Order Code 98-197 F
Updated January 17, 2001

CRS Report for Congress

Received through the CRS Web

China's Military-Owned Businesses

(name redacted)
Specialist in National Security Policy
Foreign Affairs, Defense, and Trade Division

Summary

Defense companies of the People's Republic of China (PRC) fall under two hierarchies: those belonging to the military, or the People's Liberation Army (PLA), and those in the defense industries under the State Council. This CRS Report focuses on PLA-owned businesses. Some advocate limiting economic ties with PLA companies. Others say targeting the PLA would unnecessarily hurt strategic goals with China and would be formidable to enforce. Complicating the issue is the ban on the PLA doing business that China's president ordered on July 22, 1998. The FY1999 National Defense Authorization Act (NDAA) required a published list of PLA companies operating in the United States, but some Members of Congress say the Administration did not comply. The FY2001 NDAA again required a report (may be classified) on such companies. This CRS report may be updated as warranted.

Princelings, Arms Sales, and Civilian Business

The PLA's diversification into increasingly civilian profit-making business originated with late paramount leader Deng Xiaoping's military and economic reforms. In January 1982, Deng articulated the 16-character "Military-Civilian Combination Policy," ("military-civilian unity, peacetime-wartime unity, priority for military production, use civilian production to support the military.") In addition, the Commission of Science, Technology, Industry for National Defense (COSTIND) was created in 1982 under the Central Military Commission (CMC) and the State Council to integrate the civilian and military sectors of research and development, and production.[1] In 1985, military reforms cut back the PLA's budget and began to demobilize 25% (one million) of the soldiers. There were surplus people and less money. The PLA began seeking profits in arms sales, including the sale of missiles to the Middle East. The PLA's profits were also tied to the personal fortunes of "princelings," the children (and their spouses) of top military and

[1] CRS Report 96-889, *China: Commission of Science, Technology, and Industry for National Defense (COSTIND) and Defense Industries*, updated Dec. 3, 1997, by (name redacted). In March 1998, COSTIND was reorganized solely under the State Council.

civilian leaders. The princelings' connections provided the PLA's companies with clout to make even missile sales.

Poly Technologies was a good example. The Equipment Department of the General Staff Department of the PLA set up Poly (ostensibly as part of the China International Trade and Investment Corporation (CITIC)) in 1983 to export and import military equipment. The president of Poly is He Ping, who is also the late Deng Xiaoping's son-in-law. He Ping retired from the PLA as a Major General after also serving as director of the Equipment Department. Serving as Poly's chairman is Wang Jun. Wang is also president of CITIC and a son of the late Wang Zhen, who was a retired general and a PRC vice president. Other executives included Major General He Pengfei, a son of the late Marshal He Long and director of the Equipment Department from 1986 to 1992.[2]

Poly has exported defense products, specialized technology, military vehicles, telecommunications and radar equipment, special purpose instruments and machinery, and chemical industrial machinery. It's conducted sales on a government-to-government basis through the Bureau of Military Equipment and Technology Cooperation — also under the General Staff Department. Poly Technologies was probably behind the sale of CSS-2 medium-range ballistic missiles to Saudi Arabia in 1987. The sale reportedly earned \$3-\$3.5 billion for the PLA. Like other PLA-owned companies, China Poly Group diversified from simply arms sales to more open and conventional civilian commerce.[3] A few PLA companies have sought foreign capital, overseas operations, joint ventures, foreign technology, and tax havens abroad. Civilian business, earning perhaps 80% of Poly's total profits, has become more important than arms sales. Poly has also become a conglomerate independent of CITIC with its own headquarters in Beijing: Poly Plaza.

