

# A study on corruption in China's military enterprises after the 18th national congress of the CPC

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**ABSTRACT.** *This paper has highlighted an individualistic element that often underlies corruption: sometimes, managers of military companies violate laws and regulations to pursue personal interests, resulting in vast losses for state coffers. This aspect is especially applicable in the case of Hudong Zhonghua, particularly regarding the relationships between the managers of military state enterprises and their relatives and the avenues of corruption involving the acquisition of real estate. Overall, the case study reveal serious imperfections in official control mechanisms of industrial activity, whose fine-tuning is even more desirable for Chinese leadership today in light of the government's strategy to strengthen the fight against corruption.*

**KEYWORDS:** *Military Enterprises, Corruption; Chinese, Relationships*

## 1.Introduction

The government policy of advancing the fight against corruption, strongly implemented by CCP leadership since the end of 2012[1], has facilitated development of a broad line of inquiry concerning the illegal activities of business leaders in the Chinese state military. Investigations have produced the first convictions, and legal procedures have revealed the contours of a consolidated and systematic corruption phenomenon as detailed in this work.

To contextualize the characteristics of this phenomenon, it was essential to reconstruct the history of military enterprises' transformation in the P.R.C., the policy of reform and opening in the 1980s, measures from the mid-1990s to today, and the implications of market reforms. The last period was most significant for understanding the roots of the current corruption phenomenon; only with the 1998 reform of state enterprises did the Chinese government begin to take this subject seriously, especially after the huge losses to which State coffers had been subjected

regularly[2]. Housing reform unveiled the first complex episodes of corruption, which directly involved several important leaders in military companies.

I evaluate events surrounding Gu Diqian, former president of Hudong Zhonghua, who for a long time occupied the pages of Chinese newspapers. In November 2017, the court ruled that Gu had accepted bribes of 5.34 million yuan and sentenced him to 12 years in prison. I reconstruct the company history and events leading to identification of corruption involving Gu and other important figures. I also examine the causes of this episode and possible countermeasures suggested by some analysts, offering a critical examination of the debate that ensued among the Chinese media. From the vast literature examined, I conclude by stating that analysts' and scholars' viewpoints could provide a useful starting point for identifying needed corrections for a radical reform of military state enterprises.

## **2. Methodology**

Documentation related to corruption in Chinese military companies is quite limited, my study was further complicated by the fact that most related information is kept under military secrecy; the archives of military companies and military research institutes are not available to civilians. Numerous sources were discovered through the Chinese media (including Hong Kong and overseas), particularly via investigative journalism. Chinese reporters often linked to news and information that would otherwise have remained unknown to the public, enabling me to examine the case studies included herein. In addition to analysing sources and reading activity, I was able to visit some structures that helped me to have a clearer view of the Chinese military apparatus. In particular, the Chinese Air Museum in Beijing, the first large museum in Chinese history that was opened to the public in November of the 1980s: it covers an area of 70 million square meters, collects more than 270 planes and by size is the largest of Asia and among the first five in the world. By observing these valuable aircraft from different periods and interpreting the data and illustrations of the museum, I was able to comprehend in detail the birth and growth of the Chinese aviation industry. Finally, for the case studied, I read the court judgments and the company's disciplinary documents.

## **3. Results and discussion**

### ***3.1 Gu Diqian and corruption during his term***

In 2014, Gu Diqian (former president of Hudong Zhonghua) and Shu Fanghao (former deputy general manager of Jiangnan Changxing) are put on trial. On June 9, the prosecutor's office in Shanghai arrested Gu on the grounds that he accepted bribes and on September 26 transferred the case to the municipal court, which began the trial in December. According to the prosecutor's accusations, the defendant accepted various bribes to illegally acquire assets worth 5.74 million yuan. The prosecution claimed that between 1998 and 2013, Gu collaborated with Shu to

supply steel supplies to the Renji Gongmao company of Jiao Gaozhong to obtain bribes totaling about 5.34 million yuan.

Gu purchased several properties with these funds. In 2005, he received 1.95 million yuan from Jiao Gaozhong, with whom he bought two properties in the Baoshan district of Shanghai. In 2009, a bribe from Jiao corresponded to the purchase of villas in Shanghai's Fengxian district. The prosecutors also showed how, between 2005 and 2012, Gu and Shu used bribe money to pay their relatives' travel expenses. Prosecutors further alleged that between 2003 and 2004, when Gu served as assistant general director, he assisted Lu Fagen from Jiangnan Changxing in purchasing real estate below market price in exchange for 400,000 yuan.

