

# ***CHINA IN TRANSITION: A LOOK BEHIND THE SCENES***

DIRKSEN SENATE OFFICE BUILDING  
SEPTEMBER 25, 2002

A Conference Report by Samantha Blum

## **Introduction**

**I: Challenges to Legitimacy: The Party in Transition**

**II: Income, Population, and Health: Welfare Society in Transition**

**III: Off the Beaten Track: Rural China in Transition**

**IV: The Changing Workplace: The Economy in Transition**

## **Introduction**

When China embarked on its path of “Reform and Opening” at the end of the 1970s, the country began to change in so many dimensions and at such speed that it soon became impossible for anyone to claim that they knew the country thoroughly. China has now become, for Americans, arguably the most complex and least understood country in the world. This should not be surprising. With a population equal to 22% of the world’s total, a land area the size of the United States, a richly diverse geography, levels of development ranging from medieval to Mercedes Benz, an economy that is a hodgepodge of *laissez-faire* and government control, and a Leninist political system that is experimenting with village elections, there is no question that China is complex. And despite regular reporting by journalists from China, even the most avid readers and viewers find it difficult to come to a balanced understanding of the country. But it is imperative that we seek a more informed and balanced understanding, because China is not only one of the most complex and least understood country's for Americans, it is also one of the most important for U.S. interests.

Fortunately, this “Reform and Opening” has vastly multiplied the number of opportunities for outsiders to interact intensely with China, and has thus allowed the development of a great deal of expert knowledge about the country. This knowledge is spread among the academic, diplomatic, business, journalistic and NGO communities, but too rarely reaches policy- and opinion-makers.

The National Committee on United States - China Relations and the Freeman Chair in China Studies at the Center for Strategic and International Studies (in collaboration with the China Program, Carnegie Endowment for International Peace and the Asia/Pacific Research Center of Stanford University) decided, therefore, to organize a one-day

conference to showcase some of this expertise at the crossroads of American policy-making, the United States Congress. With the encouragement of Senator Joseph R. Biden, chairman of the Senate Foreign Relations Committee, the organizers brought together on September 25, 2002 an impressive group of eighteen specialists for “China in Transition: A Look Behind the Scenes.”

This is a report of that conference. It was written by Ms. Samantha Blum, a graduate student in Political Science at George Washington University, who has done an outstanding job of summarizing an extraordinarily rich set of presentations and discussions, and to whom we are very grateful.

For the foreseeable future, the nature of the relationship between the United States and China will have a greater impact on Asia-Pacific peace and prosperity than any other bilateral relationship in the region. Moreover, we believe that what happens inside China over the next five to ten years will have an increasingly profound impact on the kind of China we face in the future. It should be self-evident, therefore, that the United States should do what it can to acquire a deeper and more nuanced understanding of Chinese society, economy and politics, and to craft its China policies accordingly. We hope that “China in Transition: A Look Behind the Scenes,” has made a useful contribution towards this goal. We also highly recommend our companion conference “Taiwan and U.S. Policy: Toward Stability or Crisis?” (whose principal organizers were the China Program, Carnegie Endowment for International Peace and the Asia/Pacific Research Center of Stanford University) which addresses this very important set of issues for U.S.-China relations.

We would like to extend our deepest appreciation to each of the panelists and chairs, and to Senator Biden and his staff, particularly Mr. Frank Jannuzi. Special thanks also go to Jan Berris, Virginia Rosell, Savina Rupani, Michael Swaine, and Moira Whelan, as well as to John Fei, Karen Jacob, Gabriel Bitol, Kathryn Gonnerman, Janet Granger, Matthew Oresman, Andrew Thompson, and Laura Wilkinson.

Dr. Bates Gill  
Freeman Chair in Chinese Studies  
Center for Strategic and  
International Studies

Mr. John L. Holden  
President  
National Committee on U.S.-China Relations

## **Challenges to Legitimacy: The Party in Transition**

Session Chair: Ambassador James Sasser, Former Ambassador to China

Prof. Joseph Fewsmith, Boston University

*So What Type of Party Is this Anyway?*

Prof. Li Cheng, Woodrow Wilson Center and Hamilton College

*Hu's in Charge after the 16<sup>th</sup> Party Congress?*

Dr. Minxin Pei, Carnegie Endowment for International Peace

*Corruption and the Rise of Systemic Risks in China*

The first panel of the conference addressed issues related to the current and future state of the Chinese Communist Party (CCP), particularly the main problems and challenges it is facing, and its efforts to deal with them. Dr. Joseph Fewsmith, a professor of international relations and political science at Boston University, led off the panel, and looked at the need for the Party to adapt to the social, political and economic changes taking place throughout the country. He was followed by Dr. Li Cheng, a fellow at the Woodrow Wilson Center and professor of government at Hamilton College, who focused on the timely issue of leadership transition, discussing how Hu Jintao represents some of the important political trends in China. Finally, the talk given by Dr. Minxin Pei, co-director of the China Program at the Carnegie Endowment for International Peace, dealt with the PRC's pervasive problem of corruption, examining the causes and political consequences for the Party if the problem is not solved. The keynote speech of the conference, given by Professor Roderick MacFarquhar, the chair of the Department of Government at Harvard University, provided a historical context for the succession issue. His talk has been posted in full in conjunction with this report, and therefore is not covered here. However, we do refer to his views in the recap of the question and answer session following the Political Reform panel, since he addressed many of the issues that the panelists did.

