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# CHINA'S STALLED "FIFTH WAVE"

## *Zhu Rongji's Reform Package of 1998–2000*

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David Zweig

In spring 1998, Zhu Rongji became China's new prime minister, bringing with him a remarkable and optimistic reform agenda. Two and a half years later, while Zhu has had some successes, particularly China's forthcoming entry into the World Trade Organization (WTO), much of his program has stalled. Why did this "reform wave" stall and what is its future?

### Reform Waves in the PRC: Seeking a Favorable Context and Content

Since 1978, most reforms in China have come washing in like a wave at high tide,<sup>1</sup> a peak period in which leaders combine reform initiatives across various realms—foreign trade and foreign policy, domestic economic reform, personnel changes, and even some political reforms—into one all-encompassing package. These waves gather when one faction's preferences come to dominate and its control over the policy process is relatively unconstrained by political or ideological opponents. But to amass such power, the political and economic context must be favorable and the content of the policies must be well received by citizens and the majority of cadres.<sup>2</sup>

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1. Carol Lee Hamrin, *China and the Challenge of the Future* (Boulder, Colo.: Westview Press, 1990).

2. Merilee S. Grindle, *Politics and Policy Implementation in the Third World* (Princeton, N.J.: Princeton University Press, 1980).

Four waves have come since the Dengist reforms began, building in 1978–79, 1984–85, 1987–88, and 1992–93. In general, these waves occurred within a positive political, economic, and global context. Good ties with the U.S. have been important for encouraging reform. Significant personnel rotation in Beijing brings new ideas, facilitates a new elite consensus, and produces new policy documents. Furthermore, society and local elites must see the changes as beneficial to their interests, while good foreign trade and domestic growth data give leaders the confidence and the leeway to experiment. A wave may arise from a period of stagnation that generates an undercurrent of opposition to policies of a conservative faction and propels a reform faction forward. Elements of society, tired of slow growth and stifling politics, then form a political base for a shift in policy and power from these conservatives to new leaders willing to accelerate economic and political change. Reform waves also stall. Runaway local investment, following economic decentralization, increases pressures on the center to slow a tide.<sup>3</sup> Similarly, a spike in imports of consumer goods and a rapid outflow of foreign currency can force the central government to end a period of economic liberalization. So, too, can economic shocks and widespread social unrest sap the force of a wave.<sup>4</sup>

The content of reform policies can create opposition by determining how strongly different groups support or oppose a reform. Redistributive policies usually generate more opposition than deregulatory policies, which, while weakening the bureaucrats, allow for more rapid growth with wide-scale benefits for many constituents. Policies that call for a change in property rights, as in the current case of state-owned enterprise (SOE) reform, are vulnerable to ideological critiques by both conservative and leftist forces. Under efforts to trim the bureaucracy, the implementers of reform become its target. A climate of fear can cause bureaucrats to hesitate to implement reforms out of wariness of political criticism. Finally, policies can have unanticipated consequences that feed back into elite politics, strengthening resistance to controversial policies.

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3. David Zweig, "Distortions in the Opening: 'Segmented Deregulation' and Weak Property as Explanations for China's 'Zone Fever' of 1992–1993," *USC Seminar Series*, no. 14 (Hong Kong: Institute of Asia-Pacific Studies, Chinese University of Hong Kong, 1999). See also Jude Howell, *China Opens Its Door: The Politics of Economic Transition* (Boulder, Colo.: Lynne Rienner Publishers, 1993).

4. Dittmer and Wu see very close links in the Deng era between policy innovation—"reform cycles"—and periods of positive economic growth—"business cycles"—with less close links to social activism or protests, what they call the "movement cycle." Lowell Dittmer and Yu-shan Wu, "The Modernization of Factionalism in Chinese Politics," *World Politics*, 47:4 (July 1995), pp. 483–85.

## Advancing the Reform Package: Good “Vibes” in 1998

In spring 1998, Zhu Rongji had reason to believe that a reform wave was building. Jiang Zemin had just consolidated his power at the 15th Party Congress in September 1997 by forcing Qiao Shi to resign, and even though Qiao represented a liberal wing in the Chinese Communist Party (CCP), Jiang felt more confident to move forward on his own reform initiatives after his only real challenger for power was gone. At the 15th Party Congress, Jiang redefined state ownership to include joint stock companies and shareholding relationships with private investors as part of the socialist economy. This ideological victory created an excellent context for accelerating SOE reform. Hong Kong “returned to the motherland” without difficulty and Deng Xiaoping’s death was discounted by the political system. It passed, as did he, without a glitch.

Zhu’s stature was at a high point. No longer merely vice-premier, he was the prime minister, elevated to number three in the political hierarchy at the 15th Party Congress. He was widely perceived as the pilot behind the soft landing of 1995–96, following the runaway growth triggered by Deng’s Southern Tour. For several years, he had been consolidating his control over China’s fiscal system. Finally, the people of China wanted a new leader who would pursue reform and growth. By announcing a willingness to go forward, despite the pitfalls, Zhu used his press conference at the 9th National People’s Congress (NPC) to show that he was the populist leader Chinese people wanted.

