Shanghai corruption scandal exposes crisis of China’s pension system

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The weeks-long “anti-corruption” campaign in Shanghai launched by Chinese President Hu Jintao, finally reached one of its major targets—the Shanghai Communist Party boss, Chen Liangyu. His downfall marks a setback for the so-called “Shanghai gang” of former president Jiang Zemin, in the ongoing factional struggles of the Chinese leadership.

The state media announced Chen’s dismissal on September 25. He was arrested and charged with lending 3.2 billion yuan (about $US400 million) in pension funds to “illegal entrepreneurs”. Han Zheng, President Hu’s protégé and Shanghai mayor, has taken over Chen’s post as acting party chief. A number of Shanghai officials and businessmen have been detained or are under investigation for the illegal use of the city’s social security funds to finance real estate and infrastructure projects.

Chen, a member of the powerful Chinese Communist Party (CCP) Politburo, is the highest-ranking Chinese official to be charged since the imprisonment of former Beijing party boss Chen Xitong in 1995. His disgrace allowed Hu to reshuffle the leadership at the annual plenum of the CCP Central Committee on October 8.

The plenum’s theme was the building of a “harmonious society”. These are code words for a discussion on China’s rising levels of inequality and social tension. China’s Gini coefficient, a measure of income inequality, has reached 0.46, higher than that for the US. The move against Chen was not about corruption, but how to best maintain the CCP’s grip on power.

Hu advocates the granting of some political rights to secure a social base among China’s emerging middle classes, whereas his opponents oppose any, even limited, liberalisation and back stronger police-state measures against any protests. In particular, Jiang and his faction have resisted any reappraisal of the military crackdown on protesters in Tiananmen Square in 1989, which is still officially justified as suppressing a “counter-revolutionary rebellion”.

The former Shanghai party leadership has been criticising Hu’s policy of curbing speculative investment. By ignoring the instructions from Beijing, Chen’s actions had encouraged property speculations and the anarchic expansion of industrial projects throughout the country in recent years. Hu feared a financial crisis, coupled with the mounting social tensions, could dramatically escalate mass unrest among workers and farmers.

The factional conflict remains far from settled. When Jiang handed over to Hu in 2002, he initially kept control of the Central Military Commission and installed his protégés in the new leadership to ensure Hu did not change the basic policy agenda of the 1990s.

At the leadership meeting, Vice President Zeng Qinghong, Jiang’s most important protégé, was appointed as the head of the preparatory committee for next year’s party congress. The position will allow Zeng to draw up the recommendations for the senior political posts.

There are some indications that Zeng may be shifting his allegiances. He played a crucial role in 2004 to forcing Jiang to resign from the top military post. During the Shanghai “pension scandal”, Zeng has functioned as a go-between between Jiang and Hu in negotiations over which officials would become the scapegoats.

There is no doubt that Chen’s removal constitutes a blow against the grip of the “Shanghai gang” over the CCP Politburo. Of the Politburo Standing Committee’s nine members, the future of two other Jiang allies is in doubt. Huang Ju reportedly has cancer and will retire next year. Jia Qinglin is likely to be forced out at the 2007 party congress.

The state-controlled media has focussed attention on the political demise of a top corrupt official, claiming that his removal demonstrates Beijing’s determination to fight for “social justice”. Such cases serve a useful role in diverting public anger over the regime’s pro-market policies, which have led to profiteering, bribery and theft at every level of government, and a deep chasm between rich and poor.

The abuse of the Shanghai pension funds is not simply a product of corrupt individuals, but flows directly from the economic and social policies adopted at the highest levels in Beijing. The country’s rudimentary social security system was established in late 1990s, amid rising social discontent and a wave of protests in rural and urban areas over worsening unemployment and lack of basic services.

Chinese employees are now required to pay a portion of their wages into local government-controlled social security funds. Theoretically, workers should have at least a limited income in case of retirement, injury, job loss or pregnancy. But wage levels are so low that workers would have to pay an estimated 40 percent of their salaries to cover all these eventualities. Moreover, many firms, especially private ones, simply refuse to participate.

A report by authorities of Hubei province last year, for instance, found that less than 10 percent of businesses paid superannuation in the five cities surveyed. Across the province, the unpaid funds amounted to 4.5 billion yuan ($US560 million). In some areas, local officials even advertised that there was no social security, in order to attract investors. Most rural residents—80 percent of China's 1.3 billion people—have little capability to pay into pension funds.

With a rapidly aging population, the Chinese authorities are facing a huge shortfall of tens of billions of yuan to fund pensions for retirees. Local governments are using the payments of current employees to cover the gap, but the difficulties can only worsen. In 25 years, it is estimated that the percentage of the population over 65 will jump from 7.5 percent to 30 percent—a consequence of the "one child" policy introduced in the 1980s.

China's new corporate elite has no interest in supporting retired workers. In 2001, the government tried to raise cash to bail out the pension system by selling shares in state enterprises on the stock market. The move was dropped after it triggered a massive sell-off and a sharp fall in share prices.

He Ping, a Chinese Academy of Labour and Social Security researcher, told the *China Daily* on September 28 that local governments are supposed to invest the $US87 billion in social security funds in central government-issued treasury bonds or in state-owned banks. These avenues, however, generate very low rates of return. Consequently, local officials are compelled to invest social security funds into riskier enterprises promising higher returns.

Beijing has turned a blind eye to the practice, making locally-controlled pension funds a lucrative source of capital for state officials working hand in hand with speculators, land developers and private entrepreneurs. Up to 16 billion yuan ($2 billion) in social security funds has been simply stolen since 1998.

The pension crisis is sharply expressed in Shanghai, China's financial and industrial centre, where the ratio of retirees to pension contributors is far higher than the national average. The city is also a focus for speculative and highly profitable property investment. At the peak of a property boom in 1996, the Shanghai government lent 6 billion yuan in pension funds to real estate developers at interest rates as high as 15-20 percent.

Under Shanghai party chief Huang Ju, the city's social security bureau established an investment arm. In 2002, when Chen Liangyu became the new party boss, he approved an investment of 3.2 billion yuan in the private company Fuxi to bid for the Shanghai-Hengzhou expressway—one of the most lucrative tollways in China. The investment became one of the corruption charges against Chen.

The scheme's principal beneficiary was Zhang Rongkun, who founded Fuxi in February 2002 largely with Shanghai pension funds. A few months later, at the age of 29, he became the vice president of the city's chamber of commerce and a member of the government advisory body, the National Peoples Political Consultative Conference. In 2005, Zhang was named by *Forbes* magazine as the 16th richest man in China.

Under former president Jiang, the corrupt use of public funds was protected in order to encourage economic growth and help create the new capitalist elite. It was only when this rampant speculation and looting threatened serious economic and social consequences that Hu targetted Shanghai to send a message to officials throughout the country to rein in such practices.

After Chen's dismissal, the Chinese government announced that by 2007, pension funds will be transferred from local governments to private fund managers acting under central government supervision. The step may curb the speculative use of pension funds but the lower interest rate returns will only compound the underlying lack of social security for the majority of the population and fuel further instability.