### **Political Reform**

Professor Fewsmith began his discussion by acknowledging that the CCP is definitely changing, but pointed out that the key question remains whether these changes are occurring fast enough to meet the multitude of challenges the Party faces. He noted that while the fourth generation of leadership is younger, better educated, less ideological, and has a more realistic understanding of the country's problems, these positive characteristics will be less significant than whether they have the ability to "muster the will and mobilize the energies of the people" to confront the issue of political reform raised by China's massive socio-economic changes. In contemplating the answers to these questions, Professor Fewsmith sees both positive and negative signs.

On the optimistic side, the CCP has been responding to a number of the challenges since the mid-1990s, when a consensus emerged among the leadership that the collapse of the Soviet Union stemmed from a lack of reform in its Communist Party. According to Fewsmith, changes have been occurring on two fronts, ideological and

organizational. The main ideological shift has been the decision to admit private entrepreneurs into the party, a step that has revised a basic tenet of Marxism and thus “hits at the very core of party legitimacy.” Organizationally, “the CCP has also been making some major changes, though not large enough yet.” Due to corruption and “societal outrage at the abuses of lower level party functionaries,” the CCP has been attempting to open up appointment procedures and other party processes at the local level. This has been done in order to attain greater public accountability and allow for increased openness to public input.

Fewsmith explained that currently the main motivation for the party to undertake significant ideological and organizational changes is that it has recognized that over time issues such as “social change, changing views among the citizenry, particularly the growth of rights consciousness, and globalization” will have “a major impact on China’s governing institutions.” However, it is the very vastness of the socio-economic and political developments the PRC will face in the future that are the source of Fewsmith’s skepticism about the Party’s ability to meet its challenges. He qualified his skepticism, though, by pointing out, “the danger here is not that the CCP will collapse, but that social conflicts will intensify and that local interests will dominate many areas of Chinese life making the sort of wide-ranging political reform China needs difficult if not impossible.” Fewsmith concluded his remarks by reemphasizing the daunting tasks the party faces in the future. The “easy reforms” have already been carried out, while those that remain not only involve the country’s basic governing institutions, but will involve dealing with vested interests.

### **The Leadership Transition**

In his talk, Li Cheng answered questions about the degree of institutionalization in the upcoming political succession and the types of new leaders that are expected to emerge. He examined the political forces and regional interests that are represented by the fourth generation of leaders, particularly Hu Jintao. He anticipates that Hu will “be in charge” after the 16<sup>th</sup> Party Congress and attributes his future success to three basic advantages. First, Hu is “ascending to power at an optimum time,” because his rise has “corresponded with the development of two important concepts in Chinese elite politics” – the “fourth generation” of leaders, and the institutionalization of political succession. With regard to the former concept, because Deng Xiaoping identified Hu as the leader of the fourth generation, he eliminated much of the competition for power that might have come from members of the third generation. On the second trend of institutionalization, not only has Hu benefited from being promoted through the leadership ranks by both Deng Xiaoping and Jiang Zemin (and thus is not seen as gaining power as a result of favoritism), but the development of institutional mechanisms such as term limits and retirement age requirements has established norms that will ensure Hu’s ascendancy. Therefore, Li believes that Hu “personifies the trend of political institutionalization in China.”

Hu Jintao’s second advantage is that of “coming from an inland region,” because one of the principal criticisms of Jiang Zemin has been that “he has cultivated a web of

patron-client ties based on his Shanghai connections.” Hu, therefore, does not need to create his own faction, for resentment of the “Shanghai Gang” means that other leaders would naturally side with him in many disputes. The third advantage is Hu’s “broad-based support due to his low-profile personality and political wisdom.” Both ends of the political spectrum in the CCP find Hu acceptable, Li explained, for on the one hand he is open-minded about issues such as political reform, but on the other he gave a strong speech following the embassy bombing in Kosovo, demonstrating “effective nationalistic appeal during a time of crisis.”

Li next discussed how Hu Jintao exemplifies several of the traits that seem to characterize the leaders of the fourth generation. For example, because their formative years took place during the calamitous Cultural Revolution, not only are most of the leaders far less ideological and more open-minded than their elders, but because they experienced China’s hardships at that time first hand, they have a strong understanding of the country’s problems and the suffering of vast segments of the population. Additionally, Li points out that the new leadership will likely be typified by “compromise and power-sharing rather than vicious factional fighting,” due to the “shift of the criteria in elite recruitment from revolutionary credentials to administrative skills,” so that “those who are skillful in coalition-building and consensus-making are often favored.”

Li concluded by looking at the significance of the transition to the fourth generation of leadership for the United States. He noted that while the political succession will be a significant test of whether “China can take a major step toward a peaceful and more institutionalized power transition,” the basic “institutional developments and political trends in China that Hu Jintao embodies converge with the interests of the United States.” Further, although the leaders in the fourth generation are not democrats, “they also do not have an ideology fundamentally hostile to American values,” and in fact the leadership “is becoming increasingly diversified in terms of political outlook, social stratification, and regional representation.”

## **Corruption**

Dr. Minxin Pei’s discussion on corruption and its systemic risks began with an outline of the extensive scope and various manifestations of the problem. Estimated at constituting 3-4% of GDP today, he explained that corruption has mainly taken the form of kickbacks in government projects, diversion of public funds, and the theft of funds and assets from state-owned banks and enterprises. However, during the 1990s it also acquired three new characteristics, which continue to seriously plague the country today: the purchase of public office, collusion among groups of officials; and large-scale capital flight.

Having described the severity of the problem, Pei next addressed the question of whether government efforts to eliminate corruption have met with success. On the surface, it appears that the government is cracking down, as illustrated by a number of high profile cases. He noted, however, that these have mostly been symbolic and do not actually deal with the root of the problem. In general, enforcement efforts are lenient; for

example, the percentage of officials prosecuted is low, and those who are in senior positions often get reduced terms. Pei believes China's massive corruption problem stems from several sources, such as "the state's extensive involvement in the economy," and the "breakdown of mechanisms for monitoring and political accountability." The latter issue is particularly significant, for it is very hard for the center to know what the various localities are doing. Therefore, the lack of monitoring capabilities combined with the low-levels of prosecution and penalties, has made corruption a "low risk, high return" endeavor.

