
CHINA IN 2002

Leadership Transition and the Political Economy of Governance

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Abstract

The 16th National Congress of the Chinese Communist Party defined the policy agenda for 2002. Hu Jintao succeeded Jiang Zemin as Party general secretary but Jiang retained the chairmanship of the Central Military Commission. Politically, the Chinese leadership gave special emphasis to stability, and continued to combat the Falungong and crack down on dissent on the Internet. In the economic sphere, China enjoyed another year of rapid growth and largely complied with the first-year requirements of its WTO membership. Restructuring and regulatory reforms in major industries accelerated. In the face of major worker protests, populism dominated social policy, with greater assistance to the poor and a crusade against tax evasion by the new rich. Major fiscal reforms were implemented. China enjoyed stable relations with the world's major powers but its ties with North Korea came under strain.

Relative calm befell China in 2002. In preparation for the much-awaited 16th National Congress of the Chinese Communist Party, China's leaders gave special emphasis to unity and stability. Yet, behind the scenes there was intense jockeying for position leading up to the Party Congress. As expected, Jiang Zemin, 76, retired as Party general secretary, having presided over the longest peaceful development in China since the end of the 19th century. But the retirement of Jiang and his senior colleagues was coupled with the appointment of trusted lieutenants and supporters to ensure political and policy continuity.

To create the "right" atmosphere for the Party Congress, the Party apparatus tightened control over press and publications, instituted stricter surveillance of the Internet, and persisted in the "Strike Hard" anti-crime campaign.

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The leadership transition also set the tone for socioeconomic reforms. While reforms in the previous few years had relied on downsizing and restructuring to improve efficiency and profitability, much of the policy focus in 2002 was on protecting the disadvantaged and placating the discontented. Where the drive to downsize and rationalize hurt people, the policies of populism, highlighted by greater assistance to the poor and a crusade against tax evasion by the new rich, helped to soothe and heal.

The populist social policies were supported by robust economic growth. While the global economy slowed to a crawl, the Chinese economy, propelled by vigorous fiscal stimulus, surprisingly strong exports, and dramatic growth in auto and housing sales, grew by an estimated 8%, well above the official target of 7.0%. This brought the Chinese gross domestic product (GDP) above 10 trillion yuan (about \$1.2 trillion: 1 US\$ = 8.28 yuan). Helped by China's entry into the World Trade Organization (WTO), the amount of realized foreign investment surpassed \$50 billion, making China probably the largest recipient of foreign investment for the first time. Benefiting from years of downsizing, state sector profitability continued to improve. While the state banking system remains the Achilles' heel of the Chinese economy, signs of improvement showed: in the first three quarters, the absolute amount of non-performing loans in the banking system decreased by 49 billion yuan (\$5.9 billion) while the ratio of non-performing loans dropped by 3.3 percentage points.¹

China's foreign relations also sailed into calmer waters as the United States concentrated on the war on terrorism and beyond, actively cultivating Chinese support and cooperation in a variety of arenas. In contrast, China's relationship with North Korea became strained.

The National Party Congress and Leadership Succession

The much-heralded sixteenth Communist Party National Congress finally convened on November 8, later than anticipated.² Despite a year-long process and some grassroots participation to choose delegates to the Congress, the Party remains as secretive as ever in the selection of Party and national leaders. There was little public accountability to speak of.

1. These data are derived from the People's Bank of China website, <<http://www.pbc.gov.cn>>.

2. While some commentators had attributed the delay to Jiang Zemin's desire to visit President George Bush in late October with all the trappings of authority, the delay gave much grist to the rumor mill about political machinations. Some even suggested that Jiang would retain his post as Party general secretary. See, for example, Susan Lawrence and Charles Hutzler, "As China Prepares to Change Leaders, Ferment Is Growing," *Wall Street Journal*, September 4, 2002.