In court, Gu denied all charges by claiming that, in 1998, he founded Shanghai Renji with Shu and Jiao. He claimed that the 5.34 million yuan provided to Jiao was not a bribe but money to which he was entitled by law, derived from dividends of corporate profits. Gu reiterated that while Jiao owned the Shanghai Renji enterprise, Gu and Shu were members. When asked about the accusation that the manager of a state-owned military company began a private company at the same time, Gu replied, 'Many acquaintances have left their positions in state-owned military enterprises to found private companies and many have already earned more than 10 million yuan. Their businesses have good profits and they all already have children to whom they will leave their belongings. Instead, I was over 40 years old, but I was neither married nor had children, plus I had signed a 20-year military confidentiality agreement. I was afraid, after reaching retirement age, to remain without any income, so in 1998 at the same time the crisis of the '90s military companies, I decided to establish a private company to have a second chance in my life.'

In 1998 Gu, Shu, and Jiao founded the Renji Gongmao enterprise, but Gu could not officially appear among its members because he was already managing a state enterprise; as a result, he decided to use his mother as a figurehead. During the trial, Gu explained he and Shu were responsible for financial management and general organizational management, whereas Jiao oversaw other tasks. Gu and Shu claimed to have collected a total of about 20 million yuan to invest in the company from their savings, rent proceeds, and Du's mother's pension. However, in court, Gu denied accepting Lu Fagen's bribe of 400,000 yuan and favoring Renji Gongmao in the steel procurement contract. When the public prosecutor asked about the purchased properties, Gu explained he hoped to secure a comfortable life for himself and his new family after retirement. In November 2017, the court ruled that Gu had accepted bribes of 5.34 million yuan and sentenced him to 12 years in prison; the corruption of 520,000 yuan came with a 2-year sentence, and both crimes were ultimately punishable by 13 years' imprisonment.

### ***3.2 Media debate around the Hudong Zhonghua case***

The Chinese press and media broadcast the story and its procedural developments, offering additional insight into corruption in P.R.C. military companies. On September 29, 2014, an article by Guoji Chuanbo read, 'Few people

know that, even if Gu Diqian has been convicted and imprisoned, he is both one of the most promising young cadres of the CSSC, that the descendant of a great intellectual as Gu Xiegang. Surely he can be considered one of the best young Chinese entrepreneurs, who has made significant contributions to the dreams of development of the Chinese shipbuilding industry. It was him who, before being put under investigation, had the greatest expectations on the restructuring and transformation of shipyards, proposing to increase the brand's popularity and reputation on the international market'. The article also reported that in 2003, when Gu was general manager of Jiangnan Changxing, he prepared a letter signed jointly with the CSSC assembly addressed to the Commission for National Development and Reform in which he requested that the government address the sudden rise in the price of steel on behalf of the Chinese shipbuilding industry. He stated, 'We urge the national authorities to take effective measures to strengthen macro-control efforts, and set a reasonable and stable pricing policy, so that the majority of construction sites and industries in China are able to survive and develop'.

In spite of these justificatory considerations, the Chinese press gradually aligned itself with justice efforts. On December 8, 2014, a new article on the case was published by Guoji Chuanbo who emphasized, 'The fight against corruption started in the naval sector. A significant number of managers of state-owned companies in this sector have been under investigation'. The online edition of Dongfang Ribao commented on the same affairs: 'The economic problems of the managers of state-owned military companies reflect the split between managers and companies. Then, although the state enterprises are in crisis, it is true that executives are still trying to enrich themselves'.

### ***3.3 Causes of corruption and possible countermeasures***

The corruption in Hudong Zhonghua highlights similar problems among P.R.C. military enterprises. Several aspects of corruption in the shipbuilding group can be extended to the Chinese military overall.

- (1) Often, managers of state military enterprises use family relationships to carry on illicit business;
- (2) parts of bribes are invested in real estate;
- (3) the system of declaration of ownership of public employees must be improved.

#### **3.3.1 Relationships between managers of military state enterprises and their relatives**

Among the various cases of corruption in Chinese military state-owned enterprises, relationships between managers and relatives can be grouped into three categories. The first includes family members who work in public institutions and help managers open private companies among other tasks. The second includes family members who, thanks to a relative's position of power, obtain work assignments and are assisted in carrying out various activities. The third category encompasses managers who actually participate in management of a private company but use family members as nominees, as in Gu's case. Because of the

numerous corruption episodes revealed to date, the Chinese government has become increasingly committed to regulating and fighting unscrupulous kinship relationships. The fight against corruption, now stronger than ever, began in 1985 when the Central Committee of the CCP committed itself to regulating business relations between business leaders and their relatives, albeit with little success. More recently, however, China has invested fully in the fight against corruption linked to family relationships. For example, in February 2015, provisions by which the relatives of industrial managers could do business, occupy public employment, and contribute to social organizations were improved, and punitive measures for illegal business were reviewed.

