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TECHNICAL BRIEFING

Corruption's Impact on
Governance, Politics and Policies

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P R O C E E D I N G S

CHAIRMAN ROBINSON: I welcome Ms. He and Mr. Cheng.

I'd like to start off with our apology for the delay in bringing you in to talk to us. We were in the midst of our last business meeting for calendar year 2002. As we prepare for our year-2 exercise here as a Commission, we obviously had an awful lot to go over in order to generate the kind of momentum that we need for the coming year and to organize ourselves. And from a time management point of view, I take responsibility for that with, again, apologies to you.

We very much value your joining us today for this more informal working meeting, technical briefing, that we have entitled "Corruption's Impact on Governance, Politics and Policies."

You're both well known to the Commission. We'll be able to dispense with some of the formalities in terms of your backgrounds. You've been kind enough to be with us in the past, and we certainly value greatly your participation today.

So, with that, I would ask, which of you would prefer to begin today? Is there a preference?

MS. HE (THROUGH INTERPRETER): Ladies first, please.

[Laughter.]

CHAIRMAN ROBINSON: Okay, Ms. He, thank you so much.

MS. HE: I'm pleased to join the meeting. My English is not good enough. I have to ask for help.

(THROUGH INTERPRETER): My topic today will cover the impact of corruption inside China. I think that corruption has already achieved a large impact on the direction of China.

The first is that it has already had a negative impact and losses in the economy. I think that you can say that the economic losses due to corruption inside of the Chinese economy have already exceeded 16 percent of GDP.

The scope of the corruption is extremely wide, but those who are working to curb corruption are very small. And there are only a handful of officials, only 6 percent of corrupt officials were punished, their cases investigated and concluded. Among those investigated, of every six investigated, there was only one who was finally punished.

Currently, corruption makes any laws in China become kind of ineffective. Somebody said that, every 18 days, there is a new law approved in China, but all those laws can never restrain the behavior of government officials.

The third impact of the corruption on Chinese society and in politics is wealth concentrated in a minority of people. Currently, 85 percent of wealth is controlled by 15 percent of the population. The main part of the minority who control the 85 percent of wealth are relatives and children of government officials.

Such kind of an interest group based upon corruption has no interest in carrying out any kind of political reform. It could be said that corruption now lubricates the operation of the Chinese government machine. Now the officials in the lower levels need to bribe their bosses to get promotions or keep their positions. In different cities and different departments of government, each position has a price in bribes.

In hinterland provinces like Hunan, the price to buy a position as a head of township is 30,000 yen. But in the more prosperous Shenzhen, the city near Hong Kong, to buy a position as a head of police office, the price would be 2 million yen.

CHAIRMAN ROBINSON: Just a quick question: Does anybody have, in rough order of magnitude, the dollar values?

COMMISSIONER DREYER: 8.3.

CHAIRMAN ROBINSON: Thank you.

MS. HE (THROUGH INTERPRETER): In those more prosperous cities and districts, the price for head of the police office is more expensive, even higher than 5 million.

Now it could be said that almost every government official who earned their personal interest through those illegal or immoral ways, it's based upon the behavior that destroyed their occupational ethics.

In many places, I was asked if the so-called middle class appearing in China is going to ask for positive political change. I tell them, on the contrary, the so-called middle class in China doesn't want political reform and democracy. The middle class believes that democratization, like in the former Soviet Union, may bring about political instability and chaos. On the contrary, maintaining the political status quo could best protect their current vested interests, which leads to the fourth factor.

There is a great amount of capital flight in China. According to my research, in 1995, the ratio of capital flight--my explanation is the capital that fled China compared to the capital invested into China was 52.36. After 1997, the situation became severe. The ratio grew to more than 90 percent. In year 2000, China absorbed foreign capital U.S.\$40.8 billion. But in this year, the amount of capital flight was \$48 billion.

So when the Chinese government advertises itself to the world about its achievements in absorbing foreign capital, it always hides the fact that a huge amount of capital fled from China. If the foreign capital had not flowed into China at the speed and the rate that it did, then there would have been a great chance of an explosion inside of China, and a financial crisis might have already been seen there.

I especially want to emphasize the capital flight concentrated in the United States. I think the government of the United States should take some measure to prevent such kinds of things taking place, because these guys are eventually criminals in

China. They don't love their own country, their own people. They won't be good citizens in the U.S.

And the fifth factor is corruption causes a great extent of social hatred. Essentially, China is not a rich country, as a huge amount of wealth is concentrated in the hands of a small group of people and a majority of the people live in a poor situation. The Chinese government takes only harsh political pressure to suppress any kind of protest at the bottom level in society. In the past recent years, the political control looks more and more like the way it did in the late Maoist era.

More and more people are arrested for criticizing the government. The only difference is that the Chinese government no longer uses the charge of counter-revolutionary, which was used in the Mao era. Instead, they use a new charge. The new charges include stealing state secrets and overthrowing the government, and leaking state secrets, threatening state security, subversion.

There is nothing that indicates that the just-past 16th National Congress of the Party, the CCP, will take any political steps. Under such kind of irresponsible government, its rule may only cause China to go into a worse and worse status. For example, the pollution in the environment already caused damage to Japan. I heard such kind of responses in Japan.