Nonetheless, the Congress saw the first peaceful and orderly—albeit still incomplete—leadership succession since the Communist takeover in 1949. Jiang Zemin, who with his colleagues presided over 13 years of rapid economic growth and helped raise China's international stature, retired from the post of Party General Secretary. His successor is his long-time understudy Hu Jintao, 59, who was handpicked by the late Deng Xiaoping and put on the Political Bureau Standing Committee (PBSC) in 1992. With the exception of Hu, all members of the old PBSC, including Li Peng and Zhu Rongji, retired and were replaced by younger members who were members of the Political Bureau (the exception is Zeng Qinghong, who served as Jiang's right-hand man but was only an alternate member of the Political Bureau). The composition of the full Political Bureau represents a triumph of Party functionaries. The Congress chose a central committee comprising 198 full members and 158 alternate members, with an average age of 55.4 years. Of these 356 members of the power elite, 180 are new faces and all but five have at least a junior college (*dazhuan*) degree. However, only five of the full Central Committee members are women, down from eight members five years ago.³

The most controversial move of the Congress was what failed to occur. Jiang Zemin, despite leaving the Central Committee and its Political Bureau, has retained his position as chairman of the Party's Central Military Commission and will thus continue to oversee China's military and foreign policies. Indeed, shortly after he was installed as Party general secretary, Hu Jintao pledged to the Central Committee that on important matters he would "seek instruction and listen to the views" of his predecessor, Jiang.⁴ Hu has good reason to show such deference. At least five of the new nine-member PBSC are Jiang's trusted followers and some, particularly Jia Qinglin, were promoted in spite of their tainted images in provinces plagued by corruption scandals. Hu has much to do to broaden his base of political support and prove himself to be a leader in his own right.

For the foreseeable future, the continuing presence of Jiang and the elevation of his followers virtually ensure that the combination of economic liberalization and political authoritarianism that has characterized Chinese governance in the reform era will not see fundamental changes. The political report of the Congress, which Jiang personally delivered, fully embodied this uneasy philosophy of governance. As expected, Jiang's doctrine of "Three Represents"—never mind that the average Chinese has trouble remembering what the three represents actually are—got pride of place in the political report and was also enshrined in the amended Party Charter. The doctrine—

3. Xinhua Newswire, November 14, 2002.

4. Erik Eckholm, "China's New Leader Promises Not to Sever Tether to Jiang," *New York Times*, November 20, 2002.

that the CCP “must always represent the development trend of China’s advanced productive forces, the orientation of China’s advanced culture, and the fundamental interests of the overwhelming majority of the Chinese people”—seeks to broaden the Party’s base by reaching out to groups such as entrepreneurs that the Party previously had shunned and even persecuted. Likewise, as Jiang announced the goal of quadrupling China’s GDP between 2000 and 2020, he emphasized that the “well-off society” will be built “in an all-round way,” thus holding out hope for groups that have been left behind amid widening income gaps.⁵

The Political Report repeatedly invoked the need for the Party to keep pace with the times. In the economic realm, the imprimatur is to further “emancipate the mind.” “Development,” said the report, “requires that we do away with all notions which hinder development, change all practices and regulations which impede it and get rid of all the drawbacks of the systems which adversely affect it.” It called for people “to come up with new ideas for development, make new breakthroughs in reform, break new ground in opening up and take new moves in all fields of endeavor.”⁶ Already, the Congress has provided important impetus for the protection of private property and the reform of the state sector.

For liberals wishing for any sign of significant opening in political reforms, however, the Political Report was disappointing. Instead, stability continues to be of “overriding importance” for maintaining CCP rule. Within this context, there will be further legal and administrative reforms. Whatever new initiatives that will come forth, however, must occur under the leadership of the Communist Party. In fact, shortly after the Congress concluded, Zhou Yongkang, 60, a Political Bureau member and member of the Party Secretariat who had previously served as minister of mineral resources and Sichuan party secretary, was appointed to the Ministry of Public Security. Zhou thus became the first Political Bureau member in more than two decades to lead the nation’s police forces.

The Struggle for Political Correctness

Though not convened until November, the National Party Congress dominated the policy agenda for the year as China’s political elite prepared for it. Publicly, much of the state apparatus was mobilized to create the “right” atmosphere for the Congress. Authorities continued to strike hard at all types of crimes and rectify the order of economic competition.

5. The full English text of Jiang’s speech is available at <http://english.people.com.cn/features/16thpartyreport/>.

6. Ibid.

In this context, the Party propaganda apparatus tightened control over the media to prime elites and masses. In the summer, the Party's Publicity Department sent detailed guidelines to editors, telling them to refrain from publishing speculations on forthcoming leadership changes and potentially explosive topics, including burdens on peasants, major accidents and crimes, and income inequalities.⁷ In fact, a number of more liberal papers discovered the limits in the spring. *Southern Weekend* had to pull a story exposing financial irregularities in Project Hope, a high-profile educational charity program affiliated with the Communist Youth League, right in the middle of printing. The *Worker's Daily* was criticized for its reports on the plight of workers.⁸ A number of books on politically sensitive topics were also banned.

