CPC Futures

The New Era of Socialism with Chinese Characteristics

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14

Common Prosperity

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On 17 August 2021, the Communist Party of China's (CPC) Central Committee on Economy and Finance (CCEF), chaired by General Secretary Xi Jinping, announced the new goal of "Common Prosperity" (Xinhua 2021). Broadly, the goals of common prosperity are to address the inequalities in society, to control what Xi termed the "excessive expansion of capital" and to deliver prosperity for all in the "New Era". Common prosperity is an integral part of the "New Development Philosophy for the New Era", which in turn is a cornerstone of the "China Dream" of the rejuvenation of the Chinese nation.

The origins of common prosperity

Common prosperity is first and foremost a political objective. The concept itself still is a moving target, and until now few concrete measures to achieve it have been announced. This is not unusual for China: the exact meaning of the previous socio-economic target, *xiaokang,* or a Moderately Prosperous Society, was only vaguely defined after Deng Xiaoping had declared it to be the goal of China's reforms in 1981. Only by 2011 was it given a more precise interpretation in terms of a general GDP and GDP per capita target to be achieved by the centennial of the birth of the CPC in 2021, in addition to the eradication of extreme poverty. The *xiaokang* society was officially declared as having been achieved in the spring of 2021.

Common prosperity was gradually conceived after the 19th Party Congress in 2017. The Congress announced a change in the "major contradiction", or major challenge, for the Party. The last time such a change had happened was in 1981, when "the ever-growing material and cultural needs of the people versus backward social production" had been identified as the major contradiction.

In 2017, the new contradiction became the one "between unbalanced and inadequate development and the people's ever-growing needs for a better life". Both contradictions may seem quite similar but, as we shall see, have vastly different implications.

The term common prosperity itself is hardly new. The China Media Project traces the use of the term back to the 1950s (Bandurski 2021). It first appeared in the *People's Daily*, the Communist Party's official newspaper, on 25 September 1953, and was used by Mao Zedong in the 1950s collectivisation campaign. The term faded into obscurity in the three decades after Mao's death to be replaced by Deng Xiaoping's "some may get rich first" in the early reform period. The policies under the "rich first" slogan fuelled China's extraordinary growth, but resulted in rising income and wealth inequality which increasingly became a major political issue.

The Hu-Wen Harmonious Society programme had started to address these issues by expanding social spending on health, education and welfare. It had some modest success: over the past decade, income inequality has come down slightly, and people at the bottom part of the income distribution have seen their incomes rise by more than the average.

How unequal is China?

Despite China's leadership's concerns, China's income inequality is not exceptional for an upper-middle-income country. Wealth inequality, though more difficult to measure, is unremarkable and hardly rising according to data from Credit Suisse (Credit Suisse Research Institute 2021). China's own data from the National Bureau of Statistics show that the Gini coefficient of income inequality—a measure that is zero with total equality of income and 100 with maximum inequality—peaked at 49 in 2008 to drift down to 47 in 2019, the latest available number.

The World Bank, which publishes internationally comparable numbers, puts the 2010 peak in the Gini coefficient at 43.7, and at 38.2 in 2019 (World Bank n.d.). This is lower than the US (41.5), Brazil (48.9) and Mexico (45.4) and comparable to Indonesia (37.3). China's Gini coefficient of income is higher than most European countries and former Soviet republics, but China's inequality is likely to be on a downward trend. In recent years, a declining labour force and higher education have resulted in wage increases that outpaced the growth of the GDP. This is a pattern not unlike the experience of other countries, and is known as the Kuznets curve, after the statistician who detected a pattern of increasing and decreasing inequality as incomes rise.

It is also hard to detect Xi's "excessive expansion of capital" in available national account numbers. The share of capital is best measured by the share of "operating surplus" (or profits before interest and taxes) in the primary income distribution. This share in China is now about 36 per cent of GDP, about the same as Germany's, and slightly less than the European Union's or the United States' at around 40 per cent. The share of labour in the economy has been rising in the past decade. From 54 per cent in 1992 it bottomed out at 46 per cent in 2011, but has since bounced back to 52 per cent, which is higher than the EU, and definitely higher than most developing countries.

What is common prosperity?

Irrespective of the numbers, with the "moderately prosperous society" achieved, the goalposts are shifting. The *Decisions* of the Third Plenum of the 18th Central Committee in 2013, Xi's first programme to focus on economic reforms, already alluded to this shift:

> We will improve the regulatory mechanism of income redistribution mainly by the means of taxation, social security and transfer payments and enhance the regulatory role of taxation (...) We will regulate excessively high incomes, redefine and clear away hidden incomes, outlaw illegal incomes, increase the incomes of low-income groups, and increase the proportion of the middle-income group in society as a whole.