That the government has proven incapable of dealing with the problem has serious political implications for China and the CCP, for it increases "the systemic risks for instability." Pei identified five main consequences of the continued pervasiveness of corruption. First, although it will not directly bring down the government, it does undermine public support for the party, and thus harms the regime's legitimacy. Second, corruption is a direct cause of social tension, because it contributes to rising inequality throughout the country. Third, it "increases systemic risks in key sectors," including finance, national defense, critical infrastructure, and public health (such as in dealing with epidemics like HIV/AIDS). Fourth, the breakdown of monitoring systems has meant a "blocking of political signals" from the bottom, such as local cover-ups of social unrest. Finally, local governments are descending into "local mafia states," which "can destroy the government from the bottom up." In concluding his discussion, Dr. Pei pointed to one way in which the United States can help China in its fight against corruption – by helping to stop capital flight, for America is one its primary destinations.

### **Question and Answer**

Many of the people in the audience asked Professor MacFarquhar his thoughts on the fourth generation of leaders, and the impact of their ascendance to power on the United States and its interests. His comments stressed just how little we know about their specific views, but also made clear that it was unlikely that their policies would initially be overly different from those of the third generation. (Additionally, he noted that it was uncertain how well all the members of the new generation knew each other and were aware of their individual long term goals and strategies.) On the Taiwan issue, he predicted that in the first couple years the new leaders would likely adhere to the "rulebook" written by their predecessors, nor did he foresee any changes in perception of the U.S. role in Asia, because the two generations hold similar views on the subject. Turning to the impact on the domestic arena, MacFarquhar shared the views expressed by Fewsmith and Li that the new generation had a greater perception not only of China's problems, but also of what it means to be a modern society. Further, he felt that with the fourth generation in command, the military might try to "push around" the young leaders, but they in turn would most likely try to further policies begun by Deng Xiaoping in the 1980s to put the military firmly under state control.

On the issue of the ideological changes taking place in the party, MacFarquhar's emphasis was somewhat different from that of Fewsmith, in that he did not think allowing entrepreneurs into the party would bring about very profound political changes.

He explained that for most people, the CCP represents a way to get ahead in life – for capitalists a better way to make business deals. Bringing economic powerhouses into the party would give them more influence, but it would definitely not spur the CCP along the path towards inter-party democracy, for “businessmen are not nature’s democrats.” While widening the elite will not bring about inter-party democracy, he felt other forces might, such as the impact of the West and the need to have a contented population, especially if the economy declines while other problems increase. Professor MacFarquhar also commented that he does not think economic deterioration would destroy the party; it could, however, create big problems because it is key to stability. Lastly he noted that the party will not be able to solve its problems by promoting nationalism. Although without Marxist ideology nationalism is the only way to rouse support, there are growing numbers of people who do not trust the government, as indicated by the prevalence of demonstrations throughout the countryside.

The issue of political reform was raised again in the question and answer period: Professor Li predicted that although the issue was on the fourth generation leaders’ agenda, they were not yet ready to proceed. When they do, however, it will likely be in small steps. He also noted the conceptual differences that exist on the notion of democracy: while the United States sees it as a process, China views it as substance to get to the right answer. For example, peasants and workers in the PRC consider democracy as a form of justice to be used against bad local governments, but not in conjunction with the top leadership that they perceive as good. Lastly, Li pointed out that there are many criteria for democracy, and that in a big diverse country like China it can not take place overnight; five years ago no one talked about institutionalization, but now it is a hot issue.

During discussion, one of the key issues raised was whether corruption might ultimately overwhelm the Party. Pei reiterated that he did not believe it would lead to the collapse of the government, but saw the real threat as being to China’s long term growth. If corruption continues to expand, the country will not be able to achieve its goals. However, he pointed out that the leadership could do much more to prevent further abuses if it found the political will. Professor Li stated that as long as China has the political mechanisms to deal with corruption, there is reason for hope. For example, he said, the PRC is executing more corrupt officials than ever before, and while this is not actually dealing with the root of the problem, it is sending a signal and making people think twice. Li also pointed out that in the 1990s the Chinese military was very corrupt, but the government has been successful in its decommercialization efforts, which has helped lessen the corruption rampant in that area. This was backed up by Bates Gill’s comments later that the top leaders in the PLA are very serious about professionalizing the military, and to the extent that corruption hinders that process, they would strive to counter it. One last point on the issue of corruption’s ability to undermine the government was made by Professor Li, who noted that the peak of public opinion against official corruption has not yet arrived, and is thus an unknown variable.

This discussion next turned to how the process of decentralization has affected the spread of corruption. Decentralization has both positive and negative sides; as Professor

Li pointed out, while local governments need more autonomy for economic development, such independence creates problems when it generates the conditions for corruption to flourish. In terms of local efforts to counter corruption, Dr. Pei noted that due to the diversity of problems there is not one single solution that the center can put forward. However, greater efforts should be made in furthering local democracy, and strengthening legislation and the power of the courts. Professor Fewsmith added that China will move in different directions in different places in resolving the corruption issue, and the central government will thus be under pressure as one region develops its own solutions that are different from those being employed in another.

