

Post 19th Party Congress: Xi the King of China

“He has iron in his soul.”

—Lee Kuan Yew, the late Prime Minister of Singapore, on Chinese President Xi Jinping before he assumed the Presidency (2012)

US President Donald Trump has hailed Chinese President Xi Jinping following the 19th Party Congress as the king of China. He is not far wrong. In order for investors to have a good grasp of China, it is important to understand one man well— Xi Jinping. His life, his rise to power and his China dream.

The Precarious Rise to Power

When Xi Jinping first rose to power in November 2012, he was a compromise candidate. The Communist Youth League (CYL) faction under former President Hu Jintao was pushing for Li Keqiang. Backing Bo Xilai was the extremely powerful Jiang Zemin faction, which had built a huge patronage network by tolerating corruption and protecting certain interests. The network was particularly powerful in the military, the party and the internal security system.

Xi emerged as a compromise candidate acceptable to both factions. The chief strategist of the Jiang faction, Zeng Qinghong, admitted that Xi was selected because he was acceptable to all.

Xi's father Xi Zhongxun was the Vice Premier (1954-65), one of Mao Zedong's Long March veterans and also one of the first generation of leaders of the People's Republic of China. His honesty and integrity were well known in the party. In contrast, Bo Xilai's father Bo Yibo was well known to have been the sort to throw stones on those who had fallen into the well. When Deng Xiaoping and the elders dismissed secretary general Hu Yaobang in 1987 for being too liberal and having insufficient vigour in combating spiritual pollution, Xi Zhongxun was the only one who stood up against the decision. He was banished. Hu Yaobang was the patron of the CYL faction and leaders like Hu Jintao and Wen Jiabao owed their ascendancy to him, though Wen wasn't associated with the CYL faction. Their gratitude was a key reason why Xi Jinping gained the support of the CYL faction, which was totally against Bo Xilai.

Jiang's faction calculated that Xi had no strong factional support and lacked followings in the military and the party. They felt he was weak and probably could be easily controlled like Hu Jintao.

Xi Jinping visited Singapore in November 2010 as the Vice President, which is typically the last post before someone becomes the President. I noticed at the lunch talk that Shi Zhihong, who was Xi's then chief of staff, was seated at the main table. Zeng Qinghong had assigned his men as Xi's chief of staff, his maid, and his driver, all aimed to keep an eye on Xi. Xi was too weak at that time to resist this affront. Within two years, he removed all of them. Informed analysts in Beijing and Hong Kong have long commented on the plot to depose Xi and replace him with Bo Xilai within 2 to 3 years after 2012. Unfortunately for the

Jiang faction, the plot was exposed by Wang Liqun, who had fallen out with Bo Xilai. Wang. Fearing for his life he entered the US embassy in Chengdu in February 2012.

This chain of events was never publicly acknowledged from 2012 to 2017 until the 19th Party Congress by CSRC chairman Liu Shiyu, who was a confidante of both Xi Jinping and Wang Qishan. On 19 October 2017, Liu publicly accused Zhou Yongkang, Bo Xilai, Sun Zengcai, Ling Jihua, Xu Caihou and Guo Boxiong as “engaging in conspiratorial activities to seize power in the party”. Given the nature of the political system, this has to be agreed to by Xi. To even acknowledge the plot was an indication that Xi was fully confident of his position.

When Xi became secretary general in 2012, he was rather weak. Out of the 7 members in the Politburo Standing Committee (PSC), he could only count on fellow princeling Wang Qishan and maybe half a vote from Yu Zhengsheng, compared to 3 solid votes for the Jiang faction from Zhang Dejiang, Liu Yunshan and Zhang Gaoli. To bypass them, he set up small steering groups to comprehensively deepen reform in the areas of economy and finance, the national security commission, the military, and foreign affairs. A lot of western analysts interpreted that as Xi grabbing power as “chairman of everything”. It was actually a move he had to make, in light of his initial weakness.

With Wang Liqun’s exposure and incontrovertible evidence of the plot, there was little the powerful Jiang faction could do. Xi Jinping and Wang Qishan were able to bring down all the big tigers by using reasons such as corruption, improper lifestyle and abuse of power. This began the process of dismantling the factional power base of Jiang in the military, the party, the internal security apparatus, the public security department, the provincial leadership, financial regulatory bodies, SOEs, and the media. Apart from netting tigers on political motives, the campaign also brought down other officials at the “monkey and flies” level purely based on corruption. The purged officials were conveniently replaced by Xi’s men. While some were relatively junior, they were promoted rapidly. By the eve of the 19th party congress in October 2017, Xi had emerged supreme.