Top Players. In 1998, there were about 24 large businesses that belonged to the highest levels of the PLA and the People's Armed Police (PAP).[4] These companies included: China Poly Group (Baoli or Poly Technologies Incorporated), under the General Staff Department (GSD); Kaili Corporation (also known as Carrie Enterprises), under the General Political Department; Xinxing Corporation (Group), under the General Logistics Department (GLD); and Xinshidai (New Era) Development Corporation, under the General Equipment Department (GED). After changes in 1998, many trading companies previously under the PLA are now directed by the State Council or its ministries.[5]

---

[2] Yang, Richard, *SCPS PLA Yearbook: 1988/89;* U.S.-China Business Council, *A Guide to China's Trade and Investment Organizations,* 1989; U.S.-China Business Council files (June 1991); Kristof, Nicholas D., "Potent Office Weaves Web in China Arms," *New York Times*, August 21, 1991; Tai Ming Cheung, "Arms Reduction," *Far Eastern Economic Review,* October 14, 1993; Tai Ming Cheung, "China's Princelings," *Kim Eng Securities*, January 1995; Henry Sender and Bruce Gilley, "Changing the Guard," *Far Eastern Economic Review,* February 6, 1997.

[3] Discussion about profits and numbers of PLA companies draws from Tai Ming Cheung's briefing at a CRS Program, "China's Military in Business: An Overview," June 6, 1997.

[4] Defense Intelligence Agency, "China's International Defense-Industrial Organizations," Defense Intelligence Reference Document DI-1921-60A-98, June 1998.

[5] Defense Intelligence Agency, "China's Defense-Industrial Organizations," Defense Intelligence

(continued...)

Ban on PLA Businesses. Total PLA-owned companies — from conglomerates to small factories and shops — numbered an estimated 20,000 at its peak in 1993.[6] From 1993 to 1996, the leadership tried to bring greater discipline and control to military-run businesses and restrict commercial operations to units above the group armies. In 1998, there were approximately 10,000-15,000 PLA-owned businesses.

Complicating identification of such companies is the 1998 ban on the PLA doing business in the most ostentatious and commercial areas. In conceding the PLA and PAP's detrimental problems with criminal activities (like smuggling) and corruption, President Jiang Zemin, on July 22, 1998, ordered the PLA and PAP to stop engaging in "commercial activities." China said that the PLA and PAP completed the divestment of commercial enterprises by December 15, 1998, having transferred them to the State Economic and Trade Commission at the central or local level. Hong Kong-based specialist Tai Ming Cheung reported that the 5,000 or so transferred commercial businesses actually remained in a period of transition for a few years, while about 10,000 self-supporting, industrial enterprises and those employing dependents remain as before. The divestment focused on large conglomerates, but with exceptions. The arms sales parts of the Poly Group were reassigned to the GED. Some of Xinxing's factories supplying the PLA remained in the GLD. The PLA Air Force retained its United Airline. The PLA kept telecommunications ventures (e.g., Great Wall Mobile, Century Mobile Communication Corp.), partly to keep up with useful technological advances.[7]

U.S. Operations and Joint Ventures

Before the 1998 ban on military businesses, the PLA set up subsidiaries in the United States. These companies may have retained some ties to the PLA. Seeking capital, technology, and, at times, intelligence, PLA companies increasingly established U.S. operations or joint ventures with U.S. companies. Some stress that these developments have increased the burden to U.S. law enforcement, counter-intelligence efforts, and export controls, while others say that just a small fraction of the PRC companies are in illicit business.

Beyond the complications presented by the ban on PLA businesses, estimating the total number of PLA companies in the United States depends on whether the parent companies or their proliferating subsidiaries are counted. Depending on how they are set up, it is also difficult to identify which companies are owned by the PLA. Each of the conglomerates has dozens to hundreds of subsidiaries, including some in the United States and other countries. The two most well-known companies in the United States are the GSD's Poly Technologies and the GLD's Xinxing Corporation. A study by the AFL-CIO found that eight of these parent companies may have a number of U.S. subsidiaries. The Rand Corporation estimated that between 20-30 of the PLA's companies are operating in the United States. Some said that almost 800 small PRC businesses are seeking

---

[5] (...continued)
Report DI-1921-65-00, December 2000.

[6] Cheung, Tai Ming. "Serve the People," *Far Eastern Economic Review*, October 14, 1993.