Zhu drew strength from the emerging consensus that something had to be done about SOEs. Continued red ink from SOEs mobilized support for a major initiative at solving this long-term problem. But should they merely be reformed or privatized? The global context was favorable. After Jiang’s relatively successful summit in the U.S., and Bill Clinton’s enthusiasm for a return visit to China, the U.S. and China were building what was described as a strategic partnership, though the content of that relationship was never defined. And while the Asian financial crisis was wreaking havoc throughout much of East Asia, China remained relatively unaffected at this early date.

### The Content of the Fifth Wave

It was within this positive climate that Zhu introduced a bold program. It included reforming SOEs, privatizing public housing, legitimizing and increasing the private sector, entering the WTO and reforming relations with foreign investors, halving the bureaucracy, closing the army’s businesses, an accelerated anti-corruption struggle, and establishing a viable unemployment insurance and retirement scheme.

Many policies were interconnected so reforms in one sector could not succeed without change in others. SOE reform was the fulcrum. For example, by shifting the burden of social insurance and home ownership from SOEs, the state helps SOEs escape their social welfare role and function according to market principles. But if SOE reform was not successful, individuals would not have funds to buy their own apartments, jeopardizing housing reform. Similarly, banks could not shift to market principles if they were still compelled to expand their bad loan portfolios in order to prop up failing SOEs. Finally, bureaucratic reform and economic reform were intertwined, since cutting the number of state cadres would weaken the bureaucracy's interventionist capacity and strengthen market forces.

Although Zhu initially was not enthusiastic about joining WTO,<sup>5</sup> he came to see that external pressure from WTO rules and foreign competition would weaken domestic resistance to SOE reform. Once a date was set for WTO accession, ministries and enterprises could put off the reforms needed to increase their competitiveness only at their peril. Moreover, Zhu could then argue that the WTO rules and impending foreign competition, not his own preferences, were driving this process. Accession also helps Zhu and Jiang fight corruption, since with high tariffs there is an incentive to smuggle; cut tariffs and smuggling becomes unprofitable. And since much smuggling was carried out by People's Liberation Army (PLA) companies, closing those companies would put many smugglers out of business.

### *Potential Breakwaters*

Despite the apparent positive political context for the building of a fifth wave of reform, there were signs after the 15th Party Congress that breakwaters may lie in the way. As number two in the political line-up, Li Peng still had great influence in the Standing Committee of the Politburo. As head of the NPC, he could also slow down laws that were part of Zhu's reforms and keep the pressure on the prime minister.<sup>6</sup> Many in Zhu's cabinet—the State Council—were Jiang loyalists, not Zhu's people. Personnel decisions in the top party hierarchy were controlled by Zeng Qinghong, Jiang's alter-ego. Like Zhao Ziyang and Hu Yaobang before him, Zhu had a political boss he needed to patronize, not antagonize. Some battles he could solve himself; but for others, he needed Jiang's intervention. So when Jiang wavered on sensitive issues, Zhu's hands were tied.

In the meantime, the collapse of the Hong Kong stock market complicated SOE reform because IPOs (initial public offerings) in Hong Kong had been

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5. Joseph Fewsmith, "China and the WTO: The Politics Behind the Agreement," *National Bureau of Research (NBR) Analysis* 10:5, Essay 2 (November 1999).

6. "Zhu Rongji jiujiunian rizi nanguo" [The difficult days of 1999 for Zhu Rongji], *Kaifang zazhi* (Open magazine, Hong Kong), January 1999, p. 17.

key to raising capital to finance SOE restructuring. The general public, too, had now become wary of reform as the voices of the losers, and the depth of their losses, began to drown out the voices of those benefiting from the reforms. With consumer confidence declining, the economy slipped into a recession. Zhu's soft landing was turning into a crash landing. Regional, urban-rural, and class inequalities were now a major problem constraining Zhu's efforts to enter the WTO, expand the private sector, and reform the housing and SOE sector.<sup>7</sup>

Stagnant reforms in one sector stymied solutions in other sectors. Massive layoffs of workers and bureaucrats meant few would have the funds to buy the enterprise housing slated to be sold off. Cutting the state bureaucracy complicated the entire program, as deciding who would survive in each bureau was a political selection. Cadres who introduced reforms that challenged a colleague's interests could become targets of administrative restructuring. As a result, the traditional bureaucratic mentality of "do little, make few mistakes; do nothing, no mistake!" (*xiao zuo, xiao cuo; bu zuo, bucuo*) dominated bureaucratic calculations throughout the past two and a half years.

Finally, Zhu's political style remained a liability. Relying on top down initiatives, Zhu drained localities of their own initiatives and forced them to spend their energy negotiating with central administrators and deflecting central policies.

### *The Wave Stalls: Summer 1998–Spring 2000*

By summer 1998, the economic and social context changed. Widespread urban protests, following massive layoffs, forced the leadership in June to call for a slowdown in industrial restructuring. Rural unrest was also on the rise, due in part to an increasing urban-rural income gap.

Zhu made maintaining 8% growth in 1998 a goal of great political significance, not merely an economic target. This pressured local governments to fudge their data to prove their loyalty to the prime minister's politicized program of maintaining high growth. But by August, Hong Kong magazines reported that not only was 8% growth problematic, but the entire reform package was at risk.<sup>8</sup> Deflation and declining prices became a major problem, when the soft landing turned hard. Yet, Zhu and his allies in the People's Bank increased money for infrastructure projects, thereby increasing waste and corruption, rather than cut interest rates to stimulate private consumption and the growth of private business. Finally, external factors also

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7. Wang Shaoguang, "Openness, Distributive Conflict, and Social Insurance: The Social and Political Implications of China's WTO Membership" (Department of Government and Public Administration, Chinese University of Hong Kong, March 15, 2000).