The Man and his Soul: Making China Great Again

According to some informed pundits, Xi has confided to his very close aides that “...my father was too honest and upright, which was why he suffered enormously...being purged and sent to a labour camp for 16 years...” He revered his father, whose significant contribution to the Shenzhen miracle was under-appreciated in the public domain, though appreciated in some inner circles.

Xi seemed intent not to make the same mistakes as his father. During the military restructuring, the party rectification campaign, and the anti-corruption struggle, he managed to keep all of his opponents and detractors off balance. He held all his cards very close to his Mao suit.

Princeling Mission: Inheriting the Mandate of Heaven

Unlike his immediate predecessors Jiang and Hu, Xi’s “princeling” status – from being the direct offspring of one of the regime’s founding fathers - imbued him with supreme self-confidence. He grew up during the 1950s in the compounds of the Zhongnanhai leaders’ residence. This centre of power was next to the

Forbidden City and it was also the Chinese imperial palace from the Ming dynasty to the end of the Qing dynasty, a period lasting from 1420 to 1912.

Xi has a unique sense of “manifest destiny”, born of a genuine princeling who had inherited the new “mandate of heaven”. He is convinced he knows what is best for his party and his country. With the party in atrophy and corrosive corruption endemic, he sees himself as the new saviour leading it to revitalization.

The princeling advantage gave him unique insights into how the inner circle of the system really works, as well as a network of fellow princelings and insiders within key power centres like the military, party organs, the internal security apparatus, provincial networks, bureaucracies, and major SOEs.

In my years of interacting with some princelings, it is discernible that deep down inside, some princelings in China are sometimes sceptical of the loyalty and perseverance of some of those “external hired hands” who have climbed the party ladder through professional expertise and educational pedigree but whose fathers never shed blood for the revolution. Mere technical expertise but no “redness”. The princelings feel that at critical moments of reckoning, it is unclear whether these technocrats would bail out.

In his keynote speech at the 19th Party Congress Xi announced the hallmarks of his administration: “The China Dream” and “The great rejuvenation of the Chinese nation”. It was delivered like the coronation of a new emperor of a dynasty founded by his forefathers, in contrast with the monotonous affairs of past.

Xi’s China Dream laid down the vision of achieving the Two Centenaries. One was the economic and social target of China becoming a “moderately well-off society” by 2021 - the 100th anniversary of the CCP. The other was the goal of modernization, with China becoming a “fully developed nation” by 2049, the 100th anniversary of the founding of the PRC by Mao. Both were landmark years of the party.

Western analysts have largely missed the most significant characteristics of Xi. He is first and foremost a traditional Chinese leader. There is actually very little Marxism in Xi’s ideological world. He has publicly displayed his mastery of Chinese classics and poetry, encouraged the study of Confucianism, and proudly extolled Chinese traditions and culture. He also praised and openly admired the patriotism of the Sung Dynasty general Yue Fei (1103-1142), whom some liberal Chinese intellectuals have criticised as a blind patriot.

The western interpretation of Xi could be too clouded by the preoccupation with the Leninist framework of dictatorial control. It is likely that Xi will eventually prove to be a traditional Chinese emperor adapted to a digital age, striving to be an enlightened authoritarian with a complex mixture of coercive power and paternalism. This would dovetail better with his strong policy focus on eliminating poverty, addressing inequality, quality of life and environmental concerns.

The conventional wisdom is to regard Xi as the compromise candidate for the top leadership. A deeper interpretation is that Xi is acutely conscious of the danger of showing even small signs of ambition in the Chinese system. He had been very low key, and had succeeded in convincing top leaders that he was a weak pushover, a smiling nice guy like his father without any aspiration for power, while quietly planning his strategy.

There are historical examples in China. Liu Bei (161 – 223), the warlord in the late Eastern Han dynasty who founded the state of Shu Han in the Three Kingdoms period (184-280), pretended to be so frightened of the thunder and dropped his chopsticks in front of the rival warlord Cao Cao. Cao calculated that Liu was a timid pushover and lived to regret that assessment.

As the flamboyant Bo Xilai made enemies, Xi quietly cultivated the military personnel while he was working in Fujian and Zhejiang. These drinking buddies later became his trusted supporters in the present military. His constant and quiet contact with his fellow princelings was also instrumental in his later consolidation of power in the military. The rapid elimination of his political enemies and swift success in his consolidation of power in the military and party were far beyond the expectation of any domestic and international observers. It revealed a longstanding and meticulously crafted plan that was carefully put together while under wraps. He caught everyone flat footed, especially his political enemies. They all had greatly underestimated him.

