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China Takes On Its New Tycoons

Fearing the rise of Russia-style oligarchs, Xi Jinping looks to remind China's wealthy class of entrepreneurs who is really in charge

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On the eve of his anointment by the Chinese Communist Party for a second five-year term as China's leader, Xi Jinping seems to be the master of all he surveys. He has centralized economic and national-security policy in his office. The military and the police are firmly under control. Legions of corrupt officials—some of them political rivals, others caught brazenly on the take—are in jail. Dissidents and activists have been sidelined or locked up.

But Mr. Xi's most consequential political battle today has received little attention. As he has tightened his grip on the party and the military, he now faces only one potential set of genuine rivals: China's new class of wealthy entrepreneurs. China's communist leaders have long been known to dread a Soviet-style collapse, but Mr. Xi and his senior colleagues are equally worried about replicating what came in its aftermath: the rise of the Russian oligarchs, who snatched control of state assets and turned themselves into billionaires and pushy political players. Mr. Xi is determined not to let that happen in China.

Some of China's new tycoons have challenged the state; others have acquiesced after clashes with the authorities; most have kept their heads down and concentrated on making money. But whether or not the entrepreneurs are taking on Mr. Xi, Mr. Xi has decided to pre-empt any threat by taking the fight to them first.

Mr. Xi's campaign to corral the private sector seems to have begun in earnest in June, with the disappearance of the swashbuckling businessman who had become a standard-bearer for local tycoons leading a new wave of aggressive deal-making overseas. Wu Xiaohui, the chairman of Anbang Insurance Group, went the way that communist members who fall afoul of the system do, vanishing without official explanation into the party's extralegal detention system.

Only months earlier, Mr. Wu had been leading negotiations to spend $14 billion buying Starwood Hotels & Resorts Worldwide Inc. before the deal collapsed. Mr. Wu hasn't been heard from since his detention; no charges have been filed.

From a near-standing start in the 1990s, entrepreneurs now account for three-quarters of China's economic output and employ more than 80% of workers in its cities, according to Andy Rothman, an investment strategist with Matthews Asia in San Francisco. "The Chinese economy has been for the last decade—and will be forever into the future—driven by the private sector.

That’s not in dispute,” said Mr. Rothman. “There’s more people in Berkeley, where I live, who believe in Marxist-Leninist theory than in Beijing.”

But while China’s new entrepreneurial class may not believe in Marx, its leaders have other ideas. “If we deviate from or abandon Marxism, our party would lose its soul and direction,” Mr. Xi told a meeting of senior party officials in September. That same week, the party and the government issued a joint statement defining for the first time the essential qualities of “Chinese entrepreneurship.” At the top was “patriotism.”

As this year’s party congress, which opens Oct. 18 in Beijing, draws near, the conventional wisdom holds that Mr. Xi’s central economic challenge is energizing China’s sprawling and declining state-owned enterprises, which are clustered in heavy industry and utilities. But this view gets this issue upside down. Unproductive state ventures are hard to reform, but they have always been part of the Chinese system, with their top executives hired and fired by the party.

The private sector, however, was born outside of the party’s control. To borrow an analogy from the popular geopolitical theory known as the “Thucydides trap,” China’s entrepreneurs are the rising power destined to battle the established power of the party and the state. “It’s been clear from before Xi’s time that if entrepreneurs try to use their business networks for political power, the party will quickly cut them down,” said Ding Xueliang of the Hong Kong University of Science and Technology. “But the party cannot control everyone in China in the private sector forever.”

As China’s private sector has blossomed, the state has hardened its Leninist core, which dictates that the communist party should face no rival centers of power. Mr. Wu’s detention—and the harassment of other rich entrepreneurs—seems to be a taste of the struggles to come between the party and the business class.