Yet, in the age of the Internet and fierce market competition, controlling the media is no longer as easy as ordering newspapers to print only what the Party sees fit. Some of the banned books continue to be available in pirated editions. Visits to street corners and railway stations suggest that the publication of tabloids of questionable political correctness remains a thriving business. Indeed, armed with the new technologies, anti-government groups, particularly the Falungong sect, displayed a new level of tenacity in challenging the Chinese government's dominance. Kept away from Tiananmen Square, members of the Falungong have been distributing leaflets, making unsolicited phone calls, and sending fax and Internet messages in their campaign to tell their story.⁹ While *Beijing Spring*, the flagship publication of overseas Chinese dissidents, struggled financially after Taiwan discontinued its subsidies early in the year, the Falungong organization's many websites appeared as the most technically sophisticated and ubiquitous that the Chinese state has had to contend with. Indeed, both English- and Chinese-language searches via <Google.com> for "Jiang Zemin" produce "Exposing the Crimes of Jiang Zemin," the Falungong's no-holds-barred attacks on the Chinese leader, on the top page.

7. Elisabeth Rosenthal, "Beijing in a Rear-Guard Battle against a Newly Spirited Press," *New York Times*, September 15, 2002. Not all of the regulation is unjustified. Chinese journalists are widely known for writing favorable corporate stories in exchange for bribes. Intense competition has also resulted in a spate of fake news. In August, a Hunan news website released a story about 34 people dying in an auto mishap in Xinjiang. The report was picked up by other sites and foreign news agencies, before it was found to be fabricated. See *Straits Times* (Singapore), October 3, 2002.

8. *South China Morning Post* (Hong Kong), May 4, 2002.

9. "Falungong Using Phones, Faxes, Internet to Directly Reach Chinese," Agence France Presse (AFP), July 11, 2002.

The sect also brought its fight with the government to new heights by hacking into cable broadcast networks in a number of cities.¹⁰ Chinese authorities also accused the sect of repeatedly jamming and hijacking satellite TV transmissions intended for China's remote regions from a base in Taiwan. These activities provoked severe countermeasures on the part of the state. In Changchun, where exiled Falungong leader Li Hongzhi originated, 15 Falungong followers were arrested and sentenced to prison terms of between four and 20 years in September for illegally cutting into TV trunk lines and replacing state television broadcasts with programs advocating the Falungong.

Yet, it was the Internet that captured the attention of regulators. In late August and early September, authorities blocked popular Internet search engines AltaVista and Google outright. Google was the major thorn in the regime's side because its caching function allowed users to read copies of blocked sites. By all accounts, some of Google's search results, notably the search on "Jiang Zemin" mentioned earlier, became the last straw on the camel's back for the censors. The blunt blocking of Google and other sites caused an uproar in the international media, and much resentment among Chinese Internet users. In September, the Internet censors lifted the blocks but introduced sophisticated technology to filter Internet traffic (including Google's caching services) and to deny access to proxy servers. Meanwhile, the unruly "Internet cafes" were targeted for rectification. Between May 10 and October 1, authorities closed more than 80,000 out of nearly 200,000 commercial "Internet cafes," citing the lack of proper operating licenses and various illegalities.¹¹ Such ratcheting up of the ability to control led some to conclude that the Chinese state has largely been successful in taming the Internet as a tool of subversion, for now.¹² In such confrontations, the state is also being remade, and not always for the better.

Economic Governance

While the Chinese economy enjoyed robust growth, Western press and wire reports highlighted the loss of reformist momentum during Premier Zhu Rongji's last year in office. Following extensive public debate, the central government formally scrapped its policy of selling state-owned shares in listed firms, dealing a setback to the plan to use the proceeds from stock sales

10. The Falungong's websites such as <<http://www.minghui.com>> have provided how-to guides on these activities at different times, as well as a growing archive of audio-visual materials.

11. *Beijing Qingnian Bao* (Beijing Youth Daily), October 15, 2002.