And also, more and more people smuggling into other neighboring countries threaten the stability of the countries around China.

My time has arrived, so I'm open to questions.

COMMISSIONER MULLOY: Can we hear the second speaker?

CHAIRMAN ROBINSON: I think, if the other Commissioners are willing, we would follow that format that we generally follow.

And, Mr. Cheng, we'd value your remarks, and then we'd like to open it for questions to both of you, if we might.

MR. CHENG: Thank you very much for giving me the chance to get here once again to present my analysis of the situation in China. Now I would like to take this opportunity to describe something in rural China.

Corruption now in rural China has already become institutionalized. In other words, many government organizations in rural China, at the township level, live by corruption. And

the corruption becomes their only way to collect illegal money from peasants. I'll give two examples.

Number one, everybody knows that there is a kind of birth control organization in rural townships in China to conduct the birth control policy. However, now those organizations often sell the birth quota for money. So instead of conducting their part to control the birth rate, they encourage the peasants to have a woman to get pregnant. And at the end, they try to find out who has got pregnant, and then they say to the peasant, "Now it's your turn to give money. If you want more children, give me money and then I'll give you the quota."

So in this situation more and more rural peasant families have more than one child, even more than three children. And the local birth control officials become rich by selling those quotas. So that's a typical way.

Another case is that in many local police offices, they tend to ignore some illegal activities, such as gambling. They know everything about that, but they do not try to prevent that at the very beginning. Instead, they wait until the gambling is going on, then they knock on the door and say, "Hi, guys. You're gambling. Give me money."

So in this way, you can find that those organizations are eventually using corruption as part of their way to collect more money for their living.

So about 2 years ago, many local peasants reported to journalists and even wrote letters to the top level, to the central government, complaining that the collection of fees and the duties are too heavy to be afforded. However, the central government did nothing to improve it, because the political foundation of the central government is those corrupt rural cadres, rural government officials.

The only thing the central government tried was 2 years ago. Once the central government, the premier, Zhu Rongji, accepted a policy suggestion from somebody and tried so-called reform of taxation in a hinterland province. Just several months later, the experimentation was stopped because the local government and the county and the township officials rejected the experiment.

And then a policy advisor gave a suggestion to Premier Zhu Rongji, saying that: "If you really want to keep rural stability, you better stop your experimentation. Forget about peasants,

because peasants are not your social foundation. Those rural government officials are your foundation. You better not make those rural officials angry."

Then the central government finally gave up the option to do any reform to reduce the over collection of fees and duties.

That's actually a process one can see that gradually the local government dominates the institutional formation in the rural area. They decide how large the local government body should be, how many people they want to hire, and what kind of level of salary they want to pay, and in what way they'll collect money, no matter what the laws or the documents from the central government say.

In other words, now the central government has nothing to do or is unable to do anything to control the rural government's behavior in over collecting fees and duties. The central government has no way to prevent or stop corruption at the rural level.

So the corruption in the rural area, at the township level or county government level, has already been institutionalized, although the institutionalized corrupt system is against the law itself set by the central government.

The best example is, since 1984 till now, the Chinese central government declared at least 100 times that it was going to stop over collection of fees and duties. However, it never became effective. So nothing changed, and the situation becomes more and more explosive in rural areas.

Now agriculture itself no longer makes peasants' ends meet. For the average peasant family in a hinterland province, now pure agriculture could not feed their children. The cost for planting and for fertilizer, including everything, is over their income. The only way to feed their children is they go out, make some money, find some jobs in cities, and they send money back to their home village. So some scholars in China say that agriculture in China has already been bankrupted.

As most prices of agricultural products already are higher than that of the average prices in the world market, there's no way for the Chinese government to raise the prices of agricultural products. In other words, the kind of bankruptcy of agriculture in China has no way to be improved.

Then people may want to know, is there anyway that China's peasants could be better off? Probably the only answer is to get rid of those government officials. That means political reform. However, neither the bottom level rural township government nor the central government has motivation to carry out such kind of political reform.

So this could be understood in another way, that corruption is and has been institutionalized in China, and it has become a kind of foundation of the current legitimacy and rule of Chinese government.

Thank you very much.

CHAIRMAN ROBINSON: Thank you. Those were, as in the past, very provocative, sobering, even shocking, revelations and comments. There's an awful lot there that I'm sure we want to pursue.

Why don't we begin with Commissioners' questions? Commissioner Dreyer?

COMMISSIONER DREYER: First of all, thank you both so much for coming back. The reason we asked you back is because we enjoyed hearing so much of what you had to say the first time.

My question is directed toward the assumption in the Western press, particularly in the United States, that as the middle class in China grows, it will inevitably bring democracy with it. Dr. He has told us that the middle class is not in favor of democracy because it fears instability.

I wonder, however, to what extent each of you feels that the middle class is actually growing. I read in the writings of Hu Angang and Wang Shaoguang that, in fact, the Gini coefficient is becoming higher and higher and higher. So more wealth is being concentrated among fewer people and more people are poor.

And I have read in Dr. He's work that, in fact, what you should have is a diamond-shaped society income distribution, but what you actually have is a pyramid.

