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Before the U.S.-China Economic and Security Review Commission

Major Challenges Facing the Chinese Leadership  
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Firstly, I must offer my thanks to all the Commissioners for inviting me to participate in this hearing. Thank you to hearing co-chairmen, Commissioner Wortzel and Commissioner Reinsch. The good work of the U.S.-China Economic and Security Review Commission continues to inform the debate and educate the Congress and the American public on the difficult questions of U.S.-China relations.

I appreciate the chance to speak to the issue of worker unrest in China and that country's prospect for long-term stability under Chinese Communist Party rule.

When looking at China's present system, one has to wonder if the language of economists is useful. The country is run by a one-party authoritarian dictatorship that calls itself "communist" but tolerates a hybrid market economy that combines some of the worst mercantilist policies, some of the harshest laissez-faire practices and some blatant state planning under the banner of "reform." And yet this system has defied most expectations – maybe defied economic gravity – for more than 25 years. The Party has jettisoned revolutionary zeal as its guiding force in favor of growth and inequality as its cardinal principles.

However, past performance is no indicator of future results.

In fact, we don't know too much about China's recent performance either. The revision of the gross domestic product figures shows that even the macroeconomic picture is quite hazy. As one comment on Brad Setser's weblog put it: the change in denominator means that every "of GDP" figure needs to be revised – it does not however improve the quality of any numerators. One report from a research arm of the official National Development and Reform Commission released earlier this month predicted growth between 8.5% and 9% for 2006 but also warned that deflation could return this year. The Wall Street Journal reported "some economists said the think tank is putting out confusing signals, reflecting official uncertainty about how to keep economic growth on track." No wonder many observers are confused.

In its 2003 monograph Fault Lines in China's Economic Terrain, the RAND Corporation set out to take a "countervailing perspective to what has been a generally prevailing consensus" that "China's economy will be able to sustain high rates of economic growth for the indefinite future." I think they selected a representative universe of "fault lines" that lay underneath the apparently functioning Chinese economy. The report identifies eight specific issues of potential danger to China's assumed growth path: massive unemployment and rural poverty; corruption and its effects; epidemic disease;

environmental degradation; energy price shocks; state finance and state owned enterprise failures; shrinkage of foreign investment flows; and “Taiwan and Other Potential Conflicts.” This seems to be a reasonable list.

Another series of factors was compiled by the China Labour Bulletin, the labor rights advocacy NGO headed by Han Dongfang in a report titled The Workers Movement in China 2000-2004 published in Chinese in 2005 that has not yet been translated into English thus is not widely distributed among Western observers. The authors identify two distinct groups of workers impacted by economic policies of the CCP under the banner of “reform.” One passage is worth quoting at length:

In the period of the report, the participants in the worker collective demand actions (author translation of *gongren jiti weiquan xingdong*) can be divided into two types:

One type is where the unemployed and laid-off (*xiagang*) are the majority but this group includes smaller numbers of retirees and present workers. They generally are found in the northeast, northwest, southwest and the central plains among the older industrial bases. They are concentrated in the energy, forestry, military production, textiles, iron and steel, petroleum, construction, sugar and other such industries. These industries are precisely the primary object of the state sector reforms and restructuring.

One type is comprised of workers who do not have city residence *hukou* yet work in all types of enterprises; this group of workers is called “peasant laborers.” These workers are primarily found in the southeast coastal regions’ economically developed areas among the locally-invested or foreign invested private companies.

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Among the collective actions by the unemployed and *xiagang* workers, the primary collective grievances are: to demand their right to active employment; to demand the promised wages, social insurance payments, collective payments; to demand raises in basic living safeguards; to demand the release of detained worker representatives.

The CLB report tellingly notes, “It must be first pointed out that the predicament faced by Chinese workers is not a problem of ‘lack of rights’ but more so the ‘expropriation of rights.’ Because of this, over the last few years, the conflicts between labor and capital have given rise to conflicts between workers and local governments and become major social conflicts.”

The difference between lists of economic factors of unrest of many foreign observers and factors identified by China Labor Bulletin or other Chinese civil-rights activists can be traced to their basic views of “reform.” I believe there are two primary opposing camps:

a camp that feels that Chinese reform has followed a bumpy yet correct path and a camp who feels that “reform and opening up” itself – the methods, the decisions, the policies of the party – is in error and poor party-led implementation has only added to the problem.

But both camps certainly would agree that this present CCP leadership is committed to this path of reform – one of economic restructuring with minor support in social safety nets without accompanying political restructuring that would make the authorities accountable. And since this present path of reform is exacerbating the contradictions between the people and the government, then the answer to the question of whether protests in China will grow, contract or remain constant is clear: the protests will grow as the “reform” accelerates.

The questions surrounding whether or not China should undertake wholesale economic changes were settled inside the CCP long ago. Now the questions of what form those changes will take and under what system they will be implemented is the crux of the conflicts both between labor and capital in China but also between those who support “this path only faster” reform and those who support “not this path” reform. In the run-up to the great bargain on China’s accession to the WTO, there were internal party discussions and even limited debate between the party and civic-minded public intellectuals on what exactly “reform” under the WTO would be and what impact it would have. This internal debate was stifled by the Jiang clique and the collective party leadership decided to plow forward with wrenching economic displacements under a one-party administrative and legal structure that has no real mechanism to listening to the ever growing voices of the displaced. The potential for a split in party leadership where a clique that advocates “lesser reform” more focused on supporting the displaced is quite small in my view; the party discipline functionaries are still potent, but the enrichment through corruption is much more of a factor in keeping party members loyal to the present policies.