12. Michael Chase and James Mulvenon, *You've Got Dissent! Chinese Dissident Use of the Internet and Beijing's Counter-Strategies*, Rand Corporation, Santa Monica, Calif., 2002; "Beijing Gaining Ground in Battle to Control Internet," AFP, September 19, 2002

to replenish the social security fund. A planned second board for emerging companies was also put on hold. Yet, these setbacks were nothing unusual, amid the general malaise affecting stock markets worldwide, and they were partially compensated by other policies. After ending the state-share sale plan on domestic markets, regulators made it easier for foreign companies to purchase state companies and have also started to devise a Qualified Foreign Institution Investor scheme to allow foreign investors to invest in yuan-denominated A shares and bonds listed in China for the first time. Likewise, while the launch of China's own second board stalled amid the global slump of technology stocks, China's gold exchange was inaugurated at the end of October and there was talk of resurrecting bond futures to allow financial institutions to hedge their bond purchases. Indeed, while top policy makers worked on the Party's blueprint for the next five years, plenty of initiatives remained on the policy implementation agenda, including compliance with the terms of WTO membership, reorganization of industry and regulation, reform of the troubled banking system, fiscal reforms, as well as the revival of rural fee and tax reforms. Much was achieved in each of these areas.

WTO Compliance and Domestic Responses

China's first year in the WTO turned out to be far more uneventful than skeptics had predicted. China largely fulfilled its pledges, by cutting tariffs to 12% and by revising many laws and regulations to bring them into compliance with WTO requirements. In fact, for much of the year it was the U.S. government that got the international limelight for its protectionist policies on steel and farm support.

Some contentious issues did arise, however. For example, foreign auto companies were unable to quickly set up financing operations, as government regulations on such operations became delayed even as Chinese auto sales jumped. There was concern that in the general area of finance, including banking, insurance, and securities companies, Beijing had adopted a go-slow attitude in order to protect its banks and other financial companies from foreign competition.¹³ American business associations also complained about the Chinese government's delay in allocating import quotas for automobiles, fertilizer, wheat, corn, wool, and sugar.¹⁴

By October most of those concerns were being addressed. The People's Bank of China released trial regulations on auto financing for public comment, and the financing subsidiaries of Ford and General Motors filed appli-

13. Karby Leggett, "China Lags in Auto Financing, Failing Its WTO Commitment," *Wall Street Journal*, September 2, 2002.

14. Andrew Batson, "Bureaucracy Hinders China WTO Compliance," *Dow Jones Newswires*, September 19, 2002.

cations with the central bank to set up auto financing operations.¹⁵ In a groundbreaking move, Newbridge Capital Inc., a U.S.-based investment firm, received approval to purchase a stake in state-owned Shenzhen Development Bank, and was given full management control by the bank's board of directors.¹⁶ The U.S. and China also reached a deal for China to extend its interim regulations on the import of biotech foods, set to expire on December 20, through September 2003 so as to promote the flow of U.S. soybean sales to China.

China's WTO membership helped unleash significant changes at the corporate level. Take the auto industry. Though the prices of imported cars did not come down much owing to the existence of import quotas, due to be phased out at the end of 2004, China's domestic automakers cut prices and promoted new brands aggressively. The price wars finally unleashed domestic demand but also put inefficient producers under pressure, leading to a wave of alliances and mergers. First Auto Works (FAW), which has joint ventures with Volkswagen, took control of fourth-ranked Tianjin Automotive Xiali Co., a leading economy car producer, and entered into a joint venture with Toyota. Dongfeng entered into a broad alliance with Nissan. Shanghai Automotive Industry Corp (SAIC), which already partners with GM and Volkswagen, also lined up some smaller producers and, in a small and important change in the direction of investment, paid about \$60 million for a stake in GM Daewoo. Perennial laggard Beijing Auto entered into a joint venture with Hyundai.

Managing Competition: Industrial Reorganization and Regulatory Reforms

China's economic czars also continued to engineer competition by breaking up monopolies and encouraging mergers and consolidations in industries suffering from vicious competition. In the former category are the telecom, power, and railway industries. In May 2002, in a long-awaited move to introduce competition into fixed-line services, the giant China Telecom was formally split into two (China Telecom and China Netcom). The two successor companies join China Mobile, China Unicom, China Railcom, and China Satcom in an increasingly competitive field. Growing competition, rising incomes, and tariff cuts helped boost the nation's number of telephone subscribers to 388.4 million by August. China's tele-density (number of subscribers per 100 people) rose from 8.1 at the end of 1987 to 30.2 in Au-

15. *China Daily*, October 10, 2002.

16. Dow Jones Newswires, October 9, 2002.

gust 2002.¹⁷ Never have so many people acquired telephone services in such a short time in any country.