These words were not dissimilar to those spoken at the August 2021 CCEF meeting mentioned at the beginning of this chapter. Xi's CCEF speech clarified that common prosperity is not a return to Maoism, as some had hoped and others had feared. To realise it, he said, hard work and innovation remain necessary. Making the pie bigger is as important as distributing the slices fairly, and "welfarism" should be avoided.

The speech contains six areas of objectives and instruments to achieve common prosperity:

1. Identifying a more balanced, coordinated, and inclusive development path;
2. Endeavouring to expand the middle-income group;
3. Facilitating equal access to basic public services;
4. Intensifying the regulation and adjustment of excessive income;
5. Promoting common prosperity of the people's spiritual life;
6. Promoting common prosperity in rural areas.

Of the policy measures to achieve common prosperity, "regulating and adjusting excessive incomes" drew the most attention. Though it started before the policy was announced, the regulatory clampdown on internet companies was increasingly presented as part of the common prosperity campaign. The wide-ranging campaign, triggered by the speech of Alibaba founder Jack Ma in Shanghai in October 2020, addressed issues such as monopolistic behaviour in e-commerce, financial risk in online finance, online tutoring, high income of influencers and contents of online video games.

Also noteworthy has been the emphasis on philanthropy as a means to achieve common prosperity. Though desirable in itself, in no country in the world is philanthropy large enough to make a dent in income inequality. In the United States, which has a long philanthropic tradition, philanthropy adds up to some 0.4 per cent of GDP, whereas the Netherlands, the world's most generous country by this measure, spends about 0.9 per cent of GDP according to the Global Philanthropy Report (Johnson 2013).

Where China stands out is in the limited redistribution though the government budget. Redistribution is by and large the route European countries have taken, as have to some extent the United States and Japan. Strikingly, these countries all have Gini coefficients of market incomes similar to or higher than China's. However, after redistribution though taxes and transfers, most have Gini coefficients of disposable income below that of China.[1]

Remarkably, despite the concerns about income distribution, China's actual income-tax takings remain very modest (Hofman 2021; Table 1). Though the highest rate of income taxation is 48 per cent, comparable to that of OECD countries, the revenues it generates have been relatively small. Income tax yielded only 1.1 per cent of GDP according to OECD data, or only 4 per cent of total revenues. This is far less than the 8.4 per cent of GDP for an average OECD country, where personal income tax constitutes some 20 per cent in revenues. In the United States, personal income taxes bring in almost 11 per cent of GDP. Even in India, the yield is 2.3 per cent of GDP.

China exempts most people from paying personal income tax. The basic exemption is relatively high, which leaves most out of the tax net. China also does not tax capital gains taxes or inheritance, and income from dividends and interest—income sources particularly relevant for the rich—are taxed at a flat rate of 20 per cent. The bulk of China's tax revenues comes from value-added tax (VAT), consumption (luxury) tax and social security contributions. The VAT, which is a very efficient tax to raise, puts a higher burden on the less well-off than on the rich. Relatively poor people spend more of their income on consumption, which is why VAT makes the tax system regressive. Social security contributions have a minimum contribution at the low-income end and a cap at higher incomes, which also makes these taxes regressive, not just in China but in most other countries as well.

China's heavy reliance on the value-added tax and modest income taxes mean that the tax system needs to be reformed for it to contribute to the common prosperity agenda. This is technically hard, and politically even harder, as more direct, visible taxation through income taxes is likely to be highly unpopular.

Table 1. Tax Structure 2019, various countries and country groupings (per cent of GDP)

	Personal income taxes	**Corporate income taxes**	**Social security contributions**	**Taxes on goods and services**	**Taxes on property**	**Other**	**TOTAL**
China	1.1	4.4	6.1	9.1	1.4	0.0	22.1
OECD average	8.1	3.1	9.0	10.9	1.9	0.8	33.9
New Zealand	12.8	4.0	0.0	12.6	2.0	0.9	32.3
Japan	6.1	4.1	12.9	6.2	2.6	0.1	32.0
Australia	11.8	5.5	0.0	7.3	2.7	1.4	28.7
Korea	4.8	4.3	7.3	7.1	3.1	0.8	27.4
Asia-Pacific (24) average	3.6	3.6	1.6	9.9	0.7	1.5	21.0
Philippines	2.6	3.7	2.6	7.7	0.4	1.1	18.0
Viet Nam	1.8	4.5	0.0	11.1	0.0	0.0	17.4
Thailand	1.8	4.4	1.0	9.5	0.5	0.1	17.2
Singapore	2.4	3.6	0.0	3.8	1.8	1.6	13.3
Malaysia	2.6	5.6	0.3	3.2	0.0	0.8	12.4
Indonesia	1.1	3.7	0.5	4.7	0.2	1.3	11.6