I see China’s largest economic fault line lies within the policy disconnect of so-called “privatization” of state-owned enterprises in a country where the authoritarian regime’s rubber stamp “legislature” can’t pass a law that recognizes “private property.” Throughout the entire existence of the People’s Republic of China, the workers have been told that the assets of the state are collectively owned and therefore the individuals had a stake not only in their place of work but in the national wealth. Yet, under so-called “reform”, the authorities are now saying that the worker has no claim to these assets, that the previous party-cum-managers are now the personal shareholders of the state enterprises and there is no compensation for previously committed wages, benefits or pensions or payment to “purchase” the collectively owned share of the facility and assets.

In an admittedly simplified comparison, at least in the United States when a company like IBM unilaterally changes its pension program, the workers have recourse to taking this decision to the courts for protection of their rights. In this IBM example, the courts sided with the workers and the company was compelled to pay court-determined compensation. In China, the workers are losing their jobs, their back-pay, their right to residence, their right to social benefits like health care and education, their pensions and their “share” of

the collectively owned asset. And there is no third party that can enforce external discipline on the authorities.

I feel that the widespread demands over the 'expropriation' of workers' rights is a larger threat in the immediate to medium term than the demands over the 'exploitation' of workers situations. In the case of 'peasant labor', the migrants are leaving families behind in the rural and agricultural regions to seek wages and jobs in the manufacturing areas near cities and along the coast. There are factors that push them off the farms like subsistence tenancy and hard labor and factors that pull them into the factories like a need for wages in the new cash-based reality. These peasant laborers have a great responsibility to send their wages back home, so they may have a higher sense of obligation to withstand the exploitation they find in the factories. In the case of the state-owned workforce, there was a full network of social services and state support up until very recently. The laid-off workers and the pensioners of state-owned enterprises were fairly secure in their position and were called in party propaganda China's elite. These workers feel a double loss: first the loss of their jobs and security and then the 'loss' of proper compensation which compounds the anger and creates a sense of being cheated. The peasant laborers truly are starting with nothing, so the something they get in wages is at least temporarily an improvement.

The potential role of independent trade unions in China is as bleak as the hoped for independent judiciary. The All-China Federation of Trade Unions is simply one pillar of the party's United Front strategy on controlling the population. The workers know that the union officials – in many plants concurrent members of both the Communist Party and management – are primarily there to gather intelligence on the workforce. In state-owned enterprises the unions are literally a joke among the workers. In foreign invested enterprises, there is very little study of what role ACFTU branch unions exactly are meant to do.

The trade union laws in China state that all foreign firms must allow for ACFTU branch unions in the workplace. The story of Wal-mart's struggle with the ACFTU is indicative of how the union and party interact. The Workers Daily named Wal-mart, among a handful of other international branded corporations, as deficient in following the trade union law. The initial response from the Wal-mart spokesmen in China was that the company didn't have unions anywhere in the world and they didn't want unions in China. This answer got the Chinese ultra-nationalists in an uproar with accusations that foreign companies could simply ignore Chinese law. So the party was being challenged by these nationalists. And, conveniently, the next time the Wal-mart CEO was in Beijing to open a university "research center" with company funds, he also announced a correction of the company's policy: that the company would allow the ACFTU if the workers themselves advocated for union representation. I read that as meaning that the ACFTU central bodies were not empowered to approach Wal-mart workers directly to create a branch union. This suggests that the party could direct or dissuade the ACFTU from building branch unions inside certain undefined but politically supported foreign enterprises. In the face of that collusion between party-cum-managers, party-state authorities and party

unions, the workers rightly have no expectation that trade unions are a part of the solution to their predicament.

Most Chinese workers do not see collective representation as having any power under the present structure, and thus the influence that trade unions had in other countries to bring changes surrounding such early 20<sup>th</sup> Century issues like child labor, indentured labor or horrid workplace safety is absent in 21<sup>st</sup> Century China. There is no reason to believe in the benevolence of the party to step in and relieve these basic labor deficiencies, never mind to see the party thoroughly enforce minimum wage or maximum working hours laws that are already on the books.

In the present laissez-faire market that is the Chinese labor market, there are limited external disciplines influencing workplace conditions – officials scrambling to avoid environmental disasters for one - and in certain local markets influencing wages as well even in the absence of a workers' movement. The size of the Chinese workforce, however, breaks the economic models that forecast a “rising tide lifts all boats” scenario over a mid- or long-term timeframe. The thousands of deaths in the mining industry or the tens of thousands of serious industrial injuries like amputations have yet to inform scores of potential workers to opt out of the labor pool and stay away from the dangerous jobs. There is potential for a small minority of skilled workers to move quickly up the production ladder and move from the most dangerous employers to more “reputable” domestic employers and even to foreign funded enterprises with international standards. But the rapidly growing gap of the prospects of this minority and the struggle for existence for a large majority of workers in China only fuels the sentiment of dissatisfaction and abandonment and thus unrest.

The overall lack of such external disciplines on the laissez-faire market forces in China results in the so-called “China price.” A government that was more responsive to the workers could impose some regulations – to mandate limits in the exposure to toxic chemicals in a plastics plant, to appropriate for larger compensation for state employees, or to enforce standards for wage accounting for example – that would put upward pressure on the China price. But again the consensus is that this leadership will continue down this present path of “reform.” If the party rhetoric of addressing the inequality or the deteriorating safeguards is acted upon promptly, then perhaps the scale of the unrest will moderate but the China price will become less of a competitive advantage in attracting new investment. Thus, growth would level off and the bargain between the party and the people for “prosperity” in exchange for “stability” might be questioned by even larger numbers of Chinese. The party may judge that there is greater threat to their control in the perception of failing momentum behind prosperity than in the slow-burn of unrest by those who “reform” is leaving behind.

Thank you.