Toward Common Prosperity: 
Better Market Mechanisms and A More Functional Government

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Abstract: Market-driven increase in productivity is the main source for income growth. However, the market has many defects including imperfect competition, information asymmetry, varied factor endowments and externalities that stem appropriate income distribution and thus hinder progress toward common prosperity. To address market failures requires the government to play its due roles in terms of competition, resource allocation, redistribution and public goods provision. Better market mechanisms and a more functional market are both indispensable to achieving common prosperity.

Common prosperity is the underlying goal of China’s modernization drive. Chinese President Xi Jinping stressed at a recent Central Finance and Economics Committee (CFEC) conference the importance of the people-centered philosophy and high-quality development to achieving common prosperity. The 14th Five-Year Plan proposed that China should sustain the efforts toward common prosperity, make sure that economic development creates tangible benefits for the people, protect the people’s fundamental rights and interests, and promote social fairness and the people’s wellbeing.

The pursuit of common prosperity is a dynamic, long-term process. It entails sustained efforts, effective policy combination and flexible, practical adjustments. In this process, it’s important to coordinate the roles of the market and the government. An effective market and a functional government are both essential for China to

1 This article was first published in Chinese on CF40’s WeChat blog on August 23. The views expressed herewith are the author’s own and do not represent those of CF40 or other organizations.
achieve common prosperity.

I. UNDERSTAND THE RELATIONSHIP BETWEEN THE GOVERNMENT AND THE MARKET

The pursuit of common prosperity is a dynamic, long-term process that spans across generations. It requires scientific planning, steady progress and sustained momentum. It’s particularly crucial to correctly understand the relationship between government functions and market forces and their coordination in the following three dimensions.

**The first dimension is the relation between productive forces and production relations.** Common prosperity involves both of the two aspects: “prosperity” indicates productivity growth, while “common” indicate production relations and distribution. On one hand, China should give full play to market mechanisms in enriching means of labor, improving subjects of labor and upgrading labor skills to boost sustained productivity growth. This will lay a solid material foundation for achieving common prosperity. On the other hand, the government should play its due role in market regulation to foster a proper ownership system that suits the actual conditions and the economic development stage, sound division of labor and reasonable product distribution. Improving relations of production is an important institutional and policy premise for common prosperity.

**The second dimension is the balance between fairness and efficiency.** This balance can be tilted toward one side depending on the stage of development. In general, at the primary stage of development, greater emphasis is placed on efficiency; as the economy grows, the two sides are more balanced, until the pendulum swing towards fairness with increasing wealth accumulation.

China first proposed the income distribution policy of “taking efficiency as the priority with due consideration given to fairness” on the Third Plenary Session of the 14th CPC Central Committee; later, policymakers stated at the 16th CPC National Congress that “more attention shall be paid to efficiency in primary distribution, while fairness is the main consideration in redistribution”; the 17th Congress saw the tone adjusted to “the relationship between efficiency and fairness should be properly
managed in both primary distribution and redistribution, while the latter shall pay more attention to fairness”; the 18th Congress fine-tuned the principle to “balance efficiency and fairness in both primary distribution and redistribution, while the latter shall pay more attention to fairness”; and it was brought forward at the 19th Congress that China should “strive for higher-quality, more efficient, fairer and more sustainable development.”

This review shows that China has turned from focusing more on efficiency to placing equal emphasis on efficiency and fairness. It has made this change so that economic development can benefit more people in a fairer way to promote the sustained and balanced growth of the Chinese economy.

The third dimension is how to cope with externalities and market failures. In the process toward common prosperity, market-driven increase in productivity is the main source for income growth, market forces are the determinants of the income distribution structure, the pricing mechanism drives the transmission of income distribution, and market incentives improve the efficiency of national income distribution. However, the market has many defects, including imperfect competition, information asymmetry, regional disparity due to varied factor endowments, and externalities that could result in failures in income distribution. That’s where the government can make a difference. The government could work to create a level playing field, improve factor allocation, put in place reallocation measures and provide public goods to make up for market failures.

Of course, policy tools are not perfect, either, and could involve problems like high costs and over-intervention. Thus, it’s crucial to act at both fronts for high-quality, balanced and sustained common prosperity: improve market mechanisms, and build a more functional market by fully fulfilling the government’s role.

II. IMPROVE MARKET MECHANISM AND GIVE FULL PLAY OF ITS ROLES

The fundamental role of the market in the process of achieving common prosperity is mainly reflected in the primary distribution. It is essential to have market play its role
in improving the quality and efficiency of economic development and consolidating the material foundation of common prosperity. It’s a must to improve the market mechanism at the factor level so as to enhance fair competition and provide basic guarantee for achieving common prosperity.