He had indeed learned from his father's misfortune. To what extent he was advised by his father, we don't know.

Sent down youth: feeling peasants' pain

His family's tumultuous fall from grace during the chaos of the Cultural Revolution (1966 –76) is another key pillar in any serious effort to understand the man.

As a "sent-down youth", that was how Xi first came to understand and experience the poverty in rural China first hand. He was shocked by the abject poverty that he came across in those seven years. He talked about his experience in Liangjiahe village in rural Shaanxi province: staying in a cave home, digging wells, trekking several kilometres of mountain road while carrying a shoulder pole weighing more than 50 kilograms, and suffering an infestation of fleas that left his body covered in sores.

Consequently, Xi has the unique experience of being a princeling in the Zhongnanhai compound who also suffered the deprivation faced by a poor peasant, giving him the ability to relate to the common folk. It gave him insights into, and a deep appreciation of, the real China.

It is noteworthy that his closest comrade-in-arms, anti-corruption czar Wang Qishan (born 1948), shared his princeling pedigree as well as the "sent-down youth" experience.

In the new leadership line-up, his closest and most trusted lieutenants, Li Zhanshu (born 1950; in charge of party affairs) and Liu He (born 1952; in charge of economy and finance) are also princelings who shared similar experiences.

Consolidation of Power and the 19th Party Congress

Over the past 5 years, Xi successfully aligned with the CYL faction under Hu Jintao in dealing with the Jiang faction. He later also worked skilfully to somewhat weaken the CYL faction, allowing his own faction to emerge and reign supreme without unduly alienating Hu.

Xi's existing power grab has to be viewed in perspective. While Western analysts see him as a power-hungry Mao 2.0, it is more likely an over-reaction to his precarious position and profound insecurity when he assumed power in 2012. He almost did not survive those early years. The power pendulum will likely swing back closer to equilibrium over the next five years as he feels more secure.

Over the past seventy years, Chinese leaders who had gotten things done - whether it was Mao uniting China or Deng igniting China's opening up and economic development - were autocratic. The major economic reforms in the 1990s that laid the foundations of the dynamic economy today were accomplished by the autocratic Zhu Rongji. Xi is convinced that only a strong autocrat can force change and reform by cutting through complex levels of military and party bureaucracies, as well as entrenched vested interests and deep rooted webs of corruption.

Like Mao, Xi has mastered political manoeuvring, constantly keeping his rivals off-balance. By creating uncertainty and destabilizing his political enemies from time to time, it has helped him weaken opponents and move his agenda forward.

Enshrining Xi Jinping's Thoughts

The greatest achievement of Xi at the 19th Party Congress was enshrining "Xi Jinping's Thoughts on Socialism with Chinese Characteristics for a New Era" in the constitution.

This achievement has great historical significance.

In the history of the PRC, only Mao Zedong had his "Mao Zedong's Thoughts" enshrined in the constitution when he was alive. Deng's "Lilun", which means theories, was enshrined in the constitution about 6 months after his death in early 1997. Moreover, theories are of lesser importance than thoughts, or "sixiang" within the Chinese constitution. Jiang Zemin had his "Three Represents" and Hu Jintao his "Scientific Outlook on Development" enshrined without their names mentioned, which is a lesser achievement.

This illustrates how Xi's power was the result of his own achievements, not conferred by Deng as was the case for Jiang and Hu.

Next, Xi built upon Deng's "Socialism with Chinese Characteristics" for "A New Era", modifying it for the new era of 'China Dream' and "The great rejuvenation of the Chinese nation" and "international assertiveness". His thought now becomes the new party line. In the ideological pantheon of China, the amendment ensures that he will be regarded as the country's paramount leader even after he leaves office. Any challenge will no longer be only directed at Xi but also at the enshrined party line in the constitution. This almost certainly ensures that he will remain a dominant figure even after retirement.

To that end, he succeeded in delaying the naming of a clear successor.

With these two critical battles won, Xi can afford to be magnanimous to ensure harmony at the 19th Party Congress. In that vein, he made compromises on the make-up of the politburo standing committee members.

Dominance of Party Leadership

As noted earlier, Xi was in the minority in the previous Politburo Standing Committee, with only 2 firm votes out of 7 (Xi and Wang Qishan). The Jiang faction had 3 votes (Zheng Dejiang, Liu Yunshan, Zhang Gaoli) and the Hu faction had only 1 vote (Li Keqiang). Yu Zhengsheng was close to the Deng family and should be considered a floating vote.