The issue of rule of law was raised in the context of preventing corruption, and Professor Fewsmith explained that the notion is not really a problem at the top level of government but at the bottom. The Chinese people, he stated, do not really see the courts as a means of redress, which is why there have been protests against corruption. Ambassador Sasser pointed out that development of the PRC legal system is one way the United States can have an effect on eliminating corruption, and suggested that we do more to train lawyers and judges in China. In contrast to the weakness of legislation and courts in combating corruption, Dr. Pei pointed out that the Chinese press has shown ability and courage in exposing problems. Professor Fewsmith agreed about the effectiveness of the media, noting that one of the first things people will do if they want to fight corruption is to turn to the press.

## **Income, Population, and Health: Welfare Society in Transition**

Session Chair: Dr. Bates Gill, Center for Strategic and International Studies  
Prof. Deborah Davis, Yale University

*Getting Ahead, Falling Behind*

Prof. Huang Yanzhong, Grand Valley State University

*Reform as Pandora's Box: China's Public Health Crisis*

Dr. Joan Kaufman, Radcliffe Institute for Advanced Study

*China's Family Planning Program: Recent Developments and Prospects for Change*

In the second panel, the conference turned from changes and problems within the Party to some of the developmental challenges and issues in society at large. The first speaker, Dr. Deborah Davis, a sociology professor at Yale University, presented an overview of the socio-economic effects of China's impressive economic growth. Dr. Huang Yanzhong, an assistant professor of political science at Grand Valley State University, then discussed the PRC's current public health crisis and its implications for regime legitimacy. Finally, Dr. Joan Kaufman, a visiting scholar at the East Asian Legal Studies Program at Harvard Law School, examined the positive and negative results that have emerged from China's one-child policy.

## **The Effects of Economic Growth**

Professor Davis discussed the emergent dichotomies resulting from China's economic growth and rapid shift from an agrarian to an industrial-service society – the upsides and downsides, the winners and losers. She identified the positive results as sustained growth, the rise of imports and exports as a percentage of GDP, and tremendous advances in reducing poverty. In this latter area China has seen a very dramatic drop in absolute numbers of people below the poverty level, but there also has been a shift in the distribution of the poor from predominantly rural areas in the 1980s, to a significant increase in urban poverty today. The benefits China has derived from economic growth have also been accompanied by some serious negative developments: income inequality (urban incomes are five to six times those in rural areas); corruption; the weakening of social insurance, particularly medical; and the emergence of jobless growth.

From these positive and negative trends, winners and losers emerge more prominently. The main beneficiaries according to Professor Davis are healthy males, under forty, who reside in coastal cities, and who have a secondary education. Additionally, she noted, belonging to the CCP also helps in finding jobs and having higher salaries. On the other hand, those most harmed by the developments of the past 20 years have been females over the age of 35 who live in cities (which constitutes a large portion of the population); retirees forced out of work by early retirement age requirements; industrial workers in the rust belts; and the seriously ill as well as their families. During the question and answer period Davis also mentioned another determining factor: a person's place of employment. For example, a failing unit will declare bankruptcy and write its people off, leaving them without pensions. Davis concluded with the recommendation that the U.S. government could make a contribution in this area through funding to improve the gathering of statistics about the mobility of China's population, which would assist government in creating a viable social safety net.

## **The Public Health Crisis**

Professor Huang began his discussion by reviewing why the PRC is now facing a public health crisis. He explained that the process of liberalizing agriculture undertaken in the early 1980s led to the collapse of the rural health care system, because communal welfare funds – “the main source of rural health financing” – were terminated as part of the decollectivization policy. Thereafter, the state encouraged market functions to replace reduced public subsidies by “encouraging public facilities to recoup their expenses from user charges.” This type of “market-oriented healthcare reform transformed public health institutions into revenue-making machines.” Consequently, as they turned to drug sales and extra services for profits, medical organizations drove up the level of health spending.

Throughout the 1990s, the cost of health care continued to increase, but the number of people covered by insurance dropped. As a result, people now only go to doctors for emergencies, and as pointed out earlier by Professor Davis, those who are

seriously ill end up in poverty. Further signs of potential troubles in China's health system are indicated by the fact that "the overall improvement in [the country's] health status during the reform era conceals more recent trends" of a negative nature. For example, "major health indicators such as life expectancy at birth became stagnant in the 1990s," and there are vast numbers of people infected with tuberculosis and hepatitis B. The looming HIV/AIDS crisis, if not contained, could mean that the PRC might "have the largest number of people infected with HIV in the world within a few years."

China's massive medical care and public health problems have "important implications for political legitimacy." If the government is increasingly seen as being unable to provide the public with health and other social services, then people "will be alienated" leading to an increased sense of "deprivation." Popular discontent can thus "contribute to the erosion of the regime." Huang further noted that the lack of health services leads to the rise of "non-state sources of moral authority and spiritual well-being," such as the Falun Gong, which the Chinese government perceives as a threat.

The principle impediment to dealing with and solving China's public health problems, according to Professor Huang, "is the disproportion between the country's daunting health problems and the inadequacy of the government capacity to handle such problems." One manifestation of government deficiencies is "its lack of responsiveness," a prime example being how it has reacted to the HIV/AIDS epidemic. However Huang pointed out that even when the government attempts to address a public health problem it is impeded by a "lack of bureaucratic capacities in policy implementation." Government agencies often "work at cross-purposes," leading to inconsistent policies and impasse. Such "bureaucratic fragmentation also inhibits sound regulation in the health sector."

Huang concluded by pointing to the serious implications for the United States if Chinese government deficiencies continue to contribute to a deteriorating public health system – it is not in American interests to have the PRC move in the direction of a "failed state." Consequently, he recommends that the United States formulate a China policy that "incorporates efforts to improve the Chinese state capacities in selected policy domains such as public health and welfare provision." In particular it could provide technical and financial assistance, on the condition that the PRC government devote more resources to health care. Finally, Huang suggests that public health issues could be promoted as part of America's human rights agenda, an approach he believes would be acceptable to the Chinese government.