The deliberate pace with which China's regulators have engineered telecom competition has served the Chinese government well in terms of revenue raised in the stock markets without allowing foreign players to take control of Chinese providers for stock that is valued at far less only months later. As a result, China's telecom industry has largely escaped the sort of dramatic boom-and-bust shakeout that is now plaguing some of the biggest Western telephone companies. In an interesting role reversal, Chinese Minister of Information Industry Wu Jichuan, widely known for resisting the entrance of foreign players during China's WTO negotiations, reminded his counterparts in other countries that "the 'game' cannot continue properly without rules, and in the meantime, inappropriate deregulation is detrimental to development."¹⁸

Besides the telecom industry, the Chinese government also introduced bidding, on a limited basis, into the electric power industry. So far the introduction of energy trading has helped bring power prices down without producing the sort of crisis that gripped California. A plan for breaking up the State Power Corporation into several independent power producers and separate power grid operators, thereby separating power generation and transmission, received State Council approval for implementation. A similar proposal for reforming the railway industry, by separating ownership of rail lines from transport companies, has also been mooted, and Xu Kuangdi, the popular former mayor of Shanghai, has reportedly been tapped by Zhu Rongji to spearhead this effort.

While reforms of network-based industries are designed to increase competition, the reorganization of other industries such as oil and petrochemicals has been intended to moderate competition. In October, a long-awaited reorganization of the airline industry, which has struggled from the effects of high oil prices, illegal ticket discounting, as well as the impact of global terrorism, finally took place. Nine airlines owned by industry regulator CAAC (Civil Aviation Administration of China) were consolidated into three groups: Air China, China Southern Airlines Group, and China Eastern Airlines Group. While other regional players continue to exist, the big three were given the bulk of the trunk routes so that they could be more competitive vis-à-vis their global competitors.

17. These data were derived from the Ministry of Information Industry website <<http://www.mii.gov.cn>>.

18. "Chinese Official Says Telecom Competition Not 'Game Without Rules'," Xinhua News Agency, May 29, 2002, FBIS-CHI-2002-0529. This is quoted from Wu's address to the 5th APEC (Asia-Pacific Economic Cooperation) Ministerial Meeting of the Telecommunication and Information Industry.

Until recently, China's industry regulators also served as owners of the state enterprises in their respective sectors. Such incestuous relationships made the regulators champions of producer interests, often to the detriment of consumer interests. With the reorganization of the various industrial sectors, the regulators generally no longer act simultaneously as owners. For example, following the reorganization of the airline industry, CAAC will be regulating issues such as safety, market order, and air traffic control and is no longer responsible for the profits and losses of the airline companies. Instead, the State Council appoints a board of supervisors to each of the groups while the Ministry of Finance represents the state as owner. Though such an arrangement is more cumbersome than before, it establishes an arms-length relationship between the regulator and the regulated companies.

Restructuring, Social Protest, and Welfare

In the reorganization and restructuring of the corporate sector, each major state corporation, ranging from the giant oil and petrochemical companies to state commercial banks, has aggressively cut jobs to reduce costs and improve efficiency, while thousands of others have been privatized or closed. The parent company of Sinopec alone laid off 213,700 workers in 2001, lowering its number of employees to 947,800 by the end of 2001. According to data from the State Statistical Bureau, total employment in the state sector dropped from 110.4 million at the end of 1997 to 76.4 million at the end of 2001. The 30.8% reduction in state sector employment in four years is extraordinary in any economy. Even though some of the former state sector employees found alternative employment, there is little doubt that urban unemployment and poverty rates have risen sharply during this time.¹⁹

The sharp reduction in state sector employment reminds us of the drastic nature of China's economic restructuring in the past five years, as well as the Chinese leadership's deep worries about social unrest. In fact, a spate of high-profile protests, the largest and most sustained since 1989, occurred in spring 2002 in the cities of Daqing, Fushun, and Liaoyang in China's northeast, as well as in cities in other parts of China. In the oil town of Daqing, former oil industry workers who had received, by Chinese standards, relatively generous severance payments from oil giant PetroChina, the listed arm of China National Petroleum Corporation, fought against arbitrary changes in severance benefits promised by the company.²⁰ In contrast, laid-off workers in Liaoyang and Fushan protested nonpayment of back wages and pensions.

19. See, for example, David Murphy, "Nothing More to Lose," *Far Eastern Economic Review*, November 7, 2002.

20. "Laid-Off Workers Protest at Chinese Oil Field," AP, June 20, 2002.