After the 19th Party Congress, Xi now has the majority of 4 firm votes (Xi, Li Zhanshu, Wang Huning, Zhao Leji). Hu faction now has increased to 2 votes (Li Keqiang and Wang Yang) while the Jiang faction was marginalised to just 1 vote (Han Zheng).

Both the Xi and Hu factions gained from the fall of the Jiang faction. But Xi still maintained factional peace by making some concessions despite his very firm grip on power.

The ideological composition of the new PSC is certainly more liberal than the previous one. In particular, more hard-line members like Zhang Dejiang - a graduate of Marxist Economics at the Kim Il Sung University in North Korea - and Lu Yunshan have been replaced by more liberal members like Wang Yang and Wang Huning.

The dominance of the Xi faction was even clearer at the 25-member politburo level. Fifteen new members were elected. Xi got in 11 of his loyalists among the 15 new members. As a result, Xi now has 18 votes he can count on within the politburo.

Presently, Xi's likely future successor will probably come from one of these five Politburo members: Chen Min'er (born 1960: party chief of Chongqing), Li Qiang (born 1959: party chief of Shanghai), Ding Xuexiang (born 1962: chief of the General Office of the CCP or Xi's chief of staff), Li Xi (born 1956: party chief of Guangdong) and Huang Kunming (born 1956: head of the Propaganda Department).

It is noteworthy that none of them is a princeling. If history is any guide, one must not rule out surprises.

The new direction of the party can be gleaned from Xi's speech. The Party received the highest number of mentions (331 times) compared to an average of about 240 over the past 5 speeches by Jiang and Hu (1992-2012); followed by the military (86 vs 42); China (186 vs 117); perseverance (128 vs 88); discipline (15 vs 7); rejuvenation (31 vs 6); Deng Xiaoping (2 vs 21); and Mao Zedong (2 vs 10).

Notably, reform and opening up (8 vs 30) and market (19 vs 43) were mentioned much less frequently.

Xi might be viewed within the Party as having gone too far in his centralization of power. Moderating forces may surface to counter his strong political power. Xi may be able to successfully assert himself in the political arena, public security, foreign policies and foreign affairs. However, in terms of economic reform and management, policies based on regional experimentation and flexible reform methods under the "Deng system" that was dominant from 1978 to 2008 may prevail. This is because of the reformists in the PSC and the politburo.

Economic and Financial Reform

The widely accepted view of Xi as a party hardliner preoccupied with the Leninist framework of dictatorial control who is detrimental to further economic reform is, in our view, greatly mistaken.

Xi might have been seen to have been preoccupied with his political agenda in his first term. Power consolidation, military modernization, enforcing domestic party discipline, anti-corruption and the pursuit of great power diplomacy received top priority.

Xi's political commitment to the goal of doubling GDP by 2020 compromised sound economic and monetary policies. This term he will have to focus on high debt levels, excess capacity and environmental degradation.

However, it should be noted that Xi hails from the market reform wing of the CCP. His father, an early and ardent supporter of Deng, was a major contributor to the miracle of Shenzhen. Xi served for 17 years in Fujian and 5 years in Zhejiang, presiding over two dynamic and highly successful economic provinces. In my extensive discussion with Fujian officials, some of which were my students, and businessmen who invested substantially in Fujian, Xi was known to have heavily promoted foreign investments during his tenure from 1985 to 2002. As the party secretary of Zhejiang from 2002 to 2007, he facilitated the acquisition of Volvo by Geely, a Zhejiang-based private automobile company.

At the 19th party congress, the GDP growth target of 6.5% was quietly dropped, very likely due to the rising influence of Liu He, a liberal reformist. The focus has now shifted to quality rather than quantity. A decisive role for the market, as well as supply side structural economic reforms, is now written into the Party Constitution.

However, this does not necessarily mean uninhibited economic liberalization and full SOE reform. Xi and his key economic advisors may have made the assessment that the progressive marketization of the economy has reached some sort of equilibrium, where the private sector has already steadily risen to comprise about 70% of the economy, from almost nothing in 1978. That is deemed to be satisfactory. As a result, the state sector's 30% share is viewed as necessary and critical for "socialism with Chinese characteristics", playing the crucial stabilizing and strategic roles for both politics and society.

There is also rising confidence that one of China's greatest sources of resilience is its balanced economic structure. The successful shift to consumption spending, which now contributes to about two-thirds of overall growth since 2013, has further boosted government confidence because the contribution of net exports has averaged zero since 2013. This point, however, is not well appreciated outside China.