### **The One Child Policy**

Dr. Kaufman's discussion of China's one child policy outlined the positive and negative consequences of the strategy, and illustrated how in recent years the results have led to a reexamination of the policy and brought about reforms. In terms of constructive and advantageous outcomes, China has clearly benefited from population growth being controlled, a decline in infant and maternal mortality, and an increase in life expectancy. Kaufman also pointed to more "normative changes," in particular that most Chinese have come to recognize the need for population control. Further, there have also been

“changing fertility desires,” as most urban couples only want one child, while those in rural areas desire two (one boy and one girl).

On the negative side, however, there have been some “major social and demographic consequences” of the policy, such as the skewed sex ratio, in part due to sex selective abortions and female infant abandonment. An increasingly salient issue in the future will also be the uneven age ratio that will contribute to “an elderly burden.” The third adverse trend Kaufman highlighted, is the failing of the government’s system to carry out the policy. The main problem has been that in order to achieve population control targets, some local officials resorted to “overzealous implementation” and rights abuses. Rural opposition to the policy implementation methods has thus been “one of the major complaints about local governance.” Additionally, the central government has not always been aware of the true situation in the countryside, because “pressure to achieve targets has led to false reporting.”

According to Kaufman, growing acknowledgment of the policy’s negative “costs” led to its review and reform. In particular, government desires to “regulate coercive practices and increase accountability of local government” coincided with the rise of “a new generation of more professional leaders” at both the provincial and national levels. The 2002 New Population Law is the most recent manifestation of attempts at the national level to create new guidelines. One of the key elements of the law is its very strong language on the illegality of coercion.

### **Question and Answer**

Much of the question and answer period following the presentations was devoted to health issues, including drug regulations, government functions, and the HIV/AIDS epidemic. One audience member raised a question about the prevalence of pseudo-science miracle drugs in China. Professor Huang attributed the phenomenon to the failed health system, and in an explanation similar to that which he gave for the increased popularity of the Falun Gong, he stated that because it is so expensive to see a doctor, people have begun turning to self-help and pseudo-science. He noted that such drugs elude national standards and regulation because it has proved difficult for China to establish an American-style FDA. Dr. Gill pointed out that the PRC’s lack of government capacity in handling the disbursement and regulation of drugs was going to prove to be a big problem in proper administration and monitoring of anti-HIV drug regimens.

The tension between the need for central government control and the trend of decentralization also arose, as Professor Davis emphasized that today it is the people who are most in need of medical attention that are “invisible and without power.” In contrast, she noted, under Mao Zedong the state was forced to “see” those people. Professor Huang suggested that the solution was for the Chinese government to refine its functions – withdraw from some sectors, but strengthen its power in others such as public health and welfare.

The panel members were asked about the potential HIV/AIDS epidemic that the PRC is facing. Dr. Kaufman asserted that the real obstacle in dealing with the problem lies not at the national level, but at the provincial level and below. She then identified several reasons for the local level hindrances: stonewalling because of complicity; lack of understanding about what the epidemic will mean; and the high financial costs of meeting the challenge. Professor Huang concurred that local governments are the main problem in fighting the spread of HIV/AIDS, largely because they treat it as an embarrassing issue and are unwilling to be frank about the situation. However, he also saw potential troubles existing in national plans that focus on prevention, not treatment, and which rely on the traditional and less effective means of promotion, such as mass mobilization.

Also during the question and answer period, Professor Kaufman elaborated on her discussion of the 2002 New Population Law and the importance of the illegality of coercion. She explained that coercion is a code word for forced abortions, and that the spirit of the law is to send a message to the local officials. Additionally, she suggested that one way to solve the problems associated with population control would be for China to reform its cadre promotion system because it has been based on performance in achieving targets.

### **Off the Beaten Track: Rural China in Transition**

Session Chair: Mr. John L. Holden, National Committee on United States-China Relations  
Prof. Thomas P. Bernstein, Columbia University

*Tax Burdens in Rural China and their Implications for Instability*

Mr. Brian Schwarzwald, Rural Development Institute

*Whose Land Is It Anyway? Land Tenure Reforms and the Rule of Law in Rural China*

Prof. Liu Yawei, Carter Center, Emory University

*Chinese Rural Elections and their Impact on Political Reform in China*

The third panel focused on the positive and negative in rural areas, ranging from peasant unrest due to government incapacity, to the challenges and limitations of rural elections, to the very constructive developments the government is instigating in terms of farmers' land rights. First, Thomas Bernstein, a professor of political science at Columbia University, discussed how the peasants' financial burden is leading to rural unrest and the government's inability to solve the problem. He was followed by Brian Schwarzwald, China Program Coordinator for the Rural Development Institute, who explained how a new land reform law will contribute to greater rural incomes, production, and development, and further promote the rule of law in the PRC. Liu Yawei, associate director of The Carter Center's China Village Elections Project, spoke last about the significance of rural elections and their impact on political reform.

## **Rural Tax Burdens**

Current rural discontent in China stems from many sources, but according to Professor Bernstein, it mainly derives from “financial burdens of the peasants.” Rural residents are encumbered with a number of fees and taxes, which in many areas are exacted in “arbitrary, brutal, and excessive ways.” Particularly as rural incomes have been falling, this financial obligation and the means by which it is levied have been increasingly resented. The situation, however, is not the same throughout the country, for there are what Bernstein describes as the “three rural China’s”: prosperous, industrial, coastal China with the resources to promote development and public services; agricultural central China, which is where the bulk of the protests take place because officials squeeze the peasants for funds; and poor, western China, which due to its extreme poverty, receives some monetary assistance from the central government.