In that case, is the middle class in China really growing?

MS. HE (THROUGH INTERPRETER): That's true, to say that the middle class is not growing and that the pyramid pattern is more and more apparent. And there's one piece of evidence I can point to, that the college graduates inside China are having a more

and more difficult time finding work, and the work that they do find is worse and worse.

One phenomenon needs to be noticed, that in a situation that the illiteracy rate remains very high in China, the intellectual labor or the college students with high education could hardly find good jobs. Such phenomenon has never appeared in other Asian developing countries. Universities and colleges are the creator for the appearing middle class.

Yesterday, I read a report from China about tuition in China. It said that during the past 10 years, the tuition increased 100 times. Now you could say it's strange that, in rural China, those families who have children who are receiving college educations are the poorest of families in rural areas.

Peasant families support the children for college education by borrowing more and more money. However, it's very likely that their children even finished with their master's programs still couldn't find jobs. That may lead less and less peasant families to support their children for college educations in the future.

And in terms of the Gini coefficient, the coefficient recognized by the Chinese government is much lower than what scholars found.

COMMISSIONER DREYER: Just one question. The Chinese government says that the number of illiterates in China is down to 85 million. But at the same time, the Chinese press says that the number of school dropouts is rising. Do you believe the government's figures on illiteracy?

MR. CHENG: Personally, I don't believe it.

COMMISSIONER DREYER: Okay.

MS. HE (THROUGH INTERPRETER): I've done research into these types of things, and the government officials are never correct.

[Laughter.]

COMMISSIONER DREYER: Thank you.

MS. HE (THROUGH INTERPRETER): I can give an example. When the Chinese government tried to collect the data about the literacy rate, then they sent some people to collect data on the village level. However, the local government sends the village schoolteachers to go to the place to take the test, to show the

investigators that, "Well, we only have a few people who really don't know anything."

A schoolteacher told me that he took at least 12 such tests. And every time he was required to take the test, he was paid. So that's how this data was produced.

COMMISSIONER DREYER: Thank you.

MR. CHENG: And I can add a small personal experience about that because, during the 1970s, I worked in a township level office. At that time, I was a student sent down to the rural area. If you know the Chinese history, all urban young people were sent to the rural area to work as a peasant. And I got the opportunity to be raised up to the township office.

At the time when I was there, I was the person who was in charge of all reports to the top, including statistics. So I know how those statistics are collected. Nothing was really collected; it was simply made by myself. At that time, there was not telephone line. I couldn't call anybody. That township includes about 12,000 population and about 10 brigades.

I often got phone calls from the county government to ask me: "How many tons of grain have been collected from the field?" I have no idea how to collect data, but I have to report. So the only way is that I guess. And I called the other townships. "How many did you report?" And then I decided the growth rate. And then I tried to figure out in which brigades the figure should be distributed, to which brigades.

And those heads of brigades never know the figure I distributed to them. And nobody cared about it. So that's the way they collect data.

I don't believe that such kind of statistics have been really changed in China.

CHAIRMAN ROBINSON: Commissioner Waldron?

COMMISSIONER WALDRON: I'd like to thank you both for your very interesting comments. I always find people who have grown up in China to be much more informative about China even than our very finest American specialists.

One of the experiences that American business regularly encounters in China is being shaken down, or being blackmailed,

by Chinese criminal gangs, such as triads in Shanghai and various other traditional underground illegal organizations.

And it's also well known that these groups operate outside of China. They operate in Hong Kong. They operate in Taiwan. They operate in Southeast Asia. They operate in the United States and in Europe.

I wonder if you could both say a little bit about the problem, if there is indeed a problem, of China-based organized crime, and to what extent this is coterminous with the government. We all remember that Deng Xiaoping said that there were bad triads but there were also patriotic triads. And it's not unheard of for Chinese politicians--or, for that matter, even American politicians--to stay in power by relying on criminal gangs.

So I'd welcome your comments on that and particularly on to what extent this is coming into the United States now. I worry very much about this.

MS. HE (THROUGH INTERPRETER): To analyze Chinese politics, one may need to notice the growing importance of the organized criminal organizations in China. In 1998, when I wrote my book, I indicated that problem. But such a problem becomes more severe in the past years.

It could be said that many local governments have already been mafia-ized. In many cases, the local governments want to collect illegal money, but they better not do it themselves. Then they rely upon the help of mafia organizations.

It's a commonly known secret in China that the entertainment industry in China is controlled by mafia organizations. Since 1997, criminal organizations began to expand to other industries. I have collected a lot of information about the topic, and I am going to do a report about it. I'm seeking a grant for the research, and it has not been finished yet.

There are several typical ways that the criminal organizations cooperate with the government officials. One way is the criminal organizations establish a company, a business, in which they receive privileges in doing business by the local government officials and protected by the officials.

There are several typical cases. One is in Wenling city in Zhejiang province. The gang head was called Zhang Wei. His company was finally closed by the top government. And when the

case was investigated, it was found that at least 67 local government officials were involved in the case and the business of the company. Those officials included the mayor and the party secretary of the city and the chief judge of the court and the head of the local Public Security Bureau, and also the director of local taxation, director of local business administration. All those key figures in the government were involved in that.