8. "Zhu Rongji gaige liang hong deng" [Zhu Rongji's reforms face a red traffic light], *Kaifang zazhi*, August 1998, pp. 14–15.

buffeted the reform drive. Foreign direct investment and exports, two pillars of China's growth of the past decade, dried up as overseas Chinese in Southeast Asia saw the value of their currencies collapse. Instability in the region led to massive capital flight, one result of which was a slowing of China's economy.

Zhu's ambitious goal outlined at the NPC in March 1998 of solving the SOE problem in three years was the target of criticism in early 1999. In light of central party concerns about maintaining social stability and the large number of SOEs needing reform, and with half the timetable already elapsed, it became clear that resolving this problem in three years was just "not very likely."<sup>9</sup> His political problems peaked after President Clinton walked away from the promised WTO deal in April. Clinton had sent signals that he wanted the deal by twice writing letters to Jiang Zemin. Zhu and Jiang then used this promise to gain final concessions from domestic opponents of the WTO deal. According to Fewsmith, an expanded Politburo meeting at the end of February approved China's broad concessions.<sup>10</sup> But when Zhu returned empty handed from the U.S. after presenting China's magnanimous offer, he became an easy target for WTO opponents. The launching of the Kosovo war by the U.S. without seeking China's approval in the U.N. and the tragic bombing of the Chinese embassy by North Atlantic Treaty Organization (NATO) forces in May left Zhu reeling.

In the following months, Zhu reportedly offered to resign three times, the last in August. But Jiang refused this request and called on Politburo members to support Zhu.<sup>11</sup> Still in Chinese politics, one need not leave one's post to lose influence. While remaining prime minister, he lost key portfolios. The job of reforming SOEs went to Wu Bangguo, who had managed that portfolio unsuccessfully in the mid-1990s. Zhu was savaged by students on the Internet as a traitor, while older cadres reportedly compared him to Wang Jingwei, who headed the puppet government in occupied China on behalf of the Japanese. The politically astute Li Peng argued that while many of the reforms were good, Zhu was pursuing too many too quickly; they simply could not be done at the same time. Li reportedly launched a stinging attack on Zhu's management of the economy at the summer 1999 Beidahe Conference, complaining that cutting the bureaucracy hurt many good cadres, while housing and medical reforms hurt the common people.<sup>12</sup>

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9. Gu Haibing, "Guoqi gaige 'dao wei' san nian bu gou" [Three years to bring SOE reform to completion is not enough], *Gaige neican*, no. 4, 1999, pp. 6-8.

10. Fewsmith, "China and the WTO."

11. See "Zhu Rongji san du qingci neiqing" [Zhu Rongji offers to resign three times], *Cheng ming*, September 1999, p. 15.

12. Fewsmith, "China and the WTO."

Still, both Chinese and American leaders wanted a WTO deal. So by the end of the summer, after tempers cooled, both sides sent messages demonstrating a willingness to make a deal. After talking with Jiang twice by phone, President Clinton sent Trade Representative Charlene Barshefsky and National Economic Council Chief Gene Sperling to Beijing on November 8, and on November 15 an accord was reached. That agreement helped Zhu dramatically, as he had remained the point man on negotiating with the U.S., and, perhaps even more than Jiang, Zhu and his reform program had much to gain from WTO accession.

## The Reform Issues

What were the debates surrounding policies that formed the “fifth wave”? This section considers first the trimming of the bureaucracy and the battle against corruption and then the debate surrounding WTO accession, SOE reform, and the expansion of the private sector.

### *Political Administrative Reforms*

China has too many bureaucrats and supporting this cast of millions debilitates the state’s budget. In 1997, before the 9th NPC in March 1998, the Politburo approved a program to cut the number of state cadres in half and reduce the number of ministries from 40 to 29. Cuts would occur at administrative levels, from the top to the grassroots. Interestingly, this reform was introduced while then-Prime Minister Li Peng was still in office, before the vote on Zhu’s ascension took place. And, to protect Zhu and ensure a positive vote for his election, Luo Gan, secretary-general of the State Council, not Zhu, introduced the policy to the NPC.

But administrative cuts give the real power holders in China incentives to protect their interests collectively. A month after the policy was introduced, reports circulated in Hong Kong that local governments were opposing the cut in staff.<sup>13</sup> Ministries slated for the trash bin begged the central government to let them maintain their status as bureaus within someone else’s ministry. Despite central demands in October 1998 and April 1999 that the provinces cut their staff, as of May 1999, 22 provinces were still refusing to do so. Top administrators sent in to investigate met strong resistance. Still by the end of 1999, over four million officials had lost their bureaucratic posts, and industrial bureaus throughout China had been transformed into non-governmental industrial associations.

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13. Chen Zhinong, “Zhu Rongji yu bu wei nan,” *Jiushi niandai* (The nineties), May 1998, pp. 29–31.

### *Battling Corruption*

Corruption is the result of partial economic reform. Continued regulatory controls over economic exchange, even as markets emerge, afford bureaucrats opportunities to charge fees for services and “rents” in the form of above market-clearing prices.<sup>14</sup> But greater marketization under the WTO should end much of this. Lower tariffs too cut the benefits of smuggling, boosting the entire reform program.