**Improve the supply capacity and efficiency to meet people's needs for higher-quality life.** The principal contradiction facing the Chinese society today is between people’s ever-growing needs for a better life and unbalanced and inadequate development. To solve the problem of insufficient development, China needs to accelerate the development of productive forces, in which process market mechanism can play a fundamental role.

The first is to improve the new system concentrating nationwide efforts and resources under the socialist market economy. Bearing in mind the needs of improving people's lives and health, China needs to implement the strategy of rejuvenating the country through science and education, the strategy of developing the country through human resources, and the strategy of innovation-driven development. It is also suggested to enhance the empowering effect of digitalization to improve product quality and optimize user experience so as to meet people’s urgent needs for consumption upgrades.

The second is to have the service industry prosper by further opening the sector both to both domestic and international investors, encouraging social forces to expand supply of diversified and multi-level services, and promoting digital and intelligent transformation and cross-industry integration, so as to improve the efficiency and quality of the service sector, and facilitate people's access to services.

The third is to insist on preserving and safeguarding the ecological environment. China has to walk on a road to develop sustainable ecological products featuring government dominance, participation of all sectors, and market operations so as to satisfy people's longing for clean waters, green mountains and a blue sky. The fourth is to create spiritual products guided by core socialist values, enrich people's spiritual life, and meet the diverse, multi-level, and multi-faceted spiritual and cultural needs of the people.
Construct a market-oriented mechanism for production factors that is conducive to perfecting primary distribution. It’s essential to improve the mechanism in which production factors are evaluated by the market and remuneration determined by contribution as soon as possible, so as to effectively increase the proportion of labor remuneration in the primary distribution, and create critical conditions for achieving common prosperity. Specific measures required are as follows.

The first is to promote market-oriented allocation of land that is designed for commercial use, improve the rural collective property rights system, deepen the reform of land management system, complete a market system for construction land, and carry out pilot projects for cross-regional transactions of land indicators to bridge the regional gap in the country.

The second is to promote the orderly flow of labor forces and deepen the reform of the household registration system. It is a must to guarantee equal pay for the same work, and narrow the gap between urban and rural areas as well as the income gap between the people.

The third is to promote healthy development of the capital market. Efforts can focus on advancing the reform of the stock issuance registration system in a steady manner, establishing a normalized delisting mechanism and improving financial supervision of the capital market so as to safeguard residents' financial investment, and increase people’s property income through multiple channels.

The fourth is to boost the knowledge and technology market. It is critical to complete the property rights system for job-related scientific and technological achievements, promote integrated development of technological and capital factors, and continue to develop a rational distribution mechanism for scientific and technological talents according to their contributions.

Fifth, actively cultivate the data market. Efforts should be made to promote the sharing of government data, increase the value of social data resources, strengthen data consolidation and security protection, and continuously raise the function and
status of data in the primary distribution.

Create a market environment where all types of entities are treated equally and can compete fairly. Unfair market competition can seriously aggravate unfair income distribution. Monopolistic market entities rely on their strong exclusive advantages to capture high profits and achieve high welfare and wages under the control of insiders. Therefore, it is necessary to accelerate the pace of securing equal market access, enhancing supervision, and upholding integrity and law-abiding.

First, China has to adhere to the policy of unswervingly developing the public sector and unswervingly encouraging, supporting, and guiding the development of the non-public sector. Specifically, China needs to take measures to support private enterprises, deepen the mixed ownership reform of state-owned enterprises, improve the market-based income distribution mechanism of state-owned enterprises, and ensure that entities of different ownership are able to use production factors in an equal manner in accordance with the law.

The second is to comprehensively enhance intellectual property rights protection, implement a market access negative list, strengthen the rigid constraints of the fair competition review system, reinforce law enforcement concerning anti-monopoly and anti-unfair competition, break down regional division and local protection, and promote the institutional opening-up of rules so as to ensure fair participation of various market entities in competition.

The third is to further implement the "Opinions on Providing Judicial Services and Guarantees for Improving the Socialist Market Economic System in the New Era", improve judicial system to better protect market entities, strengthen property rights protection, maintain social integrity and market order, and enhance judicial protection concerning foreign affairs. A mechanism for resolving conflicts and disputes with Chinese characteristics should be established, so that all types of market entities can be covered by legal protection.
III. GIVE FULL PLAY TO POLICIES AND REGULATIONS – THE SAFEGUARD OF COMMON PROSPERITY

The Kuznets curve in development economics, an inverted U curve that measures the relationship between economic growth and income distribution, has not been verified in the practices of all nations. Therefore, when the market fails to function, a government should strengthen its regulation and guidance to redistribution (at the “secondary” or even “tertiary” distribution), to safeguard the realization of "common prosperity".