A former auto dealer who married the granddaughter of the former Chinese leader Deng Xiaoping, Mr. Wu had pulled off some big offshore acquisitions, including the 2014 purchase of New York’s famed Waldorf Astoria Hotel. In the 18 months before his fall from grace, his company had outlaid more than $20 billion. His high profile, deep connections and audacious deal-making seem to have helped make him a target for a leadership looking to remind China’s newly minted CEO class who was really in charge.

Several other tycoons running large private companies fell under clouds around the same time. In July, Mr. Xi blocked Chinese state-owned banks from giving the Dalian Wanda Group, which owns AMC Theatres, new loans for expansion abroad. Wang Jianlin, the company’s billionaire chairman, backed out of major offshore deals under government pressure and, after the company’s stock price plunged on rumors that he had been banned from leaving China, issued a statement denying the travel ban.

Similarly, the billionaire Guo Guangchang—whose Fosun Group in Shanghai bought the resort operator Club Méditerranée and a stake in Cirque du Soleil—has been forced more than once to deny that he was in detention after rumors circulated online and the local press. At one point in 2015, Mr. Guo traveled to New York, pointedly posting a photo of himself online to prove he was still at liberty—and in business.

Ahead of the party congress, Mr. Xi has had a bruising firsthand experience with what can happen when an entrepreneur goes rogue. From his luxurious apartment in Manhattan, Guo Wengui, a onetime Beijing property developer, has been bombarding Beijing with lurid disclosures—in widely discussed video interviews and Twitter posts—about alleged top-level corruption and Politburo members who have children out of wedlock. Not all of his sometimes outlandish claims about China's leaders can be independently confirmed, but the exiled entrepreneur's ties to former high officials—notably Ma Jian, a onetime spy chief who is now in jail after a bribery and abuse-of-power probe—lend him some authority.

Mr. Guo, who is fleeing charges of corruption in China, had promised further revelations—contained, he has said on YouTube, in "91 folders and 18 videotapes" that he had spirited out of China when he left in 2015. In October, Facebook blocked his online profile, saying that it had included someone else's personal information without their consent. Then the Hudson Institute, a Washington think tank, postponed an event featuring Mr. Guo, who said that he suspected pressure from the Chinese government. (A Hudson Institute spokesman said that the Chinese embassy to the U.S. had complained about the event with Mr. Guo but said that it was canceled because of "poor planning" on the institute's part.)

For now, Mr. Guo is an outlier. Few of China's big business leaders—who range from robber barons to genuine visionaries—have dared to challenge the party's leadership head on. For many, their party membership and connections have become paths to cheap bank loans, advancement and enrichment.

"The private companies were presented with a very clear choice: You can make money, but you must acknowledge the communist party's ascendancy," said Barry Naughton, an expert on the Chinese economy at the University of California, San Diego.

The Chinese Communist Party took a long time to declare its love for business. In the early 1980s, a few years after Deng launched his transformational market reforms, the party's constitution still boasted of socialism's "incomparable superiority over the capitalist system." Local officials, nervous about discovering thriving private businesses in their midst, often checked with Deng before allowing them to stay open.

The party didn't cross the ideological Rubicon until early in the 21st century, when Chinese leaders realized that they badly needed private business to provide more jobs as the state sector shrank. Jiang Zemin, who led the party from 1989 to 2002, fashioned amendments to party documents to put private business on a stronger political footing. "Entrepreneurs are all builders of socialism with Chinese characteristics," Mr. Jiang declared.

Even so, China's leaders remain wary about unbound capitalism. Over the past decade, Chinese officials at all ranks have been forced to attend study sessions about the collapse of the Soviet Union—and about its aftermath, with the rise of a new class of Russian oligarchs enriched by their virtual theft of state assets.

Chinese leaders watched in horror as the Soviet Union disintegrated and its assets were privatized. Having seen business threaten to take over the state in Russia, officials in China decided to do the reverse. Over the past two decades, Beijing has tried to colonize the private sector to make sure entrepreneurs stay under control.