This uphill battle against corruption is often met with cynical comments, such as “no big fish really get fried.” With so many people on the take, “killing chickens to scare monkeys”—a classic Chinese strategy—may not work because the probability of being arrested is very low (given the scale of corruption and the minimal number of people getting caught) while the rewards are great. Note the level of corruption in the building of the Three Gorges Dam, where funds for relocating one million people are constantly misappropriated. Also, *China Youth Daily* reported that low quality concrete was used to build the dam—the suspicion was that the builders were getting money for high-grade concrete, providing low-cost substandard concrete, and pocketing the difference—thereby threatening its strength and the lives of millions of people downstream.<sup>15</sup>

However, Zhu’s efforts in 1998 to cut smuggling in Guangdong Province apparently were successful.<sup>16</sup> Since summer 1999, the anti-corruption struggle has indeed fried some big fish, catching some powerful men and women in cities all along the coast, particularly Zhanjiang, Xiamen, Shantou, and Ningpo.<sup>17</sup> Moreover, the execution of former NPC vice-chairman Cheng Kejie, while challenged by Li Peng, was popular with average citizens.

### The Debate over the WTO

In the weeks and months preceding the conclusion of the Sino-U.S. negotiations on WTO, heated debates filled the pages of internal newspapers and journals (*neibu*). According to Leung, one group saw accession and globalization as inevitable. Not only should China participate, but only by joining can China help set the rules that would govern global trade. According to

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14. David Zweig, “Undemocratic Capitalism: China and the Limits of Economism,” *National Interest*, no. 56 (Summer 1999), pp. 63–72.

15. See “Shiyong luobiao chanpin san xia er qi dabai keneng cunzai yanzong jihuan” [Because it used lower quality products, the second stage of the Three Gorges dam faces the possibility of a serious catastrophe], at the Sina.com home page on the World Wide Web at <<http://dailynews.sina.com.cn/china/2000-08—08/115393.html>> [accessed August 8, 2000].

16. Peter Seidlitz and David Murphy, “Zhu succeeds in fight against illegal traders,” *South China Morning Post*, 8 November 1998, p. 4.

17. Karby Leggett, “China Intensifies Campaign to Stamp Out Corruption,” *Asian Wall Street Journal (AWSJ)*, December 9, 1999, pp. 1, 8.



Long Yongtu, China's chief negotiator, if China wants a permanent position in the world's agricultural market, it must abide by the WTO's rules.<sup>18</sup>

Much of the intellectual debate over WTO has been linked to globalization. Moses saw four schools, all of whom agree that globalization means less control for China over the direction and consequences of its policies.<sup>19</sup> The "sovereignty" school sees globalization as a threat to national sovereignty because China cannot influence the new global rules that are emerging. So, while China must enter the WTO, the process should be careful and not so wholehearted. This school would also include those analysts who fear that if China becomes dependent on foreign technology, a cut-off to that technology flow during a time of conflict would threaten China's "national economic security" and military capacity.<sup>20</sup>

The "American" school saw globalization as a U.S.-orchestrated process, whose goals include American cultural hegemony and Taiwan independence. Advocates of this view feared that WTO accession would harm the domestic economy and lead to a domestic collapse in China. Yet, more positive views were also expressed. A third group, which Moses calls the "nothing" school (*mei you*), believes that the forces of regionalism and national economic development are as powerful as globalization, so the fears of WTO are exaggerated. Finally, the "partnership" school sees China's admission to the WTO as indicating Western acceptance of China's great power status, so China should use this welcome mat to shape the new rules emerging in the global system.<sup>21</sup>

These differing views prevented unanimity on the final deal. The Friday before the WTO deal with the U.S. was announced, the Standing Committee of the Politburo held a final vote on whether to accept America's terms. While six favored the deal, Li Peng opposed it.

### *Resisting WTO: The Threat to Agriculture*

Agriculture led the resistance to WTO accession because the problems it would experience with entry would be particularly acute and the number of people affected by the opening of rural markets to global competition is so

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18. Ricky Leung, "Probing Chinese Internal Debates on Global Economic Interdependence and WTO Entry" (Hong Kong: Hong Kong University of Science and Technology, spring 2000).

19. Russell Leigh Moses, "Chinese Views on Globalization," ChinaOnline, April 14, 2000, on the World Wide Web at <[http://www.chinaonline.com/commentary\\_analysis/intrelations/current\\_news/secure/c000411Moses-s.asp](http://www.chinaonline.com/commentary_analysis/intrelations/current_news/secure/c000411Moses-s.asp)> [accessed May 10, 2000].

20. Susan V. Lawrence, "The Say No Club," *Far Eastern Economic Review (FEER)*, January 13, 2000, pp. 16–18. See also Fang Ning, Wang Xiaodong, and Song Qing, *Quanqiuhua yinxiang xia de Zhongguo zhi lu* [China's road under the influence of globalization] (Beijing: Zhongguo kexue chubanshe, 1999).