And the head of the criminal organization, Zhang Wei himself, has eight official titles. He was a local People's Congress deputy and also president of local media. In his house, there was a special notice put on the wall of his house. It said that this house was particularly protected by the Public Security Bureau of the city.

Such criminal organizations can be found in Liaoning, Sichuan, Guangxi, in those provinces. If there is a journalist who dares to report such kinds of activities, the criminal organization may kill him.

So sometimes foreign investors, when they go to China to find their business partnership, they don't know that they're going to do business with criminal organizations. There are many cases of Taiwanese and Hong Kong businessmen who are involved in business with such organizations, and they're found dead there, killed by those organizations.

Investors from Western countries usually invest in big cities, especially in those industries that the Chinese mafia organization is not involved yet, so they have fewer experiences with those Chinese mafia organizations. It's a real, speaking in Chinese, economic elite.

They say that if you want to be a successful businessman in China, you need to build up a good relationship with government officials at the top. At the bottom level, you need to build a close relationship with mafia organizations. You have to stand on two ships, one is black, one is white. White means the legal way. The black means the illegal way, the mafia way. You need both.

So if one wants to describe Chinese politics from now on, it might be important to notice that the criminal organizations have more and more important influence in Chinese politics, if people want to get a complete picture about Chinese politics.

The Chinese Communist Party has a close relationship with those gangs and mafias in Southeast Asian countries. When China unified Hong Kong in 1997, to maintain the stability of Hong Kong, the Chinese government did cooperate with some kind of a patriotic mafia organization and asked them to help stabilize Hong Kong. Sometimes the Chinese government also utilizes mafia organizations in Southeast Asian countries to arrest or grhtm those officials escaped from China.

COMMISSIONER WALDRON: How about in the United States?

MS. HE (THROUGH INTERPRETER): If one studies the Fuk Ching gang in Chinatown, New York City, one can find out how the Chinese mafia grow up in the United States. For example, they often use the Fuk Ching gang against the Falun Gong believers in the United States. When those believers protest in the United States, the Chinese Embassy hires Chinese mafia organization members to hit those Falun Gong believers.

Also, it is noticeable that the Chinese Embassy hires visiting scholars and Chinese overseas students here to spy on other Chinese students by paying them high salaries. When I was at the University of Chicago, I found that there are several Chinese students there who receive salaries from the Chinese Embassy every month, and they got opportunities to spend vacations in the village of the Chinese Embassy. Also, they collect information for the embassy and also they try to threaten some people, what the embassy wants them to do.

CHAIRMAN ROBINSON: Mr. Cheng, do you have any further observations on those questions?

MR. CHENG: In terms of the Chinese gang in the United States, I want to mention one thing. In the past 10 years, there are many illegal immigrants, especially from the Fujian province, smuggled into the United States. They especially concentrated in the Chinatown of Manhattan. And there, many of them apply for political asylum here in this country with different reasons. In the early 1990s, they applied for the Tiananmen massacre, and then for birth control, and later for Falun Gong. As soon as they've got their asylum approved, they immediately go to the Chinese Embassy or consulate to get a Chinese passport. With the green card and the Chinese passport, they go back to China.

So this country never really punishes those guys, because according to the law in this country, if they apply for political asylum, they should not go to China again. If they can

go to China, they have no reason to get asylum. But those guys are eventually the foundation for the local mafia organization.

MR. WELKER: Ms. He just had one story about the Fuk Ching gang in Manhattan, that the New York City-based consulate has been very successful in turning out the Fuk Ching gang for both the welcoming of dignitaries of China when they go to New York, for containing the Falun Gong in their public protests, and even this year for the June 4th protests. They employed the Fuk Ching gang to contain those protests.

CHAIRMAN ROBINSON: With that, I'd like to turn to Commissioner Lewis.

COMMISSIONER LEWIS: Thank you both very much for coming and helping educate us about what's going on.

You made the point that there's a large capital flight in China, and had there not been the direct investment coming back into China, there could have been an explosion. How much of the capital flight is coming back into China as direct investment?

COMMISSIONER DREYER: The so-called roundtrip capital, which looks like foreign direct investment, but is actually Chinese capital that left China and is coming back.

COMMISSIONER LEWIS: Right. That's the question.

MR. CHENG: The case of the roundtrip capital eventually took place between Mainland China and Hong Kong. That's the kind of capital manipulated by the state-owned companies. They send money to Hong Kong and then establish a company in Hong Kong as a foreign company, then reinvest back into China to get taxation benefits.

COMMISSIONER LEWIS: Those are the SOEs.

MR. CHENG: Yes. But what she talked about, in my understanding, the key component of capital flight now into the United States is capital that will never go back to China.

COMMISSIONER LEWIS: I see.

MR. CHENG: For example, in Fort Lee, New Jersey, just opposite the Hudson River from Manhattan, I know there are a lot of luxury houses bought by anonymous Chinese rich people. They buy houses with cash. They do not have any work. They just live

there, using the money they took from China. So that money is the money they're going to live upon.

COMMISSIONER LEWIS: So the capital flight money that Ms. He was talking about does not go back?