Now armed with a stronger political mandate, the upcoming Central Economic Work Conference in December will indicate a clearer direction on economic and financial reforms. The promotion of a new cadre of talented young officials personally loyal to Xi may also facilitate smoother and more effective policy implementation. The same can't be said in the past because policies had sometimes been confusing and their implementation chaotic.

The recent deleveraging in the financial sector could offer a glimpse of what is to come. It is generally recognised that the recent reshufflings of leadership at the helms of key oversight agencies like the CSRC (Liu Shiyu), the CBRC (Guo Shuqing, a protégé of Zhu Rongji) and the CIRC (removal of Xiang Junbo) has been critical to the success of the campaign to better control financial risk.

The team safeguarding the financial sector will be further strengthened with the addition of Jiang Chaoliang; present party secretary of Hubei who has over 31 years of experience in central banking and finance, as well as a protégé of Wang Qishan. Jiang is likely to be appointed the new PBOC governor in March 2018.

A potential downside of Xi's centralisation of policy making is the weakening of the Chinese government's adaptive and innovative capacities which have been an important buffer against crises. There is a danger that Xi's over-centralised decision making weakens the advantages of a system of distributed intelligence and local experimental initiatives that Deng had deliberately crafted into the system in the 1980s and 1990s.

Over the next five years, mitigating systemic risk will be a major focus.

The two-day National Financial Work Conference, presided over by President Xi himself in July in Beijing, made containing systemic risk one of the country's top priorities. The government has warned of potential "gray rhinos" -- highly probable, high-impact threats that people should see coming, but often don't. Xi has declared "financial security" a top priority, calling it an essential component of national security.

The introduction of the State Council financial stability and development committee will also help to improve regulatory effectiveness and address regulatory challenges brought about by increasingly complex and rapid changes in financial services.

Most significantly, at the 19th party congress, the often-cautious central bank governor Zhou Xiaochuan, who is close to Jiang Zemin, warned in unusually stark language of the risks from excessive debt and speculative investments. He used the platform of the party congress to caution that the country faced a possible "Minsky moment".

A dangerous scenario for China is a slow-burn financial crisis leading to prolonged stagnation, similar to Japan's situation over the past 27 years. This would mean that the misallocation of capital is left to simmer and not effectively addressed. Like a carriage pulled by horses gradually weakening, the speed of the carriage will bleed off and it will eventually grind to a halt. Needless to say, this will have serious economic and political consequences for China.

This is the scenario of a frog unaware that it is being cooked alive as the pot of water that it is in gradually heads to a boil. This presents the greatest possible challenge to the reformists.

Implications for Global Investors

Despite the strong performance of the Chinese economy over the past 25 years, the performance of its broader domestic A-share market has lagged. The correlation between GDP and stock market

performance, usually around 0.4 to 0.6 for most countries, has historically been 0.01 in China. Figuratively speaking, too many donkeys got listed through the back door, denying the horses their rightful chances at IPOs. The anti-corruption campaign and the collapse of the Jiang faction should address that weak spot to a large extent.

The recent clean-up of the top leadership at the CSRC saw the removal of one of the four vice-chairmen and the corrupt IPO committee chairman Yao Gang, who is a Jiang crony. The IPO approval process will increasingly favour the approval of dynamic and profitable private sector companies, rather than the poorly run but politically connected SOEs.

This is a key point that should not be missed by investors.

The increasing urgency of the government in addressing the serious debt problem and a potential banking crisis will help to ease the fears of global investors over left tail risk. The market's risk premium should gradually decline as systemic risk wanes.

While SOE reform is unlikely to move full steam, the anti-corruption campaign in the sector and the removal of Jiang faction cronies will greatly reduce asset stripping, thus improving corporate governance and profits.

A potential downside risk is that Xi's assertiveness could result in rising backlash from Western as well as Asian nations. Over the past few years, there have been undercurrents of internal criticism and a mysterious circular criticising Xi's aggressive foreign policy. If Xi stumbles in foreign relations or if domestic economic performance falters, these voices will likely be greatly amplified.

In conclusion, while further privatization of the SOE sector may be curtailed, we believe that increased financial discipline and a shift of emphasis to quality than quantity of growth should both reduce left tail risk as well as lift overall valuations in the market. We believe that in their search for alpha, bottom-up investors should do better in this environment than during the past regimes, where many investors relied on policy tipoffs and insider information for alpha.

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