21. For a more positive view of globalization, see Yu Keping and Huang Weiping, eds., *Quanqiuhua de beilun* [Contradictory theories about globalization] (Beijing: Central Compilation and Translation Press, 1998).

great. Little wonder that China's chief negotiator, Long Yongtu, admitted in early 1998 that resistance to opening the rural sector was particularly fierce. Veteran cadres and rural officials, Long noted, were constantly warning Jiang that any opening of the countryside would lead to major rural rebellions.<sup>22</sup>

Rural China was already in trouble as the 20th century came to a close. Rural incomes had been falling relative to urban incomes for several years, in part because of major cuts in state subsidies to agriculture. For example, corn subsidies in the northeast had been cut by 20% in 1999.<sup>23</sup> Rural industry, which has for years sucked up rural surplus labor, was now shedding employees. Total employment dropped 4% in 1997 and 18% in 1998, while the number of rural industrial workers dropped from 32 million in 1994 to 19 million in 1998.<sup>24</sup>

Also, Chinese agriculture is inefficient and highly vulnerable to global markets. According to one report, of nine agricultural products, China had comparative advantage in only live hogs; all others were "clearly" above international prices.<sup>25</sup> Since the state cannot raise purchasing prices to help farmers, some analysts called for continued protection of the agricultural sector. According to Yang, "We must not one-sidedly stress free markets but should scientifically and fairly (*heli*) support and protect agriculture."<sup>26</sup> On May 24, 2000, Minister of Finance Xiang Huaicheng, announced that China would use all available opportunities in the WTO's "Agricultural Agreements" to protect agriculture.<sup>27</sup>

### *Resistance in Other Sectors*

Manufacturers were calling on the state to use all legal mechanisms to protect China's industries. Although tariffs, quotas, and licenses would no longer be acceptable, after entering the WTO

the task of protecting the domestic manufacturing sector will not be over, but in fact will be more important. But the mechanisms will change; from today forward

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22. Long Yongtu, comments to the author, Cambridge, Mass., January 1998.

23. Trish Saywell and Kathy Wilhelm, "Seeds of Change," *FEER*, June 29, 2000, pp. 44–46.

24. Wang, "Openness, Distributive Conflict, and Social Insurance," p. 10; and Gan Yongxin, *Guoqi yonggong celue ji xiagang gongren de shichanghua zhuanxiang* [SOE strategies of using workers and the shift to marketization of laid-off workers] (M.A. thesis, Department of Sociology, Beijing University, June 2000).

25. Yang Shengming, "Some Ideas on Countermeasures that Our Government Must Utilize after 'Entering the WTO'" (in Chinese), *Guangming ribao* (Guangming daily), May 9, 2000, p. 2. With international prices set at 100, the price of raw sugar stood at 183; corn, 180; beans (*da dou*), 179; bean oil (*dou you*), 156; peanut oil, 153; wheat, 143; cotton, 107; rice, 101; and live hogs, 68.

26. Yang, "Some Ideas on Countermeasures."

27. "Zhongguo jiang yong lu xiang bao hu nong ye" [China will use the 'green box' to protect agriculture], *Wen hui bao* (Hong Kong), May 25, 2000, p. 1.

we will mainly use environmental protection standards and technological standards to build *an environmental and technical fortress* [emphasis added]. The history of international trade shows a constant battle between free markets and protectionism, and following the development of the international environment and science and technology, protectionist measures are constantly being renovated.<sup>28</sup>

*China Business Information Times* argued that China should use anti-subsidy, anti-dumping, and technical standards to protect the machine, electronic, chemical, and medical industries.<sup>29</sup>

While such press discussions invite Western criticism, they show how deep opposition was to the deal. It became necessary publicly to discuss these protective strategies to allay fears and undermine resistance from government bureaucrats and enterprise managers. Moreover, according to Pearson, Zhu carried out the decision-making process on WTO in an open, participatory manner to ensure that all opponents were on board when the final deal was struck.<sup>30</sup> But open decision making gave the vice-premiers responsible for specific sectors a veto power within their jurisdictions. In 1999, the minister of information industry, Wu Jichuan, stonewalled the opening of the information technology sector by not showing up at negotiation sessions called by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC); in this way, no consensus could be formed on opening his sector.

Even the State Economic and Trade Commission (SETC), Zhu Rongji's own baby, introduced regulations that flew in the face of the WTO. In 1999, the SETC forced all foreign importers of silicone sealants to sell their products through the China Yuanwang Corp., a company set up by SETC bureaucrats. Yet, despite a MOFTEC ruling in favor of foreign complainants, asserting that the SETC's new regulations violated the WTO spirit of "equal treatment," as of March 2000, these regulations were still in effect.<sup>31</sup>

But, in February 1999, convinced of the need to move forward, Jiang Zemin convened an expanded Politburo meeting and pushed through the WTO package. As Pearson puts it, however, "opposition within China was not won over . . . but rather was run over."<sup>32</sup>

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28. Yang, "Some Ideas on Countermeasures."

29. Ian Johnson, "Critical Masses: Beijing's Propaganda Corps Try to Sell WTO at Home," *AWSJ*, November 19–20, 1999, p. 1.

30. The following two paragraphs on the politics of WTO draw on Margaret Pearson, "The Case of China's Accession to GATT/WTO" in *The Making of Chinese Foreign and Security Policy in the Era of Reform, 1978–2000*, ed. David M. Lampton (Stanford: Stanford University Press, forthcoming).