These protests occurred even though local authorities refused to grant protesters permits to hold demonstrations. In the end, the authorities were able to bring the protests to an end by applying pressure, including a massive police presence and the arrest and formal indictment of four protest organizers in Liaoyang for “illegal assembly, marches, and protests,” and by promising payment of some back wages and certain benefits.²¹ In the case of Liaoyang, anti-corruption investigators from Beijing later followed up on the protesters’ complaints of official corruption. As a result of the investigations, the director of the Liaoyang Ferroalloy Factory, where most of the protesting workers had worked, was charged with corruption, and a variety of other local officials, including police chiefs, were punished.²² These moves helped address most of the worker grievances.

To China’s leaders, the spring labor protests served to remind them of their worries about worker unrest and social stability. In fact, in his government work report to the National People’s Congress, Premier Zhu Rongji gave special emphasis to helping disadvantaged groups (*ruoshi qunti*). As corporate downsizing accelerated, the central government as well as local authorities have reported sharp increases in the number of urban residents receiving minimum livelihood support (*zuidi shenghuo baozhang*) and increased outlays so that anyone qualifying for such support would receive it. At the end of 2000, the number of people on such support was four million. This number rose to 11.7 million at the end of 2001 and 19.6 million at the end of August 2002.²³ Both central and local authorities have also made major efforts to reduce wage and pension arrears.

Yet, reemployment of laid-off workers has become progressively more difficult. Whereas in 1998, 50% of laid-off workers found employment again, the percentage decreased to only 30% in 2001 and only 9.1% in the first half of 2002.²⁴ This grim trend, as well as the spring labor protests, prompted the central leadership to convene a National Reemployment Work Conference in September. At the conference, central leaders including President Jiang Zemin harped on the significance of employment for social stability, reform, and development. Caught between rising employment pressures and central government demands, local authorities began to offer subsidies and tax

21. For the broader human rights issues raised by these protests, see Human Rights Watch, “Paying the Price: Worker Unrest in Northeast China,” July 2002, available at <<http://www.hrw.org/reports/2002/chinalbr02/>>.

22. Erik Eckholm, “Corruption Protest in China Leads to Charges, Top and Bottom,” *New York Times*, September 13, 2002.

23. This information is from the website of the Ministry of Civil Affairs <<http://www.molss.gov.cn/>>.

24. Xinhua Commentator, “Focus Our Strength to Do a Good Job in the Reemployment of Laid-Off Workers from State Enterprises,” Xinhua 2002-09-19, FBIS-CHI-2002-0919.

breaks to firms that offer jobs to laid-off workers who meet certain qualifications. For example, the city of Baotou in Inner Mongolia budgeted six million yuan (about \$725,000) to “purchase” 1,000 jobs. A firm is given a subsidy of 3,000 yuan (about \$363) per year to employ a laid-off worker. Such a policy, however, is costly and hence least affordable in localities most in need.

As was mentioned last year, the central leadership had hoped to reform rural extraction in 2001 so as to reduce the burdens on farmers whose incomes have been stagnant in recent years. Yet, reforms had to be slowed in 2001 because of concerns about education funding and other issues. In 2002, these reforms were revitalized and extended to about 20 provinces with more funding from the central government, the centralization of education funding to the county-level (rather than towns and townships), the introduction of a single-fee system in schools, and the downsizing of township governments as part of the overall government reforms. Meanwhile, the central government continues to implement a massive program to lower rural power prices as well as the western development strategy.

Fiscal Reforms and the Fight against Tax Evasion

It is costly to undertake the programs mentioned above, as well as others. To help in funding growing central government outlays, the central leadership introduced a major fiscal reform measure, namely the reapportionment of the corporate and personal income taxes. Whereas the 1994 fiscal reforms, contrary to global trends, allocated all revenue from the individual income tax to local governments, beginning in 2002 the central government took a share of the personal income tax revenue and of the corporate income tax above the 2001 base figures. The center’s share was set at 50% for 2002 and 60% for 2003, with future rates to be set in light of circumstances. The central government justified the move by saying that it would use the additional revenue to boost transfer payments to interior regions.²⁵

Meanwhile, the government continued to make strenuous efforts to boost revenue collection. Now that the central government takes a share of the individual income tax revenue, it also has acquired a strong interest in combating tax evasion by individuals. In an interesting twist, the tax investigations targeted some high-profile private entrepreneurs, a master stroke that killed two birds with one stone. First, the initiative to allow private entrepreneurs to join the Communist Party, which Jiang Zemin announced in 2001, stirred much controversy. Though the Party establishment emphasized that

25. “PRC Officials on Income Tax Revenue Sharing Scheme Aimed at Common Prosperity,” Xinhua 2002-03-12; “Finance Minister Xiang Huaicheng Says Revenue Sharing to Benefit Western China,” Xinhua Newswire, March 11, 2002.

workers and peasants remained the backbone of the Party, many felt the Party was departing from its roots at a time of rising income inequalities. The crackdown on tax evasion by private entrepreneurs thus served to placate these sentiments. Second, by picking on those who flaunted their wealth and flouted the law, the tax administration sent a powerful message that wealth accumulation must be accompanied by responsibility.