Source: OECD, *Revenue Statistics - Asian and Pacific Economies: Comparative tables, OECD Tax Statistics 2021*; available at https://www.oecd.org/tax/tax-policy/revenue-statistics-in-asia-and-the-pacific-5902c320-en.htm (accessed 29 July 2022).

In the context of common prosperity, the idea of a tax on real estate was revamped. China does tax property at a level comparable to that of OECD countries (Table 1), but Chinese *households* do not pay any real estate tax (or "recurrent taxes on immovable property" as the OECD parlance goes). China actually already levies a variety of taxes on real estate (a house tax on firms operating properties, an urban maintenance tax, stamp duty, a deed tax and land appreciation tax). Together, they make up some eight per cent of total taxes in China, higher than the average for OECD countries. None of these taxes, however, classifies as a real estate tax on households currently under discussion.

A real estate tax on households is a good tax for local governments according to the "bible" of local government finances (Bahl, Linn and Wetzel 2013). It is a relatively stable source of revenues with a good correspondence between those who pay the tax and those who benefit from the services a local government provides. The tax would also be vastly superior to the current dominant source of revenues—land sales. That source is highly pro-cyclical, pushes local government to excessive land use, and, as we have seen in 2021, ties in local government revenues (and spending) with the vagaries of the real estate sector. Given that richer people usually own more property in China, taxing real estate would also contribute to a fairer tax burden overall.

Two pilots on real estate taxes, one in Shanghai and one in Chongqing, have been under way for some time. Xi Jinping's August 2021 CCEF speech suggested that the tax would be rolled out nationwide soon. At the Central Economic Work Conference in December 2021, this was toned down to an addition of more pilots in several other cities.

The Central Economic Work Conference also clarified that common prosperity would avoid western "welfarism" (tax-and-spend policies). If that is true, China needs to ensure that market outcomes become much more equal. This is by and large the approach that South Korea and Taiwan have chosen, and, to some extent Japan in the past. Redistribution is far more modest than in the European model, but market outcomes are more equal than in China.

China still has numerous opportunities to achieve more equal market outcomes. Investing in education, especially rural education; abolition of the household registration system to allow all workers to go to the place where they are most productive; and further strengthening farmers' rights to land would all contribute to a more equal division of the pie—but are also hard to do. Some of the reasons are that urban citizens do not like more competition for public services from their rural counterparts, while the fiscal system is slow to include new taxpayers in urban areas, making cash-strapped local governments reluctant to accept new citizens.

Fine-tuning common prosperity

In the wake of a major slowdown in the economy in 2022, the common prosperity goals seem to have been put on hold. The regulatory crackdown on internet companies and cooling off of the real estate market had already slowed growth in 2021. Russia's invasion of Ukraine and the outbreak of the omicron variant of COVID-19 in major population centres in China further affected growth, and the ambitious growth target the government had set at the annual NPC meeting in March 2022 seemed increasingly out of reach. The priority has shifted to maintaining stability.

In response, on 16 March 2022, the State Council Financial Stability and Development Committee (FSDC) met and decided that regulatory agencies should take "coordinated steps to support markets and confidence" and "actively introduce policies that benefit markets". In addition, the "rectification" of internet platform companies should be brought to a close. Any new policy that impacts the capital markets should also be checked with the FSDC. Separately, on the same day, the Ministry of Finance announced that it would postpone further experiments with the property tax. These messages were confirmed at a meeting of the CPC Political Bureau on 29 April 2022 (Xinhua 2022).

The delay in the pursuit of common prosperity is hardly a retreat. Economic necessity may slow down some of the fervour to achieve common prosperity, but is unlikely to derail it. President Xi Jinping has said that common prosperity is a goal like that of the *xiaokang* society that came before it—one that cannot be achieved overnight. Undoubtedly, the concept itself will evolve and policy measures to achieve it will change over time. But common prosperity is here to stay.

Note

[1] See "The Standardized World Income Inequality Database V9.1", https://fsolt.org/swiid/ (accessed 21 March 2022).

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DOI: https://doi.org/10.56159/eai.52060.15