[7] *Washington Post*, January 25, 1999; *Wall Street Journal*, March 15, 2000.

technology and intelligence in the United States, including some PLA-owned companies.[8] In 1999, the Cox Committee asserted that over 3,000 companies from China, including some with ties to the PLA, operate in the United States. A joint 1999 CIA/FBI report said that the "vast majority" of PRC businesses in the United States are "legitimate companies," while there are some that collect intelligence.[9]

Policy Issues

One View: Target PLA-owned Companies. An issue arose about whether U.S. sanctions and trade policies should target PLA-owned companies in the United States or ban U.S. firms from engaging in business with PLA-affiliated companies in China. Some in Congress, the AFL-CIO, and others advocate that U.S. trade policies target PLA-owned companies — if not defense-related companies in general. At a hearing held by the Senate Foreign Relations Committee on November 6, 1997, on the commercial activities of the PLA, the AFL-CIO's witness advocated a campaign to "kick the PLA out of the USA." Some argue that for moral reasons, U.S. companies should not trade with or invest in companies owned by the PLA or PAP, which are China's coercive instruments to suppress human rights and separatists in Tibet. Others contend that for security interests, U.S. companies, markets, and investments should not contribute to PLA modernization. Moreover, allowing PLA-owned firms to have U.S. operations and joint ventures with U.S. firms facilitates China's efforts to circumvent U.S. export controls to acquire militarily-useful U.S. technology.

Most analysts agree that the profits of the PLA's companies are used as extra-budgetary funds in support of military modernization. It is uncertain, however, as to how much of the profits directly support PLA modernization. In general, the profits are thought to be divided among personal coffers (e.g., foreign bank accounts) and lavish lifestyles, reinvestment by the companies, improving morale of the units with better wages, housing, and meals, lower level military units, training, and procuring weapons.

One expert, Tai Ming Cheung, estimated that the overall contribution of the PLA's businesses to the PRC economy in 1997 totaled that of a medium-size province in China, perhaps 2-3% of gross domestic product. The roughly 10,000 PLA-owned companies earned $1-3 billion a year. About 90% were small-scale operations; 300-400 were medium- to large-scale companies. The top 20+ conglomerates earned 80% of the total profits. Poly was the most profitable, with assets of over $1 billion.

---

[8] Fiedler, Jeff (AFL-CIO), "China's People's Liberation Army: Where to Find PLA Companies in America, What Products the PLA Sells in America, and Who are the PLA's Customers," June 1997; Mulvenon, James. *Chinese Military Commerce and U.S. National Security*. Rand Center for Asia-Pacific Policy Working Paper. June 1997; Greenberger, Robert S., "Chinese Find Bargains in Defense Equipment As Firms Unload Assets," *Wall Street Journal*, Oct. 21, 1996; Miller, Lee, "Pressure China Through the PLA?" *Washington Times*, Oct. 26, 1997; Fialka, John J., *War by Other Means* (New York: W.W. Norton & Company, 1997).

[9] "Report to Congress on Chinese Espionage Activities Against the United States," 1999.

Some who advocate targeting PLA-owned companies are concerned about their technology acquisition through U.S. operations or joint ventures with U.S. firms.[10] Although not all of the PLA-owned companies may seek to acquire militarily useful, or dual-use, technology, those belonging to the GSD or COSTIND probably focused on technology and intelligence acquisition. In July 1997, the official *China Daily* reported that COSTIND and the Equipment Department of the GSD decided to open the defense industries to foreign investment. In May 1998, COSTIND, the new GED, the Equipment Department, and the Ministry of Electronics Industry held the first China International Defense Electronics Exhibition to host U.S. and other foreign defense manufacturers.

Another concern has to do with imports of PRC guns, which became illegal in 1994. In May 1996, federal law enforcement agents ended a sting operation targeting the smuggling of 2,000 fully automatic AK-47 weapons through the port of Oakland. The two PRC companies were Poly Technologies (and its U.S. subsidiary, PTK International Inc.) and NORINCO (a non-PLA, arms industrial company).[11]

Alternative: Protect U.S. Interests but Not Target the PLA. Others argue that there is existing legislation to protect U.S. interests through law enforcement and export controls, without having to specifically target the PLA. Also, targeting PLA-owned companies would undermine larger U.S. strategic goals with China, including engagement with the PLA and obtaining cooperation in law enforcement. Third, because of the ongoing divestment of PLA firms, difficulties in identifying small PLA-owned subsidiaries, and the prevalence of PLA companies throughout the PRC economy, a policy targeting such companies would be impossible to enforce for U.S. firms doing business in China and formidable to enforce in the United States. Also, such as policy may inadvertently harm legitimate PRC or U.S. businesses. Fourth, any confusion between PLA-owned companies and those belonging to the defense industries may affect U.S. trade in aerospace, aviation, and other industries. Fifth, some point to alternative technology acquisition by other PRC nationals, such as those at U.S. corporations or universities. Last, the PLA's businesses have corrosive effects on PLA modernization.

