on Banning PLA Businesses," *Xinhua Domestic Service*, July 28, 1998, in FBIS-CHI-98-209, July 28, 1998.

¹⁰ Liu Huaqing and Zhang Zhen, "Carrying Forward Fine Traditions is a Major, Strategic Issue of Our Army's Construction Under the New Situation," *Renmin ribao* [People's Daily], July 26, 1993, pp.1,4, in FBIS-CHI-93-142, July 27, 1993, pp.22-25.

¹¹ James C. Mulvenon, *Professionalization of the Senior Chinese Officer Corps: Trends and Implications*, Santa Monica, CA: RAND, MR-901-OSD, 1997.

¹² Willy Wo-Lap Lam, "Problems Between CCP, Army," *South China Morning Post*, October 20, 1999, p.19.

¹³ "Military Meets Resistance in Enforcing Ban on Business," *Ming pao*, September 9, 1998, p.A16, in FBIS-CHI-98-253, September 10, 1998.

¹⁴ "Hu Jintao Appointed CMC Vice-Chairman," *Xinhua*, October 31, 1999.

¹⁵ Personal communication with Tai Ming Chueng.

¹⁶ 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 jih pao*, July 24, 1998, p.A5, in FBIS-CHI-98-205, July 24, 1998. For the RMB30 billion figure, see Willy Wo-Lap Lam, "PLA Chief Accepts HK47 Billion Payout," *South China Morning Post*, October 9, 1998.

¹⁷ Willy Lo-Lap Lam, "PLA to Get HK28 Billion for Businesses," *South China Morning Post*, August 3, 1998.

¹⁸ The author would like to thank Dennis Blasko for this information.

¹⁹ "Military Reportedly Raises Pay to Avoid Discontent," *Ming pao*, January 23, 1999, p.15, in FBIS-CHI-99-023, January 23, 1999.

²⁰ Interviews in Beijing, February 1999.

²¹ Kuang Tung-chou, "Beijing To Comprehensively Raise Servicemen's Remuneration," *Sing tao jih pao*, November 25, 1998, p.B14, in FBIS-CHI-98-349, December 15, 1998.

²² Willy Wo-Lap Lam, "PLA Cashes In Its Assets," *South China Morning Post*, July 29, 1998.

²³ 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*, March 18, 1999, in FBIS-CHI-1999-0320, March 18, 1999.

²⁴ Some rough, back-of-the-envelope calculations suggest that the PLA was programmed for twenty percent annual increases over the five year period, adjusted the following March for inflation. This represents a significant increase from the Eighth Five Year Plan, which was programmed at ten percent.

²⁵ Personal communication with Tai Ming Cheung, September 9, 1999.

²⁶ Susan Lawrence and Bruce Gilley, "Bitter Harvest," *FEER*, April 29, 1999, p.24.

²⁷ Ibid.

²⁸ "Hu Jintao Appointed CMC Vice-Chairman," *Xinhua*, October 31, 1999.

²⁹ Interviews, Beijing, November 2001.