31. Ian Johnson, "China Continues to Hobble Foreign Firms," *AWSJ*, March 23, 2000, pp. 1 and 5.

32. Pearson, "The Case of China's Accession."

## The Struggle over SOE Reform

President Jiang Zemin's speech at the 15th Party Congress accelerated the pace of SOE reform by making it politically legitimate to use a shareholding system to convert many medium and small enterprises into companies with mixed public-private ownership.<sup>33</sup> As long as the state held majority share in an enterprise, he argued, it was still publicly owned.

But after Jiang's speech, bureaucrats used the slogan of *zhua da fang xiao* ("grab big firms, small ones go") to enhance their control. While this strategy was intended to curb bureaucratic interference for all but the largest SOEs, local officials included relatively small, county government-owned enterprises, as "big" firms. Wu Bangguo, a Politburo member who, although opposed to privatization, criticized this bureaucratic interference in the affairs of smaller firms.<sup>34</sup>

A second trend was even more significant. Soon after the 15th Party Congress perhaps 90% of small and medium enterprises (SMEs) were privatized, and their shares were transferred to managers or bureaucrats. Managers subsequently sold the assets for a quick profit, leaving the workers on the streets.<sup>35</sup> In fact, a local "wind of privatization" sharply criticized by leftist journals, led the SETC to call for an end to the privatization of SMEs.<sup>36</sup>

But the real battle remains over the disposition of larger SOEs: must they be privatized or can they be rescued by other strategies, such as consolidation, reorganization, sub-contracting, or joint-stock ownership?<sup>37</sup> Zhu has consistently and publicly favored consolidating SOEs, with the strong buying the weak, rather than privatization. Still, while Jiang's speech purposely limited the transfer of property rights to joint stock companies and Zhu admonished provincial delegates at the March 1998 NPC meetings against privatization, massive sell-offs occurred under the slogan of "letting the smaller firms go." That spring, Shaanxi, Sichuan, and Henan Provinces passed provincial laws calling for "enlivening" SMEs and expanding the non-state sector. When Shaanxi's provincial government did not disallow the

33. *Beijing Review*, no. 41 (October 1997), pp. 21–22.

34. "Wu Bangguo tongzhi qiangdiao, 'zhua da' yao zhua zhenzhen de 'da'," [Comrade Wu Bangguo stresses that if you want to "grab the big," then you have to grab the real "big"] *Gaige neican*, no. 20, 1998, p. 42.

35. For a discussion of the problem of asset stripping and illegal privatization, see X. L. Ding, "Who Gets What, How?" *Problems of Post-Communism* (May/June 1999), pp. 32–41, and He Qinglian, *Xiandaihua de xianjing* (The pitfalls of China's modernization) (Beijing: Jinri Zhongguo chubanshe, 1998).

36. Guan Qixing, "Ci feng bu ke chang" [This wind cannot be allowed to continue], *Zhenli de zhiuqi* [The search for truth], no. 10 (1998), p. 18.

37. One article proposed seven options other than privatization. See Li Yonghai, "Guoqi gaige qineng yige 'mai' zi" [Can the problem of state owned enterprises be solved by one word—'sell'?] *Dangdai sichao* (Current intellectual trends), no. 6 (1998), pp. 53–54.

privatization of SMEs, the three provinces were attacked by Song Ping and other conservatives who wanted to protect the state's ownership of large industries.<sup>38</sup> Reportedly, Li Peng sponsored the attack, forcing Zhu to call for an investigation by the State Council's research arms. In January 1999, responding to rising social unrest, Li insisted that the state establish a system for managing and helping unemployed workers before laying off more people. As the need for stability was heightened, SOE reform was slowed.

However, in 1999, liberal elements in the government tested the waters of privatization anew. The lead page of *Zhongguo gaige* [China's reform], a journal run by the State Council's Economic Systems Reform Office, stated that "de-nationalization" (*feiguoyouhua*) of the "vast majority" (*jueda duoshu*) of SOEs was the "core" (*gengben*) solution to establishing a real socialist market economy.<sup>39</sup> Otherwise, corruption and rent-seeking would continue, individual bureaucrats would transfer public property into their own private property, and full economic efficiency would never be achieved.

Leftist journals led a withering counterattack. What worried one author was that *Zhongguo gaige* was not simply an academic journal but was published by a central government organization. Moreover, the author had been a "Commentator," meaning that it represented the views of the journal's editorial board. Third, the article was seen as an effort to influence decisions on SOE reform pending at the upcoming 4th Plenum of the 15th Central Committee. Finally, leftists argued that, by using the term "de-nationalization," reformers were hiding their real aim—privatizing all state-owned enterprises—which contravened (*weifan*) the Chinese Constitution. In other articles, leftists denounced the idea of "selling off" (*mai*) SOEs.<sup>40</sup> In fact, in April 2000, Li Peng praised an article in a leftist journal that likened officials who back the sale of SOEs to "offspring unpaired by selling ancestral lands."<sup>41</sup>

The plight of unemployed workers has undermined Zhu's reform wave. Leftists attacked the lack of institutions to help the unemployed as morally unacceptable and politically foolhardy. While a local welfare office pays all unemployed urban workers a small state stipend, only those considered *xia-gang* ("laid off") receive several hundred *yuan* a month from their original unit. But SOEs were required to carry this burden for only three years, so by 2000 most welfare benefits were to end. This pending cutoff without the introduction of an unemployment insurance scheme was problematic for the

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38. Xia Wensi, "Zhu Rongji yu yuanlao Song Ping guo zhao" [Zhu Rongji crosses swords with the venerable Song Ping], *Kaifang zazhi*, July 1998, pp. 14–15.