The illicit operations of managers' family members tend to be unique. Some operations initially appear to be legitimate; some relatives open businesses in accordance with standard procedures but then conduct business using family members' power and influence. In some cases, there is a real exchange of favors: entrepreneurs use the power and names of renowned relatives, who then use entrepreneurs to cover cases of bribery and corruption. The sudden affluence of managers' relatives is another indicator, in that family members can derive grand profits thanks to managers' help in winning funds; this trend was rampant amidst the large-scale development of construction projects across China. A third example is invisible assistance from executives who help family members obtain illicit profits by delegating a trustworthy colleague instead.

Among the causes of this phenomenon, the first factor worth considering is institutional and political. Despite rules having been in place for more than 30 years, they are often not implemented and respected. For instance, several managers driven by their enthusiasm and sense of responsibility for their role may initially seek to enforce and implement regulations; later, under pressure from family members (or acquaintances) or for their own interests, they evade these rules and even tolerate corruption. Managers are also expected by law to be transparent in publicizing their list of properties, although adherence to this rule is rare. Another problem involves the lack of supervision and control from public authorities. One cannot rely solely on managers' ethics; an effective supervisory system is required to solve the corruption problem. Market and economic factors are similarly essential. With the reform policy and opening up, the Chinese economy has developed in ways that have improved citizens' lives but also brought about negative effects. The introduction of the free market and the principle of Western-style competition has put profit first, an objective often pursued by neglecting professional ethics. Financial gain can become a false value that fuels corruption.

Historical and cultural factors are also relevant. The Chinese are profoundly influenced by the paradigm of *guan benwei*: individuals who become officials acquire enormous power, even from symbolic and relational points of view. Some leaders build on their roles and encourage their relatives[3]. Finally, some executives of state military enterprises firmly believe that, as they make important contributions to the institution, they can appropriate resources freely. In this sense, some managers confuse work-related rights with the purchase of private goods such as clothing, housing, or food. Citizens' personal interests then become entangled,

further compelling workers to use public resources to satisfy private wants and needs.

To counter this phenomenon, some scholars have suggested establishing a system for verifying company registration among relatives of the leading cadres[4]. The departments responsible for promoting or removing cadres should be able to operate by assessing relatives' conflicts of interest and be allowed to act promptly before corruption emerges. Implementation of such a control system is more important than its institution: the rules are insufficient and must be revised. A code of conduct should also be developed for leaders at all levels, who must resist the temptation to accept illicit money[5]. The formation of such measures would be fundamental in helping individuals reflect on the meanings of their roles and those of family in Chinese society. In China, corruption is a complex phenomenon that rarely affects individual matters and is often a family affair[6].

### 3.3.2 Corruption to obtain housing: Current situation and reform trends

Before 1998, China had a system for allocating housing to managers, staff, and workers of state-owned enterprises. In 1979, according to provisions of the CCP Central Committee, high-ranking executives could be assigned an accommodation that would be returned to the competent body in the event of workplace relocation; the housing unit would be relinquished even if the manager's family could not follow him to a city. Improper use occurred even then, such that accommodations remained under the same manager and his family even if the property was no longer formally owned by him. This situation posed serious financial burdens for the government, leading the State Affairs Council to issue a warning in 1998 to expand urban housing system reform and accelerate new housing construction.

Until the housing system reform in 1998, managers of Chinese companies had enjoyed housing free of charge. The newly instituted law then inspired housing-related corruption. Many officials, accustomed to having a home without needing to pay for it, tried to use their power to continue enjoying this privilege by occupying public buildings with their nominees or buying real estate at prices far below the market. The question of leaders' housing attracted the attention of the CCP Central Committee and the Council of State Affairs as a key means of combating corruption. In 2001, the Central Committee of the CCP issued new regulations regarding the 'Reform of the Beijing housing system for senior management of the central and state organs,' (Zaijing Zhongyang he Guojia Jiguan Buji Ganbu Zhufang Zhidu Gaige Shishi Yijian) and 'Rules against the employees of the central and state organs in Beijing who have not complied with or exceeded the standards of living space' (Zaijing Zhongyang he Guojia Jiguan Zhigong Zhufang Mianji Heding wei ji Dabiao Chaobiao Chuli Banfa). These documents were followed by related regulations from local and provincial governments to promote real estate market reform. However, several problems remained: the control system was not working as intended and could not substantially reduce corruption in the housing system.

In several cases, public managers have used their privileged positions to improperly direct funds in the construction sector. In Gu's case, he exploited his role as assistant to the company's general manager to help Lu obtain a contract at lower-

than-market prices for the construction of real estate projects by the Jiangnan Changxing group. The consequences of this type of corruption are extremely damaging: they interfere with the real estate market and highlight social inequalities and the weight of privileges, tarnishing the CCP's image. The recent exponential increase in house prices has spurred corruption in this sector. Some managers are now unable to buy certain types of property with their personal gains but will take risks to illegally obtain the real estate they want. A house is also no longer considered a daily necessity but a fruitful investment for the future.