MR. CHENG: No, because those people cannot go back. They are criminals.

COMMISSIONER LEWIS: Thank you. I have a question. You mentioned the pervasiveness of the corruption in rural China. In terms of the scope of this, what are the numbers of the peasant population that are involved in this system where there's corruption and they cannot afford to make it because of the payments they have to make? What are the numbers?

MR. CHENG: It could be said that in the majority of villages, peasants cannot afford those--

COMMISSIONER LEWIS: If you were to estimate the numbers of people involved in this--

MR. CHENG: You mean the people involved in collecting?

COMMISSIONER LEWIS: No, no, no. The peasants who can't make it; are you talking about hundreds of millions of people?

MR. CHENG: I would like to say that the majority of the peasant families cannot afford it. However, those collections are forced. Peasant families cannot prevent themselves from paying those. They don't want to pay, but they have to pay.

COMMISSIONER LEWIS: But how many peasant families would you say are in China?

MR. CHENG: Currently, there is a 700-million-peasant population in China, about 200 million peasant families. The majority of them cannot afford it.

The problem is the local government hire a kind of militia equipped with, sometimes, guns. So once there is a small scale of protest by peasants, they immediately send the militia in to suppress those protesters and arrest the head of those protests.

That's the way now the Chinese government is trying to silence and to suppress them.

COMMISSIONER LEWIS: In terms of the corruption that permeates everything, the students who want to come to the United States to study, are they also involved in paying off people to be able to come here? Do they also have to make payments to get permission from China to study in the United States?

MR. CHENG: I don't think so, because eventually if students want to study here, first, of course, they have to graduate from China's colleges. Then the next step is they have to pass some special language exams held in the U.S. by the U.S. organizations, like the TOEFL, the test of English as a second language, and then the GRE, what American graduate students do.

COMMISSIONER LEWIS: But the corruption doesn't include them having to make payoffs to come here?

MR. CHENG: Not yet. And then they need to apply for a visa. Those processes actually are not controlled by the Chinese government.

COMMISSIONER LEWIS: I see, I see. And the Chinese government doesn't have to give them permission to leave China?

MR. CHENG: So far, not yet. If they are accepted by an American university, with the notice, they can apply for their passport and pay just the regular fee for the passport.

COMMISSIONER LEWIS: The reason I ask this is, you alluded to this, that many Chinese students in the United States are giving information back to the government about what's going on in the United States, both security things and just industrial espionage. And I was wondering what hold the Chinese government has over these people to force the students to do this?

MR. CHENG: There are at least two ways. Number one, the government controls the extension of passport validity. So if a student does not cooperate with the government, once his Chinese passport expires, the Chinese Embassy could refuse to extend the passport. So that's one thing they can control directly.

The other thing is, all their family members are in China.

COMMISSIONER LEWIS: And threats will be made to the families?

MR. CHENG: And also I know that now the Ministry of State Security in China sometimes recruits some visiting scholars. When they heard of some people going to have a visiting

scholarship here in this country, they visit those guys and say, "Well, you better work for us. And then we'll pay you, say, \$2,000 a month. You just report to us what happened in Harvard, in Princeton. And sometimes when we need you, we'll tell you what to do."

MR. WELKER: Ms. He wanted to add, about the approval for the students to come overseas, that the middle-level bureaucrats who are doing this have not yet begun to threaten the students in that way. It is, perhaps, too dangerous for them. But also, that the--

COMMISSIONER LEWIS: Why "too dangerous"?

MR. WELKER: There are too many. There are too many students who are trying to get the applications.

The other was about the sons and daughters or the wives of the officials, of course, are the ones who don't have any problems getting visas or passports at all. They come out of the country well before the possibility of a corrupt official, lays the groundwork and uses the establishment of a family member living overseas. Most particularly, this is happening in the United States in California right now.

COMMISSIONER LEWIS: They will precede the corrupt officials so the money is here--

MR. CHENG: They send their children and wives first, to the United States--

MR. WELKER: That's correct.

MR. CHENG: --to settle down here, obtain green cards and buy a house. And then, when the senior official in China finds himself in danger for corruption, they just buy a ticket and fly to the United States.

COMMISSIONER LEWIS: My last question to each of them--

CHAIRMAN ROBINSON: Okay.

COMMISSIONER LEWIS: --where do you see this leading? If there's such corruption and such lack of faith in the government and such disillusionment, where does this lead?

MR. CHENG: I think it leads to less responsibility of the government and its bureaucratic apparatus. I heard from a director of a research department of the Chinese government about such words. I asked him, "Do you really worry about the dangers"--

COMMISSIONER LEWIS: Of revolution.

MR. CHENG: "Explosion." I didn't use the word "revolution."

COMMISSIONER LEWIS: Yes, yes.

MR. CHENG: I just asked "dangerous explosion." He said, "Well, it depends upon when.

"For me," he said, "I have my daughters and wife here in Washington, D.C. I don't care about that. I just need to bring my toothbrush and a flight ticket. That's all. One day if there's an explosion, I'm going to leave. That's all. My money is in the United States. My family is there. I don't care about that."