39. A Commentator, "Fei guo yu hua: Guo qi gaige de genben chulu" [De-nationalization: The basic solution to reforming SOEs], *Zhongguo gaige* (China's reforms), July 1999, p. 1.

40. Li, "Can the Problem."

41. Charles Hutzler, "China Digs In," Associated Press, May 23, 2000.

entire reform wave. How was China to fund people laid off in the future? In 1998 and 1999, the Leadership Small Group on Finance (Caizheng lingdao xiaozu) introduced experiments in Beijing, Shanghai, and elsewhere, trying to determine how to fund and distribute social welfare benefits.<sup>42</sup>

Housing reform, another component of Zhu's reform package, stalled due to the problems of the SOEs and the weak financial status of many urbanites.<sup>43</sup> Despite enormous interest among urbanites in improving their housing, 66 million square meters of urban housing remained vacant in 1998.<sup>44</sup> The state apparently miscalculated the amount of funds urban residents would be able and willing to spend on housing. Due to this lack of capital, many units cannot commercialize their housing. A report in summer 2000 argued that if the current pace of privatization continued, China's share of commercialized housing would reach 70% in 60 more years.<sup>45</sup>

### The Struggle over the Private Sector

Private enterprises, though legal since 1978, have faced enormous ideological and financial constraints.<sup>46</sup> Should this sector surpass the state-owned sector, could China still argue it was socialist? Private wealth exacerbates inequalities,<sup>47</sup> while jealousy among cadres and citizens slows private sector development. Thus, in February 1999 the Development Research Centre of the State Council reported that government officials still regard private firms as enemies of the state, or as "fat monks," that could be hit for taxes and fees.<sup>48</sup>

From a financial perspective, bank officials will rarely lobby on behalf of private loan applications because private firms have no guarantors; unlike SOEs, if private firms go bankrupt, no ministry will bail them out. Also, bankers were not directed to make such loans, as promoting the private sector was not a national priority—and particularly not so when compared to the pressure exerted on bankers to salvage SOEs. Instead, private firms are pressured to don a "collective" hat, allowing some bureaucrats to share in the private entrepreneur's profits.

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42. Leadership Small Group on Finance officials, interviews, Beijing, summer 1999.

43. *Xinmin wanbao*, June 9, 1999, p. 1, cited in Li Cheng, "China in 1999: Seeking Common Ground at a Time of Tension and Conflict," *Asian Survey* 40:1 (January/February 2000), pp. 112–29.

44. *Gaige neican*, no. 6, 1998, p. 13.

45. *Ibid.*, no. 7, 2000, pp. 13–15.

46. Different from privatization, which turns public property into private property, the issue with respect to the struggle over the private sector is the creation of completely private firms by individual capitalists.

47. Chinese economists estimate that 30%–40% of private savings are in the hands of less than 3% of the population. See Li, "China in 1999," p. 121.

48. Mark O'Neill, "Private Firms Win Status," *South China Morning Post (SCMP)—China Business Review*, March 11, 1999, p. 1.

Yet, in the past two to three years no sector has contributed more to economic growth. In the past five years, the private sector absorbed more labor than the TVE sector, which had previously created the most new jobs. Thus, in terms of the share of non-agricultural employment, in 1990 the ratio was for private—16.1%, collectives—21.5%, SOEs—62.3%. But by 1997, the private sector employed 31% of non-agricultural labor, collectives 14%, and SOEs 55%. Of total national industrial output, in 1992, the private sector was only 6%, collectives 38%, and SOEs 48%; by 1997 the ratio was 18:38:25.<sup>49</sup> In terms of contribution to industrial growth, in 1992, the ratio was for private firms—22%, collectives—45.5%, SOEs—32.5%. By 1997 the ratio was 66:29:4.7, making private firms the engine of industrial growth. Finally, in 1999, over 90% of new jobs and 80% of the value added growth came from the private sector.<sup>50</sup> Yet, of total short term loans by state banks, private firms got only 0.7% of the total, while SOEs got 87%.<sup>51</sup>

So, in 1999 the NPC declared that the private sector was no longer just a supplement to the state-run economy but was now a key part of the national economy. However, two amendments to the Constitution were reportedly not passed as concessions to the party's left-wing. These were "the principle of the inviolability of private property" and "the need to protect it."<sup>52</sup> Thus in 1999, a senior party leader advocated maintaining party leadership over the private sector, either by putting party organizations within private firms or by having several private firms form one party branch. Industrial and commercial bureaus were also to set up a special committee to supervise this work.<sup>53</sup> And, as of summer 2000, state media still prefer the term "people-operated" (*min ban*) rather than "private."<sup>54</sup>

But the importance of the private sector is enhanced by China's WTO ascension. Private entrepreneurs, more than state sector enterprises, are likely to compete effectively against the onslaught of foreign firms who will have greater access to the domestic market under WTO. Second, in anticipation of the rapid growth of foreign-owned foreign trade companies under WTO, the

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49. Most of the data in this section come from Chong-en Bai, David D. Li, and Yijiang Wang, "Dancing with Bureaucrats: The Evolution of China's Non-State Sector," unpublished paper, October 1999.