The protests largely began in the mid-1980s, but the frequency increased substantially in the 1990s. At present, however, they do not pose a threat to the regime for a variety of reasons: the protests are “dispersed in time and place, not coordinated, lack sustained leadership, and have no urban support.” The situation could change, and the protests could escalate in the future, Bernstein pointed out, if the protesters acquire better means of communication, or if people like the “burden reduction heroes” in Henan become long-term leaders. While the possibility of such developments worries the central government, for the moment its basic response has been to “nip protests in the bud, but also provide some relief to villages beset by protest-causing problems.” While the central government has been siding with the peasants in many of the conflicts, it has not been able to address the source of the “festering and possibly escalating problem.”

Sharing views with other panelists during the day, Bernstein found that regime incapacity is a root cause for these problems. The issue, he explained, is deeply rooted in the political system, and is not just due to corrupt officials. The primary reason is that in the country’s effort to develop quickly, “objectives were undertaken without thinking of the effect.” “Developmental ambitions” mean targets and quotas that local officials must try to achieve, the pursuit of which can lead to coercive and corrupt actions.

Bernstein sees education as being the biggest financial burden for peasants: while establishing nine years of universal education is an admirable goal, the question is who will pay for such an endeavor. Local governments are currently on their own when it comes to meeting the educational requirements, and although some wealthier areas may have the resources, in others the peasants are “squeezed” to come up with the needed financing. The central government is unable itself to provide the funds needed for local development, because it has limited revenue due to the decentralization process. Thus, argued Bernstein, the unfair financial burden and its repercussions are a “manifestation of a major problem: rising inequality, especially regional.”

Professor Bernstein concluded by suggesting steps both China and the United States could take to address the problem. For the PRC, he sees political reform as a solution. Peasants currently “lack power to defend their interests,” so there needs to be a

means for giving them a greater voice. The United States could help China in two ways: provide financial assistance designated for rural education and give technical assistance to modernize and restructure agriculture, for, in his estimation, the already struggling Chinese farmers are going to be seriously harmed by WTO.

### **Land Reform and the Rule of Law**

Mr. Schwarzwaldler began his presentation by pointing out that the Chinese government is now making “important and positive changes in farmers relationships to the land,” finally establishing clear long-term land rights and tenure security after two decades of frustration. Under the Household Responsibility System (HRS), which followed decollectivization in the late seventies and early eighties, the village or township retained the ownership of the land, but farmers were given cultivation rights. The HRS reforms, Schwarzwaldler explained, allowed farmers to “undertake a series of short-term farming improvements,” but the farmer’s rights “suffered greatly from the fact that village officials could frequently and unpredictably ‘readjust’ those rights into entirely new patterns.” Therefore, farmers were constantly unsure of their land tenure, and were disinclined to commit to long-term “productivity-enhancing investments.”

However, “a series of recent legal and policy reforms has taken great steps towards providing farmers with the long-term land tenure security they have previously lacked.” In particular, the 2002 Rural Land Contracting Law will bring about three significant and major changes. First, by enshrining 30-year land rights in law, by requiring that they be confirmed by contracts, and by prohibiting any readjustments or interference by local officials, the law provides farmers with a long enough tenure period to recover the value of long-term investments. Second, the law establishes a “framework for the development of markets for rural land use rights.” This will have two beneficial consequences: it will “allow voluntary, gradual reallocation of land rights to the most efficient farm households;” and the “higher productivity and new wealth” that will result from such exchanges will stimulate rural economic development. Third, it will “strengthen the rule of law in the countryside,” by inflicting strict penalties on local officials who transgress on farmers’ land use rights. Prior to the law’s promulgation, farmers had no means of appeal when there were violations, so the law is a definite advancement. However, Schwarzwaldler noted, it remains to be seen whether the farmers will actually avail themselves of such legal recourse.

In sum, he predicted that if the law is effectively implemented, it will “create an extraordinary opportunity to achieve increased investment, productivity and efficiency on the part of Chinese farmers.” In turn, such developments will raise the rural standard of living, “free up dead capital from the land for use in other pursuits and create an engine for broad-based rural development.” The United States, he argues, can help promote this process by giving support and assistance to rule of law programs in China, because even if they are not “directly linked to rural land reforms,” they will “help ensure their long-term success.”

## **Rural Elections**

Dr. Liu's speech focused on the implications of China's rural elections for future political reform in the country. He acknowledged that there have been significant developments, and "it certainly is a giant leap from directly electing a village chief to directly choosing a township magistrate," but also emphasized that "to expect these elections will steadily move up the political ladder in China is wishful thinking" and listed five main reasons why there are still major obstacles to true political reform through elections:

- 1) The government is not committed to "choice and accountability" at all levels;
- 2) There is only one party;
- 3) Many of the rural elections, in actuality, are "superficial ceremonies";
- 4) There have been confrontations between elites advocating village self-government and local officials; and
- 5) The "tensions between the grassroots party apparatus and the popularly elected village chairs have paralyzed the endeavors of village self-government."

However, the above factors do not mean that the elections are insignificant or futile, for Liu also set forth five ways in which they have had a considerable impact:

- 1) They have "provided a safety valve" for peasant anger;
- 2) They have "introduced legal procedures of elections into a culture that has never entertained open and free elections";
- 3) They have fostered a new value system and helped promote rights consciousness among the rural population;
- 4) They have created a new means by which the rural elite can work for "social and political change;" and
- 5) They have become a "magnet" for Chinese intellectuals to contemplate feasible paths of political reform for China to follow.