And most higher senior officials keep the same idea that he had. But those people who are at lower levels, the students have enough money to save in the United States for their family's future. They want a longer time involved in corruption to collect more money. So once they get enough, they're going to flee as well. In their view--now it's my explanation--in their view, China's just a sinking ship. They don't care about the future of the ship if the ship is going down or whatever.

COMMISSIONER LEWIS: "Going down" means "explosion"? Do you agree that that will happen?

MR. CHENG: It's not impossible, in my opinion.

MS. HE (THROUGH INTERPRETER): If one analyzes the cases of corruption in China, one can find a particular and strange phenomenon. In several cases reported in China, senior officials, when their homes were searched, several copies of foreign passports were found--not only one, several foreign passports.

For example, the former governor of Yunnan province, he was arrested for corruption years ago. When his home was searched, they found that he had five foreign passports. Another case is when the deputy mayor of Shenzhen city, where I lived, when the

deputy mayor was arrested, it was found that his wife and children already settled down in Los Angeles.

Also another case is the case of the deputy chairman of the National People's Congress in China, whose name is Cheng Kejie. When he was arrested, it was found that his lover took all the money he got through corruption and settled down in Hong Kong.

I believe China's people cannot count on such a group of government officials who are ready to escape from China at any moment. If the American people learn that President Bush left a lot of money in a foreign country, they would not have elected him as a president.

CHAIRMAN ROBINSON: May I turn to Commissioner Becker, please?

COMMISSIONER BECKER: Yes, I want to thank both of you. I find your testimony incredible in many respects.

The word used was "pervasiveness" of corruption, and I don't want to be redundant on one of the earlier questions, there is some \$50 billion worth of foreign direct investment going into China this year. To what extent do foreign investors benefit as a result of this corruption?

It seems to me that this is so pervasive with local officials that all industry and all investors going into China have to participate in some way. Yet we talk to business here in the United States and they deny it. Only under very unusual circumstances do they recognize some form of corruption. But there's an incredible amount of business that goes into China every year. This has not slowed down. In fact, it's accelerated. So this must be an acceptable practice.

I was just wondering if you would comment on the business relationship of investors to this type of corruption.

MR. CHENG: Personally, I lack such kind of evidence through business investigation. As you know, it's very difficult to do that, ask businessmen to tell you the truth of what they did in China. But I can provide a case, a story I heard from China.

About 6 years ago, when I visited the provincial government, I was given a story about a loan case to build a local expressway. This loan was borrowed by the provincial government to build a highway between Nanjing and Shanghai. And during the period,

several foreign banks competed to land the loans. The different banks used kind of a similar strategy.

One bank hired a son of the former central bank head. The other bank hired the son-in-law of the minister of finance. And then the two banks finally competed for the loan through their fathers. So they hire sons and let sons recruit their fathers to intervene in the loan case.

The condition, if the father agreed to do so, is, number one, when the son is hired, the son was given by the bank a green card in the United States. Number two, at that time it was '96, U.S.\$100,000 was deposited under the name of the son in a U.S. bank by the foreign bank who wants to get the business contract. And then finally, the two fathers involved in the competition, one threatened the provincial government, saying that, "Well, if you don't lend money from the bank my son represents, you're not going to get any loan from the central Bank of China." The other father said, "Well, if you don't lend money from my son's foreign bank, you're not going to get any taxation benefits."

So finally, the local government told me: "We have no way to deal with this. Finally, we cut it half. You each get half."

However, the competition results ended in a way that both banks got the deal at the highest rate, not the least rate. In other words, all the costs for the son's green card are covered by the Chinese side. That's the way I heard it.

COMMISSIONER BECKER: You feel that this is across-the-board, this type of activity, this type of pressuring for favorable business or even permits? That this is a common way of doing business for firms coming into China?

MR. CHENG: I cannot say that based upon my personal experiences, because I haven't enough evidence to prove that. But I heard a lot of cases like that.

Another case I heard is--

COMMISSIONER MULLOY: Could I stop you for one second? Do you happen to know the names of those foreign banks?

MR. CHENG: I was not given a name. I heard a story from Hong Kong. When I visited there, I was given a story by another failed banker. He was angry and told me the story. But later, when I visited China, I found the same story and was convinced

by the local government, the provincial government. They told me the same thing. So I believed, eventually, it's true.

COMMISSIONER BECKER: If the United States was absolutely determined to stop that kind of activity and made it illegal, punishable by severe sentence or whatever restrictions here in this country, if they enforced it, if they researched it, if they punished people for doing this, if they could find this out, do you think this would stop that activity? Is this just a price of doing business in China?

MR. CHENG: I don't think it's a necessary price, according to the general business ethics. But in the circumstances of Chinese institutions, the Chinese political system, it seems that that's the way that the Chinese businessmen, the Chinese government, and the foreign businessmen, have to encounter.

COMMISSIONER BECKER: It is the price of doing business.

MR. CHENG: It's not necessary, and it should not be, but it is.

COMMISSIONER BECKER: It is, okay.

MR. WELKER: Ms. He says that if they were to look and they were unable to find it, she would have a hard time believing that.

MS. HE (THROUGH INTERPRETER): I think that there's more than just the single example, so the Americans should know. It's similar to the relationship between Zhu Rongji's son and Morgan Stanley, or the relationship between Motorola and Jiang Zemin's son.