Although U.S. policy has not restricted business with the PLA, export controls and laws have targeted categories of military-related investment and trade, such as gun imports, technology transfers for missiles or nuclear and chemical weapons. The Administration argues that laws and export controls are enforced to protect U.S. interests. For example, existing laws allow for restricting investment in the United States by foreign firms on national security grounds. In 1990, President Bush ordered China Aero-Technology Import and Export Corporation (CATIC) (a defense-industrial, not PLA-owned, company) to divest from its earlier acquisition of Mamco Manufacturing Inc. of Seattle. President Bush acted on the recommendation of the Committee on Foreign Investment in the United States (CFIUS) and the authority of the Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418).

After the Tiananmen Square crackdown of 1989, Congress imposed sanctions on China, including a suspension of sales of munitions list items (including parts for

---

[10] Wortzel, Larry, "The Administration Must Name Chinese Defense Companies in the United States," Heritage Foundation, October 10, 2000.

[11] *Los Angeles Times*, May 23, 1996.

helicopters), satellites, and crime control and detection equipment. Those sanctions are in Sec. 902 of the Foreign Relations Authorization Act of FYs 1990-91 (P.L. 101-246). Also, the Commerce Department has the "Entity List." It bans exports to certain PRC nuclear weapon-related organizations (and other foreign entities) without a license. While not specifically targeting imports from PRC military or defense-industrial companies, President Clinton on May 26, 1994, decided to ban PRC munitions from importation into the United States. The Bureau of Alcohol, Tobacco, and Firearms then revoked all permits to import defense articles from China under the Arms Export Control Act. Enforcement of this ban was helped by targeting a specific category of trade items, which did not require evidence of whether the exporter (e.g., Poly) belonged to the PLA. In 1999, the Clinton Administration denied the export of the APMT satellite for PLA use.

Administration officials and others also contend that engaging the PLA is important for U.S. security interests in Asia. The Rand report argues that "Chinese military and defense-industrial enterprises should be allowed to operate within the United States on grounds that problems related to these companies do not appear sufficiently large to warrant the damage to Sino-U.S. relations that would result from banning them." The Administration also maintains that targeting PLA companies would be an impossible task for U.S. law enforcement agencies, because such a policy would lead to attempts to hide affiliations with the PLA or PAP. Some U.S. companies in partnerships with PLA-owned firms have found low-priced goods to import and advantages for competing in the PRC market, including large networks and privileges in transportation and distribution.

Lastly, commercialization has had corrosive effects on the PLA. Criminal activities, corruption, and uneven business opportunities hurt professionalism, training, and morale.

Congressional Action

In 1998, the FY1999 National Defense Authorization Act (NDAA) (P.L. 105-261) authorized the President to use the International Emergency Economics Powers Act (IEEPA) to investigate, regulate, or ban PRC military, police, or intelligence companies operating in the United States. The NDAA also required a published list of such companies. However, in 1999, the Secretary of Defense declined to examine U.S. persons (saying that effort would go beyond the foreign intelligence role of the Defense Intelligence Agency) and declined to publish a list that could disclose collection sources and methods.[12] The Director of the FBI also reportedly contended in a March 3, 2000 letter that the Bureau is not the appropriate agency to compile the list.[13] In 1999, some Members of Congress questioned whether the Clinton Administration complied with the law. In 2000, Congress passed the FY2001 NDAA (P.L. 106-398) with section 1233 requiring an annual report of PLA companies operating in the United States. This provision amended the earlier requirement by dropping the call for a published list and allowing the Secretary of Defense to submit a classified report, with the initial report due by March 1, 2001. In subsequent years, the Secretary is to make revisions to the list.

---

[12] Secretary of Defense William Cohen, letter to Representative Christopher Cox, August 13, 1999; Memorandum from the Defense Intelligence Agency, July 26, 1999.

[13] *Inside the Pentagon*, March 9, 2000.