Premier Zhu Rongji, who had previously downplayed the consequences of rising income inequality, took a populist stance. In early July, it was widely reported that Zhu had asked why China's richest private entrepreneurs were not paying personal income taxes. Under Zhu's prodding, the tax authorities quickly swung into action and, in a major departure, began to bring tax dodgers and cheaters to criminal prosecution. In July, famous actress-entrepreneur Liu Xiaoqing, ranked number 45 on the Forbes 2000 list of China's richest, was arrested in Beijing because her companies had evaded taxes amounting to 14.6 million yuan (about \$1.76 million). Other high-profile cases soon followed. In early October, Yang Bin, the chairman of Euro-Asia Group and second-ranked on the Forbes 2001 list, was detained for alleged tax delinquency, accounting fraud, and violations of land zoning laws. In late October, an arrest warrant was issued for Yang Rong, the deposed chairman of the New York-listed Brilliance China Automotive group (BCA), who had ranked third on the Forbes list.²⁶

These high-profile cases were only some of the many that local authorities pursued. In September, the Shenzhen Local Tax Bureau for the first time asked the police to start criminal proceedings against 10 companies that had long delayed and evaded tax payments.²⁷ In Sichuan, Liu Chuan, the legal representative of Chengdu Haihui Trading Co. and the son of a former Sichuan Construction Bureau director, was sentenced to five years in prison and fined 3.24 million yuan (about \$391,304 dollars) for tax evasion.²⁸ While targeting business people, the tax administrations also strengthened monitoring of businesses and high-income individuals by upgrading electronic information systems.

The fight against tax evasion brought some quick changes in attitudes. Business people in the past generally deducted their incomes as pre-tax expenses in their firms and thus avoided the high brackets for personal income

26. Though spelled the same in English, Yang Bin and Yang Rong have different last names in Chinese characters.

27. *Beijing Qingnian Bao*, September 29, 2002.

28. Earlier, Liu had been given an eight-year sentence for smuggling and bribery, and his combined prison terms were set at 12 years. Zhongxinshe (China News Agency), Beijing, October 10, 2002.

tax.²⁹ Amid the populist crusade against tax evasion, however, some of the richest individuals started to draw a salary from their firms so that they could pay personal income taxes. In the meantime, growing numbers of Chinese have started to see themselves as taxpayers and have begun to demand that governments provide services commensurate with such a designation.

International Relations

China's foreign relations moved into calmer waters in 2002. While in years past China's leaders and diplomats had tended to see foreign policy in zero-sum terms, increasingly they began looking for "win-win" solutions, whether in negotiating WTO entry or in bilateral relations. Such a reorientation of China's global interactions has helped imbue China's foreign policy with greater levels of pragmatism and maturity.

Since September 11, 2001, China has cooperated with the U.S. in the fight against terrorism. U.S. President George Bush visited Beijing on the 30th anniversary of President Nixon's historic first visit to China. At the end of April, Chinese Vice President Hu Jintao made his first trip to the United States. President Jiang followed in late October and was received at the Bush ranch in Crawford, Texas. While the two sides still differed on issues such as human rights and religious freedom, pragmatism prevailed as the two sides resumed military exchanges and dialogues on human rights. In anti-terrorism, China has shared intelligence with the American side, allowed the Federal Bureau of Investigation (FBI) to set up an office in Beijing, and established institutions in the Chinese central bank and the Ministry of Public Security to combat money laundering. On non-proliferation, the Chinese government promulgated regulations governing the export of missile technologies and dual-use biological agents, meeting a long-standing American request. Around the same time, the U.S. government placed the East Turkestan Islamic Movement on its list of terrorist groups. Some members of the Uighur minority are known to have trained in Osama bin Ladin's camps and were captured by American troops in late 2001. The Chinese government saw the designation by the U.S. and other countries as vindication of its crackdown on terrorists and separatists, while Uighur exiles criticized the move as abetting Chinese suppression of Uighur identity and persecution of the Uighur freedom movement.³⁰

The new pragmatism was also on show in other areas. As the U.S. sought U.N. authorization to tackle Iraq, China, the world's fastest-rising oil im-

29. See, for example, the interview with Liu Yonghao, China's richest private entrepreneur, in Peter Goodman, "China's Wealthy Facing Income Tax Crackdown," *Washington Post*, October 22, 2002.