**Improve the redistribution mechanism.** China's current redistribution policy plays a limited role in regulating income disparity, and thus it is necessary for the government to safeguard common prosperity through more potent and precise policies. **To begin, the government should invest more to secure and improve livelihoods, raising the share of state capital gains that is turned over,** cutting administrative costs and general budget expenditures, while increasing spending on education, employment, social security, healthcare, subsidized housing, and rural vitalization. **Second, basic public education should be equalized.** In order to enhance the quality and balanced development of compulsory education and the integration of urban and rural communities, education resources should be provided with an emphasis on rural, remote, poor, and ethnic areas. **The third is to improve the taxation**, such as combining comprehensive and classified taxation in the personal income tax system, **actively and steadily advancing the legislation and reform of real estate tax,** broadening and increasing resource tax collection, and investigating the best time to introduce an inheritance tax. **Fourth, reform the social security system,** as well as the social assistance and charity system, the job and security system for veterans. **Accelerate the coverage of a fair, uniform, and sustainable multi-level social security system to benefit everyone and incorporate urban and rural areas.** **Fifth, increase the supply of affordable housing, particularly rental housing.** Shared ownership housing could be explored in conformity with local conditions. The fundamental regulations and policies that promote government-subsidized housing should be enhanced. **Sixth, improve aids to low-income groups; relate low-income groups' basic living standards to price increases; and increase compassionate allowances for those in need. Seventh, bring the redistribution of wealth and income into full
play by developing charity and other social welfare undertakings, promote a positive and healthy view of social wealth throughout society, and formulate the regulations on tax exemptions for charitable donations to encourage qualified and willing enterprises or individuals to dedicate in charity.

**Promote coordinated regional development.** Regional disparity is one of the main limiting factors for common prosperity, and that’s why coordinated regional development creates critical circumstances for realizing this ideal. First, the government could strive for common development by promoting the Western Development Strategy, Northeast Area Revitalization Plan, Rise of Central China plan, and the pioneering of the east. Second, in order to close the gap between urban and rural development and living standards, the government could continue to build on its poverty-eradication achievements and promote the free flow, equal exchange, and proper allocation of public resources. Help to sustain the growth of farmers' incomes. Foster an interactive connection between industry and agriculture, a complementary relation between urban and rural areas, comprehensive integration, and ultimately, shared prosperity. Third, particular regions should be supported. Revitalize old revolutionary areas; fully manage with ecologically degraded areas, protect and restore the ecologically delicate areas; in resource-based areas, construct demonstration zones for sustainable development and pilot zones for transformation and innovation; rebuild the competitiveness of old industrial bases in manufacturing industry; address the production and living difficulties in high-altitude areas for the sake of prosperity and stability on the borders. Fourth, improve regional strategic coordination, integrated markets, regional cooperation, and compensation for inter-regional interests, financial transfer payments in support of the less developed regions, and regional cooperation and interest adjustment. Provide more support to the development of ethnic areas.

**Regulate the income distribution among different industries.** As the industries develop and labor divisions deepen in China, we are witnessing a wider distribution gap, especially in the digital economy and platform economy. Supressing capital, regulating industries, and regulating taxation are all critical parts of reducing distribution inequality in major areas and industries, and securing the optimization of national income distribution. First, one focus of financial system
regulation and fight against concentrations of undertakings is to prevent the disorderly expansion of capital in the digital and platform industries. The government should consolidate the capital system and anti-monopoly legislation to keep the oligopoly economy from harming China's industry income distribution. **Second, when it comes to excessive profits in businesses like finance and real estate, regulators should pay close attention to the capital infusion into these sectors,** synchronizing their growth with the real economy. **The third step is tax regulation. Raise the tax rates of certain luxury consumer goods and specialized products,** while reduce the tax burden on the real economy and SMEs. **Fourth, improve a long-term mechanism for higher revenue growth in the agricultural sector.** Improve the agricultural subsidy system and the distribution of land-based value-added revenue to increase farmer income. **Assist migrant workers in becoming city citizens.** Improve the integration of urban and rural development. Combine the successes of poverty eradication and rural revitalization.

**Optimize income distribution.** In its transition to a market economy and transformation of economic development pattern, China still have some problems with income distribution that should be supervised and corrected by the government, so as to achieve common prosperity. The first is to safeguard the legitimate rights and interests of workers. Improve the mechanism for guaranteeing the payment of wages and handling labor disputes. Local government should be responsible for settling unpaid wages. Second, clean up and regulate the extra-wage income of party and government organs. Improve the mechanism for sharing state-owned capital gains, state-owned capital gains paying to the public treasury, wage of civil servants and staff of public institutions, and invoices and financial reimbursements rules in government, public institutions and SOEs. The third is to improve personal income and property information systems, social credit system, income information monitoring system, and modern payment and income monitoring system. Fourth, implement the law to protect legitimate income, properly regulate excessive income and hidden income, and outlaw illegal income.