I was just in Japan and had the opportunity to talk with some Japanese officials about this problem, and the Japanese seem to have more willingness to go along with the operations inside of China to use corruption as a way of doing business. But they're having problems finding proper agents to do this because most of the sons and daughters of the high officials prefer to come to America to study as opposed to going to Japan.

COMMISSIONER WALDRON: Could I just add, I once asked an American lawyer with a top American law firm in Beijing who has many years of experience if he could think of any example of a deal being made according to the rules, that's being done the way it says that it ought to be done, and he couldn't think of a single one. Every single one was special in one way or another. American businesses, foreign businesses. In other words, had he

ever encountered a negotiation or an investment which had been done by the book from beginning to end, and he couldn't think of a single one.

MR. CHENG: I can tell another story about the way the foreign company tried to build up the connection. Years ago, my close friend wanted to get a job for foreign companies in China. He found an opportunity for Nomura, a well-known Japanese stock company.

COMMISSIONER MULLOY: Yes, securities.

MR. CHENG: Yes. And then the company set several requirements, very particular. Number one, he must have had a position before in Chinese government at the division level, no lower, not lower than division level. In other words, this guy personally had some contact with Chinese government. Number two; he has at least 3 years' work experience in banks in Western countries. Number three; his father must have a position higher than deputy minister.

And my friend lives in Boston. He had the three conditions satisfied and he applied for the job. But he told me the result, that Nomura found at least six such guys in the United States for the job, and he failed.

So this case implied that although Nomura is a Japanese company, I believe not only Nomura, many companies find this--eventually, you can't say this is illegal. It's legal to hire some people. But behind it, the deal under the table is illegal.

CHAIRMAN ROBINSON: I'd like to turn to Commissioner Mulloy, followed by Commissioner Wessel.

COMMISSIONER MULLOY: The reason I asked you whether you knew the name of those financial institutions that you testified were making bribes is because, if they are American institutions, it is illegal under the Foreign Corrupt Practices Act for American corporations to make bribes in order to get business. So the officials of those banks could be subject to criminal prosecution in the United States. So if you knew the names of those, we would be happy to forward those to the Justice Department to ask them to look into the matter.

There was an article in the Financial Times dated December 9th by Minxin Pei, who is with the Carnegie Endowment for International Peace. He says that it is critical to the survival

of the Communist Party that they must contain rampant official corruption in China that they cannot survive. The problem, he says, for the party is that in order to control corruption, they have to do three things, in his view, they have to reduce government influence in the economy, enforce the rule of law, and unleash the press and forces of civil society.

He says their problem is, if they do that, the party loses its power. But if the party doesn't do that, the party is going to lose its power anyway, so they're in a Catch-22 situation, as we sometimes say in America, from a famous novel.

Do you agree that the party is in a Catch-22 situation? That if they don't control corruption, they're going to fall into the ashbin of history, and if they try to control corruption through the measures recommended by Mr. Pei, that they're going to fall into the dustbin of history? If you could both comment on that?

MR. CHENG: In terms of the first question, I didn't know the name of the banks, but I know one of them is not an American bank. It's a British bank.

The second question, yes, I agree.

COMMISSIONER MULLOY: You think either way they're finished?

MR. CHENG: But, currently, I believe the regime already recognized that. The priority is not the fate of the country. The priority is the fate of the regime.

COMMISSIONER MULLOY: Of the party?

MR. CHENG: Yes. They refused to take any reform measures.

In terms of the threat of the corruption to the regime itself, to the system itself, its way is to utilize more kind of totalitarian measures to control society, including tighter media control, increase the size of secret police and those kinds of things.

So they believe that as long as we use those totalitarian measures, we can extend our life as long as possible.

My personal observation is, it is not impossible for the world to see a country with a market system but based on authoritarian or totalitarian.

MR. WELKER: Ms. He said that in particular the questions of the courts are that the courts are absolutely not separate from the party and that the inability of the party to bring corruption outside of its internal functions is the major problem of the corruption question.

MS. HE (THROUGH INTERPRETER): It is one way to know how deeply the corruption problem has infected the Chinese system. If you sentence all Chinese officials above division level to a death sentence without any trial, if you kill all of them, there might be some cases where they were innocent; not innocent of corruption, but innocent because not corrupt enough to be killed. But if you kill one by one, then definitely there are many people who will escape from death sentence. So that's a saying in China, years ago.

The reason why the Chinese government doesn't really punish corruption is because corruption has made an elite group into an interest group. In recent years, those officials punished in anti-corruption cases could be classified into several types. One type is those who do not want to pay money to his bosses, one who gets a lot of money, but he does not want to pay his bosses to buy some protection; then he got punished. Once he was put under investigation, nobody comes out to protect him.

Another type is his political backing is not strong enough. For example, before the 16th Party Congress, several officials who belonged to Zhu Rongji's system were punished. That's the exact case of the second type, because Zhu Rongji is going to leave his job.

So those officials punished are very unlucky. They say that: "I'm not the most corrupt guy. I'm just unlucky."

CHAIRMAN ROBINSON: Commissioner Wessel will pose the last questions of the day.

