



Investing in China in the era of Common Prosperity

Executive summary

The “Common Prosperity” agenda in China is garnering a significant amount of attention of late. But the background, implications and opportunities of this important policy framework are not fully understood by many foreign investors. It is often viewed as an ideological shift, triggering a series of policy rollouts that impacted many sectors, particularly China’s technology giants. Many foreign investors raised concerns about the regulatory risks associated with investing in the world’s second-largest economy and second-largest capital markets.

Ideological and political sentiment weighs heavily on decisions by governments around the world. China is no exception. However, it would be misleading to view Common Prosperity through a one-dimensional lens of ideology without analyzing the challenges faced by China at this point in its history and the motivations behind these policy decisions.

Common Prosperity is the overarching policy framework that will set the course for China’s new phase of quality growth over the coming decades. It will be as consequential as China’s reforms initiated over forty years ago, which transformed China from an impoverished nation to an economic powerhouse.



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Background of Common Prosperity

While many feel Common Prosperity came out of nowhere, it was first mentioned in the 1950s by Chairman Mao Zedong, founding leader of the People's Republic of China. Deng Xiaoping, the chief architect of China's reforms and policies that opened up its economy, reinitiated this policy in the 1980s. His well-known quote, "let some people and regions get rich first to help speed up economic growth and bring along others so the entire country can achieve the ultimate goal of common prosperity," highlights the two-step process of the country's vision on prosperity.

Many Chinese born in the 1970s remember this phrase vaguely as kids. It was a relatively innocuous slogan for them as even the first goal of "let some people and regions get rich first" seemed like an unattainable goal. Chinese people were indiscriminately poor, with food and other living necessities rationed. "Common Poverty" was the harsh reality and the only way to describe the economy and people's lives before China's reform era started.

Fast forward four decades, China has achieved the first goal of "uneven" prosperity by becoming the world's second-largest economy. Its GDP has grown by 300 times since 1978, and the world's largest middle class of 300 million people has emerged. However, inequality has also deepened, especially between urban and rural areas, coastal regions and inner lands, and different income groups. Although China has managed to lift 850 million people out of extreme poverty and eradicate absolute poverty by 2020, 600 million Chinese still live with less than US\$156 of disposable income per month.

A widening income and wealth divide threatens social stability. Against the backdrop of "uneven" prosperity, China is choosing to turn its focus to quality growth. China will now take measures to reduce inequality over the coming years and to put Common Prosperity — the second part of the government's promise made 40 years ago — at the centre of its long-term policies. Common Prosperity will aim to create a more equal society for its 1.4 billion people with continued household income growth, narrower income and wealth gaps, and a stronger social safety net. This policy should be viewed, within its historical context, as a logical continuation of China's long-term goal to bring prosperity to a broader swath of its population.

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Challenges to be tackled on the way to Common Prosperity

China is facing several challenges that could hinder future economic growth and social improvement:

- Widening income and wealth inequality, and uneven regional and rural-urban development
- "Three heavy mountains" burdening its citizens — namely rising costs of housing, education and healthcare/elderly care
- Ageing demographics, with the latest population census indicating declining birth rates due to the "three heavy mountains"
- While technology companies have helped to improve the livelihood and life of many Chinese, a number of problems have also emerged as these companies have grown with little regulatory intervention in the past. Concerns over monopolistic practices, unfair competition, personal data privacy and labour protection are becoming pressing issues to be addressed
- Heightened concerns on national data security as a result of US-China bilateral tensions

While many of these challenges also exist in developed countries in the West, China is tackling these issues within a different social-political system and on a much larger scale. Over the past year, a series of policy events have been put in place to address these complex problems that may not



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be resolvable by the companies themselves. Government intervention through policies and regulations may be the only option, triggering short-term volatility in pursuit of longer-term benefits for the Chinese economy and society.

How to achieve Common Prosperity

While most of the markets' concerns focus on the regulatory reset and explanation of those policies, little attention is paid to another essential component for achieving Common Prosperity — driving growth. Common Prosperity is first and foremost about quality growth to enlarge the pie so it can be shared more fairly among the entire population.

China's next stage of quality growth will be driven by advanced technology, manufacturing upgrades, domestic consumption and carbon neutrality initiatives. China strives to find the right balance between growth and sustainability, seeking to improve the overall well-being of its entire population with a bluer sky, cleaner air and water, and quality consumer products.

In an effort to build a more equal society, three distribution mechanisms will be implemented to address the increasing income and wealth gap.

First, China has made it very clear that Common Prosperity is not intended to create a welfare country. Common Prosperity will be built upon common efforts where individual hard work will be encouraged and recognized.

Second, redistribution will be carried out by the government through taxation and social security, emphasizing fairness.

And the tertiary distribution mechanism will be driven by philanthropy. China still has a long way to go, as charitable giving in the US is 14 times that in China, accounting for 2.1% of US GDP versus 0.15% of China's GDP in 2019.

With growing disposable income, an improving social safety net, and reduced education, housing and healthcare costs, the Chinese society will transform from one where wealth distribution resembles a "pyramid" to one that looks more "olive-shaped" with a much larger middle class. In turn, this will further support domestic consumption and drive economic growth. A healthy, balanced ecosystem will be established where economic development and social improvement advance hand in hand.