Obstacles to further reform largely stem from the fact that government power in rural areas remains very strong, and there is fear of both "losing political control in the countryside" and "mob politics." Liu noted that the weak power of the courts also hampers future reforms. However, he did put forward several long-term prescriptions for change (the fall of the Soviet Union made clear that a short term rapid solution is not a viable option): reduced government control in the countryside, and the promotion of non-government organizations; further land reforms, including privatization; making the CCP an "all-people Party" in rural areas, so that everyone can vote for local officials; "moving elections up the ladder;" empowering the local people's congresses; and establishing inter-party democracy at all levels of the CCP. While China needs to undertake many political reforms in the future, Li also stressed that the United States must recognize that the PRC is carrying out changes that were unthinkable a few years ago, and that for reforms to succeed the country must proceed through "baby steps."

## **Question and Answer**

Much of the discussion during the panel's question and answer period focused on issues related to Schwarzwald's presentation, in particular, specific questions about the new land law, and the development of legal consciousness in the countryside. He elaborated on one of the reasons that the Rural Land Contracting Law could have a big impact on Chinese farming practices – the fact that there is very little land concentration in the PRC, the average farm being about 2 acres in size. Currently, he pointed out, China has the most egalitarian distribution of land of any country in the world, but signs are that farmers may wish to change that. “Already there is a fledgling market for land transfers,” but those that have occurred thus far have been of a short-term duration and within a village to family or a friend.

When asked about the extent of rural legal consciousness Mr. Schwarzwald stated that at least with regard to land rights, the tide began to change with the advent of the 1998 Land Management Law. Publicity campaigns, in particular television programs, were the main way people heard about the new legislation. In general, he concluded, national laws that send a clear message and are well publicized raise consciousness. However, Professor Bernstein raised the point that there frequently is a contest between the central government promulgating the laws and the local government that has a vested interest in preventing public knowledge about the legislation. Therefore, most opposition is found at the local level. However, because peasants often protest in the name of the central government, it is clear that rights consciousness exists in rural areas.

The issue of competition between the village party secretaries, who are elected by CCP members, and the popularly elected village chairs, stood out during the discussion period. Dr. Liu explained the difficulties in overcoming this tension, but said there has been growing experimentation in a number of regions, largely centered on two possible solutions. The first holds two elections for the position of the village party secretary – the initial one an open election, where, if a candidate does not receive a certain percentage of the popular vote, s/he is out of the running in the second election which is only for party members. The other option, which a number of provinces are promoting, has been to merge the two posts.

Dr. Liu also addressed a question on the prevalence of elections in the Western regions. He replied that while they do have elections, many of the elite are gone due to the massive rural migration, which limits the impact of the elections.

## **The Changing Workplace: The Economy in Transition**

Session Chair: Mr. Pieter Botellier, School for Advanced International Studies,  
Johns Hopkins University  
Prof. Kellee Tsai, Johns Hopkins University  
*Private Entrepreneurs and Informal Finance in China*  
Dr. Stoyan Tenev, International Finance Corporation

*China's State Sector: A Painful Transformation*  
Mr. James McGregor, Vermilion Ventures  
*Chinese Returnee Entrepreneurs and Venture Capital: A Potent Combination*

The conference's final panel assessed how China's economic sector is being transformed by private, governmental and international forces. Dr. Kellee Tsai, an assistant professor of political science at Johns Hopkins University, led off the discussion by examining how private entrepreneurs finance their endeavors, given their lack of access to loans from state-owned banks. Her presentation was followed by Dr. Stoyan Tenev's talk on the progress and future prospects of state sector reform. Dr. Tenev is a lead economist for East Asia and Pacific in the International Finance Corporation of the World Bank Group. The final speaker of the day was James McGregor, the founder and managing director of Vermilion Ventures, who discussed the PRC's new development trends in high technology.

### **Private Entrepreneurs**

Professor Tsai's presentation considered the issue of whether the private sector can generate the jobs necessary to absorb laid-off SOE employees from the angle of entrepreneurs' ability to acquire the financial resources for future development and expansion. She began by outlining the private sector's impressive growth in scope and scale: from 1990 to 2000 the average annual growth rate in the number of private enterprises was 32.8%; the sector now employs 22.7% of the work force and accounts for one third of GDP; and the "creation of new private sector employment" is greater than the total for the state and collective sectors. However there is a definite paradox in how entrepreneurs have been able to achieve such progress because "what makes the dynamism of China's private sector so puzzling is the fact that private entrepreneurs do not have access to official sources of bank credit."

With less than 1% of all state-owned bank loans being extended to the private sector at the end of 2001, entrepreneurs have been forced to turn to "informal" forms of financing, that range across the spectrum between what is lawful and what is illegal. The most common means of finance in the legal realm are rotating credit and savings associations, which operate at the local level. In the middle are quasi-legal financial organizations, such as mutual assistance societies, which are not authorized by the People's Bank of China, but are registered with another government agency. The standard that determines whether financing falls into the legal or illegal category is whether or not the interest rates given are above those approved by the state. Other prohibited ways that a private venture can acquire funding include registering as a collective enterprise or as a subsidiary of an SOE.

"The bottom line," argued Tsai, "is that even today, the most dynamic part of the Chinese economy continues to be excluded from conventional sources of credit and private entrepreneurs are continuing to violate state banking laws in an effort to raise capital for their businesses." China, therefore, must diversify the forms of legal lending to enterprises, so that the primary engine of economic growth can continue to expand.

One beneficial side effect of more “formal sources of credit,” Tsai noted, is that it may lead to greater financial transparency of private enterprises.