Another cause of this form of corruption is the lack of available information related to managers' housing. No systematic system publicizes this type of housing data, thereby opening avenues for abuse. To address this situation, the government has tried in recent years to implement a registration system for the official residences of managers of state-owned companies. According to some scholars, the right to have an official residence should be reserved only for the highest government offices and the Party at the national and local level. The state must also base itself on the parameters of the real estate market in different cities, fix a table on square footage and costs, and establish housing standards for managers. In cases where a chosen accommodation exceeds these parameters, managers must pay the difference between the expected and real cost. Housing must also be established with specific provisions governing use and exit mechanisms to prevent officials' continued occupancy after promotion and related transfer of registered office.

A transparent property declaration system is necessary to ensuring accurate information about managers' housing and building a fairer society. In an effort to implement this system, the fourth plenary session of the XVII Congress of the CCP in October 2014 addressed issues related to corporate executives' self-discipline, formulating specific norms around housing. Later, the XVIII Congress of the CPC Central Committee Political Bureau issued eight measures to 'effectively improve the style of work of managers and their ties with the people' (Gaijin gongzuo zuofeng, miqie lianxi qunzhong), proposing a special regulation around the housing system. However, the system of declaration of ownership of public employees is not yet a reality in Chinese society.

### 3.3.3 The system for declaring public employees' properties

After the 18th National Congress of the CCP, the government's anti-corruption efforts were intensified to 'hit the tigers and drive away the flies' (da hu pai ying), according to a strategy promoted by President Xi Jinping. The metaphor of the tiger symbolizes high cadres of the corrupt Party (e.g., Zhou Yongkang, Bo Xilai, and Guo Boxiong), whereas the fly denotes low-level executives such as Gu Diquan. The government has instituted strong organizational efforts to stop corruption, preventing cases at the root such as by implementing a system for the declaration of property of public officials. Yet experts have pointed out that government strategies must be further refined to increase the system's effectiveness. For example, statements are often incomplete, and the bodies responsible for their acceptance are not fully independent and thus do not have authority to act against false declarations.

The development of this system has a decades-long history. In 2001, 'Provisions relating to the self-denunciation of family property by the provincial leaders' (Guanyu shengbuji xianzhi lingdao ganbu baogao jiating caichan de guiding shixing) were published; in 2010, regulations on this issue were deepened with a section dedicated to 'Personal Issues of the leading cadres' (Guanyu lingdao ganbu geren youguan shixiang de guiding). These two provisions represent the current system structure for declaring civil servants' properties, highlighting several problems. For example, many state employees are not listed as individuals to be monitored and have enormous opportunities to obtain unlawful state resources. Article 4 of the 2010 regulation describes the necessary elements to be highlighted in declarations of ownership, noting that managers and their spouses and children are required to declare properties in their possession. However, this system is mainly based on income rather than on properties owned. Another important component that could guarantee proper functioning of the property declaration system is linked to the presence of penalties to deter crime. The 2001 and 2010 provisions both referenced the need to provide severe penalties but failed to detail penalties reflecting the administrative and criminal responsibilities of those who violate the regulations.

The academic community holds two prevailing views on the system for declaring public employees' properties: the first considers this provision a fundamental premise for the fight against corruption, and the second posits that no real conditions exist to implement this law. Some scholars have argued that this provision may lead to social instability and should be replaced by more flexible control from competent bodies. Reform around property declaration is a particularly sensitive issue because it involves civil servants' interests and has thus faced great resistance. It is therefore necessary to establish an independent authority to eliminate fertile ground for corruption.

#### **4. Conclusions**

The transformation of Chinese military enterprises is complex and has not been widely investigated in academic research in China or the West, especially given the difficulty obtaining reliable data. Many sources are protected by state secrets; for others, such as military archives, access to external personnel is often prohibited. In 2014, I was not allowed to consult the archives of the library of the National University of Defense of the Chinese People's Liberation Army, as military universities are not open to the public; This sector's secrecy has also prevented me from visiting military factories that are the object of my study, where outsider access is not allowed except for delegates of state companies. One of the few ways to obtain information about the operation of military companies and their products – especially new prototypes – is to visit international military exhibitions or participate in exhibitions on the history of Chinese companies and its military, which offer excellent opportunities to meet industry insiders. Finally, this study could represent the starting point of comparative research on corruption in military enterprises in China and abroad. Although China's main military enterprises are



state-owned and often private in other countries, corruption in this field is diverse; media outlets have reported several episodes in Germany, Russia, and South Korea.

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