50. Robert A. Scalapino, "The People's Republic of China at Fifty," *National Bureau of Asian Research Analysis* 10:4 (October 1999), p. 12.

51. Bai, Li, and Wang, "Dancing with Bureaucrats."

52. Willy Wo-Lap Lam, "NPC Deputies to Push More Amendments," *SCMP*, February 26, 1999, p. 7.

53. "Zhongyang lingdao tongzhi tichu, yao zuo hao zai xin jingji zuzhi zhong jianli dang zuzhi de gongzuo" [A central leader advocates doing well the work of establishing party committees within the new economic organizations], *Gaige neican*, no. 22 (1999), p. 40.

54. Craig S. Smith, "China's Tiny Private Sector Faces Giant Obstacles," *International Herald Tribune*, July 13, 2000, p. 16.

state in 1999 approved 61 private Chinese-owned foreign trade firms in order to strengthen China's competitiveness.

## The Road Forward: Does China Need a Fifth Wave?

The deal with the U.S. on WTO, the passing of Permanent Normal Trade Relations (PNTR) by both Houses of the U.S. Congress, China's improving economic situation—particularly the dramatic jump in foreign direct investment and exports in light of improved economic conditions in Southeast Asia—and the pending accession to the WTO, altered the political context in which Zhu functions and helped him reassert some influence over economic reform. While initially many ministries had voiced significant opposition to the WTO deal, Zhu managed the internal debate within the party; after the agreement with the U.S. in November 1999, Zhu reportedly ordered all criticism of the deal stopped.<sup>55</sup> Also, with WTO accession coming, reforms of the SOEs, the banking, and finance sectors, and even changes in agricultural pricing and marketing could no longer be put off as they had been for the previous decade. Beginning in spring 2000, a wave of mergers and acquisitions among SOEs occurred, a strategy that reflects Zhu's view that China must “marry the strong with the powerful” to create hundreds of large firms that can compete with the multinational corporations that will flood China after WTO entry.<sup>56</sup>

Zhu led discussions on SOE reform at the August 2000 Beidahe meeting, where he ordered all major ministries to present concrete plans for restructuring their SOEs in light of WTO accession. An unemployment insurance scheme is emerging as the Office for Restructuring the Economic System has proposed that the state sell off 20% of the shares it owns in SOEs that are listed on the stock market and use the 220 billion *yuan* to raise funds for social security.<sup>57</sup> Such a strategy of selling so much of the state's share in the national economy would have been sacrosanct not long ago.

Major financial changes are now underway. In July 2000, the *South China Morning Post* argued that “a seismic shift is taking place” in the reform program and that Zhu's plans were finally turning into action.<sup>58</sup> In particular, numerous announcements that month on changes in the stock market that lifted restrictions on foreign investors and pressures on the PLA to continue divestitures all suggested that Zhu was back in command and that the reform

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55. Thomas Chan, lecture at the Hong Kong University of Science and Technology, March 2000.

56. Willy Wo-Lap Lam, “Zhu's Re-inventions for WTO,” *SCMP*, August 2, 2000, p. 16.

57. Josephine Ma, “Social Security Tax Triggers Debate,” *ibid.*, August 7, 2000, p. 8.

58. Anna Healy Fenton, “Reforms Snowball,” *SCMP* (Sunday money), July 30, 2000, p. 1.



program was about to undergo a major shift. Similarly, in October, the *Far Eastern Economic Review* saw major changes pending in the stock market,<sup>59</sup> while in November, support for private banks was emerging.

Still, a new wave may not emerge. Politically, Zhu may not have the power to mobilize support across so many sectors. As of that fall, Zhu was not slated to take on any major political post, such as chairmanship of the NPC, after the 16th Party Congress in 2002. Rather than follow the example of Li Peng, who kept his high profile party and government posts even after retiring as prime minister, Zhu may not keep his position on the Standing Committee of the Politburo. His influence could wane between now and the Party Congress. The domestic economy still faces problems, since deflation has not ended. Social and political unrest still worries the leadership. According to the August 2000 edition of *Dongxiang* magazine, a large number of violent protests and bombings forced Zhu to arrange a special nationwide telephone conference. As China gears up for the 16th Party Congress, the CCP may prefer stability with moderate growth to rapid growth and widespread reform.

Perhaps such waves are a thing of the past. Zhu's reform program has made serious progress in the past three years without an all-encompassing wave. With accession to the WTO, deep changes in SOEs, finance, insurance, and agriculture are inevitable. A leaner bureaucracy will be forced to rely on selective intervention in the marketplace. Ironically, while initially Zhu Rongji was no big fan of WTO accession, his reform package may succeed because of the WTO victory.

Waves were necessary in the past because polarization over public policy among factions in the 1980s and early 1990s meant that one faction needed to mobilize all of its forces to push changes past the opposition. But today, the left, Deng Liqun and company, are less influential than conservatives such as Yao Yilin, Li Peng, and Chen Yun were in the Deng era. A consensus exists among leaders who agree that the SOEs must be revamped, that China must enter the world economy through the WTO, and that market forces must expand. As long as middle-of-the-road leadership committed to gradual reform remains in power, the political system may not need intense outbursts of political and economic change for China to continue down the road of reform.

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59. Trish Saywell, "Whispers of Change: China Mulls Plans to Open Its Domestic, A-share Stockmarket to Foreign Companies," *FEER*, October 5, 2000, pp. 54–56.