"The party has been trying to figure out just how long the leash should be," said Jude Blanchette of the Conference Board's China Center for Economics and Business. "Too short, and you stifle growth. Too long, and you lose control."

'In 2016, businessmen and women made up more than 8% of the party's members.'
Entrepreneurs were encouraged to join the party, which had long styled itself as a home for workers, soldiers and peasants. In 2016, amid a sharp rise in entrepreneurs' membership, businessmen and women made up more than 8% of the party's 89.5 million members, according to its own figures. A 2015 study by Curtis Milhaupt of Columbia Law School and Wentong Zheng of the University of Florida College of Law found that 95 of the founders or de facto controllers of China's top 100 private firms and eight of the heads of its top 10 internet companies were or had been members of party-led political organizations.

The party "has figured out a way to incorporate the private sector fairly effectively," said Yasheng Huang, a China specialist at MIT. As one lever, he cited the state sector's control of such areas as finance, steel and electricity to exert strong pricing power over business. "There are many economic instruments they can exercise over the private sector."

The party's targeting of tycoons hasn't just been over alleged corruption. As tens of billions of dollars have headed offshore in recent years in search of foreign assets, Beijing has feared that a plunge in foreign-exchange reserves would destabilize China's currency. Senior officials also worried that the deal-making frenzy would end the same way that Japan's did in the early 1990s, with huge sums wasted on inflated assets.

'Beijing has taken particular pains to keep the titans of China's internet industry in line.'
Beijing has taken particular pains to keep the titans of China's internet industry in line, including Robin Li at Baidu and especially Jack Ma at Alibaba and Pony Ma at Tencent. The three companies—respectively China's dominant search engine, e-commerce platform and messaging and social-media service—are often known collectively in China by their initials, BAT. In just a few years, thanks to online searches and electronic payments, the companies have become an efficient, real-time storehouse of data that China's pervasive state security apparatus could only have dreamed of obtaining.

China's tech giants are world leaders in mobile payments, and they are also working with the government on artificial intelligence, handing China's surveillance state more tools, including face recognition. Chinese companies are using AI to try to plan and predict consumer behavior; the government wants to use the same tools to anticipate dissent and head it off. The elimination of cash is making it easier for the government to track payments—and citizens.

Baidu and Tencent have both felt the government's wrath recently. In 2016, Baidu was investigated for selling rankings on its search engine; Tencent was driven to put time limits on its top-grossing mobile game after state-media criticism that it was harmfully addictive. Both companies have also been investigated for alleged cybersecurity violations.

Jack Ma, the most outspoken and high-profile of the tech-company CEOs, has mostly stayed out of trouble with the authorities. The Alibaba founder likes to say that in China, entrepreneurs should avoid doing business with government officials. "Love them. But don't marry them," he says.

Not satisfied with threatening the tech companies, the government is now pushing companies like Alibaba and Tencent to sell Beijing shares in the companies and provide a seat at the table when business decisions are made. The government would presumably also get a steady flow of dividends from its stake.

Despite Mr. Xi's concerns about tycoons, his career should have helped him appreciate the role that business could play in making China—and the party—great again. Between 1985 and 2007, he was posted in Fujian and Zhejiang, two coastal provinces south of Shanghai that are among the most entrepreneurial in China. "I think it is assumed, based on where he has served, that he should have a very good idea of how the private sector works and its importance, but it's hard to see that," said Nicholas Lardy of the Peterson Institute for International Economics, a Washington think tank.

Mr. Xi's vision hardly seems to be one of unfettered entrepreneurship. Speaking recently about China's private sector, he declared that entrepreneurs owed their country a political duty. Business leaders, he said, should "strengthen self-study, self-education and self-improvement."

"They should not feel uncomfortable with this requirement," Mr. Xi added. "The communist party has similar and stricter requirements on its leaders."

Mr. McGregor is the author, most recently, of "Asia's Reckoning: China, Japan, and the Fate of U.S. Power in the Pacific Century" (Viking).