30. Erik Eckholm, "U.S. Labeling of Group in China as Terrorist Is Criticized," *New York Times*, September 13, 2002.

porter, placed itself squarely in the median position between the U.S. and Britain on the one hand and Russia and France on the other. With respect to U.S. weapons sales to Taiwan and certain provisions related to Taiwan in the U.S. Foreign Relations Authorization Act Fiscal Year 2003, Chinese leaders displayed remarkable restraint in not allowing irritating U.S. moves to derail bilateral visits and the broader relationship. Such a strategy paid off. During the summit meeting in Texas, President Bush reiterated American support for “One China” and stated that the U.S. does not support Taiwan independence.

Yet, Chinese leaders have no illusions about American intentions toward China, a point that was driven home by the Bush administration’s National Security Policy released in September. For their part, Chinese leaders—and in this case it is an advantage for China to have more “national leaders” (*guojia lingdao ren*)—maintained a busy schedule traveling to numerous countries to broaden China’s multilateral reach. In a two-week tour in April, for example, Jiang Zemin visited Nigeria, Tunisia, Germany, Libya, and Iran, voicing opposition to Washington’s possible unilateralist expansion of Washington’s war on terror beyond Afghanistan. Also in April, and over a 10-day period, Premier Zhu Rongji was in Turkey, Egypt, and Nigeria; National Party Congress chairman Li Peng was in Japan; Vice President Hu Jintao prefaced his trip to the United States with visits to Malaysia and Singapore; and Foreign Minister Tan Jiaxuan was in Moscow. At the World Summit on Sustainable Development in early September, Premier Zhu announced China’s ratification of the Kyoto Protocol to the United Nations Framework Convention on Climate Change, a treaty the U.S. has spurned.

China’s headache of the year concerned not its real or potential adversaries, but North Korea. China and North Korea publicly maintain friendships as “close as lips and teeth,” but they got a little too close for comfort in 2002. For years China has been host to thousands of North Koreans fleeing from famine and repression back home. Some of these North Koreans, partly with foreign assistance, entered foreign missions seeking asylum in South Korea. Rather than face international criticism for sending the refugees back to North Korea to face punishment, China allowed more than 100 North Koreans to leave for South Korea via third countries, thereby straining its ties with Pyongyang. At the same time, efforts by the Chinese armed police to erect barbed wire in the capital’s embassy district to keep refugees out of foreign missions attracted unwelcome light onto China itself. Even North Korea’s attempts at reform stepped on China’s toes. In late September, North Korean leader Kim Jong Il appointed Yang Bin, the controversial businessman noted above, as chief of the Sinuiju Special Administrative Region (SAR), right across from the Chinese city of Dandong in Liaoning Province. Days later, Yang was detained by Chinese police for tax evasion and other alleged violations of laws and regulations, throwing the future of the SAR into question.

Finally, China became extremely exasperated with Kim Jong Il's "diplomatic adventurism" after Kim admitted to the development of nuclear weapons in violation of international accords and chose to restart a mothballed nuclear reactor.³¹

Conclusion

Looking back over the past decade, China's leaders have weathered enormous upheavals both inside and outside China, pushing through significant and sometimes painful reforms. The basic framework for further economic reforms is firmly in place with the transition to a new generation of leaders. Much remains to be done, however. While China continues to enjoy rates of growth that are the envy of the rest of the world, massive industrial restructuring and deep integration with the world economy have contributed to growing unemployment and rising income inequality. As a result, the barometer of social tensions has risen substantially. In response, China's leaders have taken a hard-line stance toward dissent while working hard to ease these tensions by launching new reforms, stimulating domestic demand, increasing government spending on welfare, and fostering open markets internationally.

For now, the new generation of leaders shows no sign that they will depart from this combination of economic liberalization and political authoritarianism. Further down the road, the Chinese leadership apparently hopes that its vision of a "well-off society," the Chinese version of a middle-class society, will help provide the bedrock of social stability needed to perpetuate the Communist Party's ruling position. Will China's middle class be notably more receptive to authoritarian rule than middle classes elsewhere in East Asia?

31. Matthew Forney, "Family Feud: China's Patience for North Korea's Diplomatic Brinkmanship Has Worn Thin," *Time*, December 23, 2002.