Common Prosperity is a long journey

While policy changes have happened within a relatively short period of time, the strategic thinking and long-term vision of Common Prosperity should not be underestimated. China is targeting solid progress towards achieving the objective





of Common Prosperity by 2035 and “basically achieve” the goal by 2049 on the 100th anniversary of the founding of the People’s Republic of China.

Common Prosperity is not a slogan nor an abstract ideology. China has built a successful track record in carrying out complex and multi-year long-term initiatives, setting up demonstration zones to test the policies and fine-tune them as needed. For example, 43 years ago, Shenzhen was designated the pilot zone for the original reforms and opening-up policy. It has been transformed from a tiny fishing village to the Silicon Valley of China today, with over 18 million people and the third place ranking in terms of GDP contribution among all Chinese cities.

A pilot program in Zhejiang province, one of China’s wealthiest and home to some of the most successful private companies, was rolled out in June 2021. It will serve as another interesting case study in Common Prosperity, and more specific policy details will be revealed at the national level by 2025 based on Zhejiang’s multi-year experiences.

Common Prosperity is not the end of innovation and private enterprises

The Chinese government recognizes that private entrepreneurs are central to China’s success. The private sector contributes more than 50% of the tax revenue, more than 60% of the GDP, over 70% of the technological innovations, more than 80% of urban employment, and accounts for more than 90% of market entities in China.

The government has a target to double GDP from 2020 to 2035, implying 5% annual growth over the 15-year period, which is no easy task. China cannot grow or achieve Common Prosperity without a strong and dynamic private sector.

The newly established Beijing Stock Exchange has the specific goal of facilitating the fundraising of small and medium enterprises (SMEs) and fostering entrepreneurship. The series of antitrust and anti-monopoly policies will also help to break the “winners take all” approach and improve the overall ecosystem for innovation and SMEs. And well-established private companies will certainly benefit from a growing middle class over the long term.

Common Prosperity has an ESG approach, Chinese style

China’s impressive high-speed growth over the past four decades was achieved at a substantial environmental and social cost. Common Prosperity is an opportunity — and arguably the only opportunity — for the country to address all the legacy problems in environmental, social and governance areas. In fact, the entire country has become a case study for a future-oriented ESG approach with distinct Chinese characteristics.

China is firmly committed to carbon emissions peaking by 2030 and achieving carbon neutrality by 2060. The country’s quality growth depends on its carbon neutrality initiatives and strong support for technological innovation in this area. “No sacrificing of clean water and green mountain in exchange for gold and silver mountains”, President Xi Jinping’s famous saying, becomes a clear objective for China to provide a better living environment for its people.

Common Prosperity, in essence, is a people-centred approach to development with a focus on “S” in ESG or social equity. This all-stakeholder approach instead of a shareholder-only approach is essential for China to build a larger middle-class society and achieve long-term sustainable growth.

Many of us agree that avoiding regulatory risks helps ESG investing achieve superior returns. Investors need to understand China’s overall ESG objectives, even though they may not be familiar with nor appreciate the Chinese regulator’s heavy-handed approach.

With China’s specific Common Prosperity’s ESG approach in mind, one would better understand the rationale behind the set of recent regulatory actions targeting real problems instead of any particular sector or enterprise: profit generating after-school tutoring created excessive anxiety and workload among parents and students and further widened the social and educational gap; rising property prices as a result of speculation; tech giants’ 996 culture makes employees work from 9 a.m. to 9 p.m., six days a week; workers in some sectors have no labour protection in terms of income and insurance in case of accidents; and the addictive and violent nature of gaming on minors, to name a few.

To navigate China’s changing regulatory landscape successfully, it is critical to consider the country’s distinct cultural and political environment.



Common Prosperity's positive impact on capital markets

Under the Common Prosperity policy framework, a larger middle-class with higher disposable income will be better able to invest more in capital markets. The long-term policy of “property is for living in, not for speculation” will also help channel Chinese households’ assets from real estate investments to asset management products. And the three-pillar pension reform will continue to be deepened, providing further support to the markets.

On the supply side, more innovative companies will emerge as quality growth continues to be the key focus of the economy, supported by regulatory policies from simplified registration processes to the newly set up Beijing stock exchange.

For any ordinary Chinese, it feels incredibly overwhelming to experience Common Poverty, “uneven” Prosperity and now the start of Common Prosperity, all within half of one’s lifetime. Domestic and foreign investors alike need to put in the extra effort to cut through the short-term noise and understand China within its local context. The same level of rationalized investment mindset applied to the analysis of any other developed markets would reveal that China still appears to be a clear cut long-term investment opportunity not to be

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missed. The olive-shaped Chinese society transformation, if successful, is not only going to drive China’s growth but also be a major contributor to the global economy.

Common Prosperity sets a clear direction for China’s next chapter of quality growth and social improvement with tremendous opportunities in the sectors of advanced technology, manufacturing upgrade, domestic consumption and carbon neutrality. Policy and regulatory frameworks may seem intimidating to many overseas investors. Local insight is instrumental in making the right investment decisions.

Additional work is required for sure, but isn’t investing all about going the extra mile to uncover alpha in places other investors have overlooked?

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