COMMISSIONER WESSEL: I'd like to follow up on a question that Commissioner Becker was asking about U.S. business. He raised the issue of foreign direct investment.

During the debate on permanent normal trade relations, PNTR, we were told that dramatic increases in U.S. foreign investment in China, and moving U.S. businesses there, would dramatically change things, would bring democracy, would expand economic growth, et cetera. I've heard today that college graduates are

having trouble finding jobs. I've seen little evidence or heard nothing to indicate that corruption has been reduced.

I'd like your thoughts on whether the U.S. investment, the dramatic rise in investment, is really making a difference. Are the comments the business community are saying, how simply being there would bring about all the changes that many in Congress desire, is that coming true?

MS. HE (THROUGH INTERPRETER): It must be clarified that businessmen speak for interests, not principles.

I remember several people who work for American companies in China tell me their experiences. At the very beginning, when they told their American boss that for this case we need to invite somebody for dinner and to give some gifts, the American boss said no. But later, their boss found that if they refused to do that, they lose opportunities. And then, gradually, their bosses recognized those corrupt ways.

I have a friend who worked with the Chinese government. Many officials in the Ministry of Telecommunications in China have credit cards given from American companies. The highest credit on the credit card is 2 million Chinese yen. Of course, those American companies will not recognize that here.

I heard a legal professor of Ohio University who had worked in a company in Guangzhou. He told me his personal story. He was born in Taiwan and came to the U.S. when he was 3 years old. He worked for an American company in Guangzhou for 3 years. His job is to take care of the taxation and the fees to the local government. When he went to his office the first time, he got tables listed that there are at least 30 different types of taxes and fees the company has to pay. Later he found that what the company was asked to pay was more than the 30 types.

For example, the local environment protection office not only charges them the regular fees the company has to pay, but the government office also tried to sell the company some detergents. Every time, they try to sell 15,000 [yuan] [of] detergents to the company. The price is three times the market price. And this person refused to buy for the company. Then the Chinese government officials said, "Well, you'll wait."

Then the company received a penalty notice later, saying that their company polluted and it will be punished for 100,000 yuan as a penalty. Instead of paying the 100,000 penalty, the company

finally agreed to buy the 15,000 yuan detergents that they had no use for. So they didn't pay the 100,000 penalty.

He had a similar experience in his first year in the company. From the second year, he finally gave up the position, to enlist principles, in order to reduce his troubles. So he says that the 3-year experience for me is really valuable; otherwise, I won't understand what China will be. He said that he will never trust anything said in a Chinese newspaper.

CHAIRMAN ROBINSON: Well, we all wish to thank you once again for, really, an enormously informative and candid set of sessions.

In fact, in that connection, as a departing question, Commissioner Lewis wants to pose to you one final question. And that really will wrap it up.

But I, in advance, want to extend the Commission's heartfelt thanks to you for not only appearing today but offering such a candid, informed set of views to help us really understand the complex state of play. For that, we're very grateful.

And with that, I turn it over to Commissioner Lewis to end the day.

COMMISSIONER LEWIS: I would like to say that your lives have really been an inspiration, and it's really been so informative to us. But I'd like to ask you--you've been so honest and forthcoming, the two of you--do you have any fears that the Chinese government will go after your relatives that are still in China?

MR. CHENG: Not yet, because my parents are already 80 years old.

MS. HE (THROUGH INTERPRETER): I think it's very simple to say that since I was willing to speak openly in China about the questions of corruption and was kicked out of the country because of it, that's fairly clear. And since I was very rare in what I was talking about, I was able to get a great deal of reaction among my fellow Chinese people. But I can say that, at least in my case, since I did write these things all down in a book, it's a good sign to say that I'm quite sure my book is still selling in some places inside China. And I also know that in looking on the Internet, I see people who are referring back to my work.

COMMISSIONER LEWIS: So she has no fear, then?

MS. HE (THROUGH INTERPRETER): There's nothing for me to really be that afraid of anymore. But there is one thing that I would like to remind you all about. Since I've been here in the United States, I've had the opportunity to perhaps talk about cooperative programs with a number of people, especially those Chinese-American scholars. But many of them have a very hard time getting at the real situation inside China, because of their personal conditions.

Last month, I was able to go to a discussion at Columbia. And at that meeting, a professor from Duke University made a public presentation of his research. And in the course of the research, he determined that 68 percent of the respondents felt that everything was fine in China. So I had to ask at the time, "In the course of you carrying out your research, what was the cooperative organization of the Chinese government that you worked with, and what type of people participated in the survey?" And he said, "Well, there was none. It was me. I did it by myself." And I said, "I feel that's very strange because, as far as I know, in 1998, the central authorities put out a central directive. And in this directive, it said that anyone carrying out such surveys inside China must go through the government to find a cooperative partner organization and that all of the statistical results would have to be cleared with the Statistics Bureau. And so even those of us in China doing this work had to follow those rules. And if then you did not have to follow these rules, then you are truly exceptional."

CHAIRMAN ROBINSON: Well, may you one day be able to return to a free China.

Thank you very much.

[Whereupon, at 4:08 p.m., the Commission briefing was adjourned.]