### **State Sector Reforms**

Dr. Tenev’s presentation outlined the “painful transformation” of the reforms taking place in China’s state sector and addressed the question of whether such reforms are going to prove successful. He noted that, although reform has been ongoing for almost two decades, in the past few years it has accelerated and developed some new characteristics. First, it is taking place on a much grander scale, and “there is no single component of the state sector which is not affected.” Second, there has been extensive ownership transformation and “the wholly state-owned non-financial company in China is almost extinct.” Finally to achieve these changes, “any imaginable method, tool or instrument is being used,” from bankruptcy, to debt-for-equity swaps, to massive layoffs.

Next, Tenev highlighted several of the “relatively distinct processes of profound transformation that illustrate the scale and scope of the change.” One is that local governments have been very vigorous in carrying out “corporatization and ownership diversification” of SOEs, and by now 80-90% of small and medium SOEs have been transformed. Another is the changes in large SOEs through efforts to list them domestically and internationally, debt-for-equity swaps, and the breaking up of monopolies in the “strategically important infrastructure and energy sectors.” A third is that the government has also “nurtured over 20 giant corporations and conglomerates that have proven competitive in the international market.” And finally, the housing market has been transformed, with 65% of city housing units now privately owned.

Such massive changes and developments inevitably have negative side effects and will continue to be “socially painful” due to massive layoffs, social unrest and labor disputes. However, Tenev noted, “labor seems to be accepting the changes,” including layoffs and severance packages. Such acceptance he attributes to two factors: first, that the government has strengthened the social security system and raised unemployment benefits in the past few years; and second that finding a job in the private sector has become easier and “more attractive.”

The question remains, however, whether the government reform efforts will be successful in balancing growth and restructuring. For example, while local governments have done much to advance the privatization process of small and medium SOE’s, there is “significant variation” in “pace, speed and forms.” Most enterprises have been sold to insiders and “remain over-leveraged and overstaffed,” so “in many cases the problems have been postponed, but not solved.” Another area of concern identified by Tenev is the need to “prevent parent SOEs from using their listed offspring as ATM machines.” He did note, however, that there is reason to hope that the China Securities Commission will be able to curb and regulate such operations. Finally, due to the problems of local protectionism and market fragmentation, he discussed how “the industry rationalization process of closing obsolete plants and reducing excess capacity has shown mixed results at best.”

In conclusion, Dr. Tenev stated that “restructuring and state enterprise reform has accelerated in China, but the challenges that remain are still daunting.” He highlighted two factors that will be essential to the success of the process: “the rapid development of the national social security system and maintaining the dynamism of the non-state sector as a source of continued growth.”

### **The High-Tech Industry**

Although a lot of Chinese money was lost following the dot.com crash, Mr. McGregor pointed to two positive new trends that emerged during the boom period, and which are continuing to change the face of the PRC’s economy. The first is the growth of Chinese venture capitalism, for while many first time venture capitalists suffered in the crash, in its aftermath more than 100 new venture capital firms have appeared and are serving as financial resources to private companies. The second “by-product of the dot.com boom and its introduction of technology and venture capitalism” is what McGregor calls an “axis of innovation” between the Silicon Valley, China and Taiwan that is rapidly “turning China into a high tech center.”

According to McGregor, the roots of this “axis” were planted in the 1970s, when Taiwan students “flooded the science, math and engineering departments in American universities” and then “became the backbone of the R&D departments of Silicon Valley companies.” In the 1980s, while Taiwan businessmen tried to entice them home by creating tech centers, the Silicon Valley companies began outsourcing manufacturing to the island, and soon Taiwan companies “became technical innovators in their own right.” In the 1990s, the same pattern was being repeated in the PRC, as mainlanders in large numbers began replacing Taiwanese in U.S. graduate programs and the Silicon Valley. As the Chinese government tried to lure them home, Taiwan companies began shifting manufacturing to the mainland. Then as the mainlanders returned, many Taiwanese venture capitalists rushed across the Taiwan Straits. These new developments have come together, McGregor explains, in the PRC’s “fast growing silicon chip industry.” China, he elaborated is “hell-bent on building its chip industry” because the country is a vast market for chips, and “by 2010, China will be second only to the United States in chip consumption.”

McGregor concluded his remarks by looking at the implications of the new business and development trends for the United States. He stressed that promoting “axis of innovation” ties is in American interests. China functions as an overseas engineering center for Silicon Valley businesses, and at least for the United States, most of the high technology intellectual property rights and innovation remains at home. (By contrast, during the discussion period he noted that while most Taiwanese companies are also trying not to transfer R&D capabilities, there are some individual entrepreneurs that are shifting intellectual property to the mainland.) McGregor suggested that the United States must “continuously update” its policy controls on dual use and cutting edge technology. Additionally, he noted that another very positive outgrowth of the “axis”

would be that development of closer economic ties would help lead to a peaceful solution of the Taiwan issue.

### **Question and Answer**

Several of the issues raised during the question and answer period focused on the impact of economic reform and transformation on average Chinese people, with particular attention to what happens to those who are laid off by SOEs. Both Professor Tsai and Dr. Tenev agreed that there is significant regional variation in government efforts to retrain such workers, but also noted that it is the private sector that is absorbing the biggest percentage of those laid off. When asked how the changes in the economy are affecting women, Tsai said that, with the increasing economic modernization, women have been laid off more and retire earlier, echoing a point made by Dr. Davis in a previous panel.

The debate on opening up financial institutions was also discussed, and Dr. Pieter Botellier remarked that if the sector does not open and reform, then it will hamper the reform of the rest of the economy. Dr. Tenev commented that there have been some big changes recently in the four main banks and noted that in terms of opening, the Chinese have “intrinsic benefits” in their extensive branch networks compared to foreign banks. He concurred that the process of opening up the financial sector would be beneficial, particularly because of the impact it would have on the issue raised by Professor Tsai, the link between private financial institutions and funding private enterprises.