

# The Relationship between Government and Market

–Based on the practice of implementing the Three Lists System in Shanghai Free Trade Zone

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**Abstract**—Whether it is the reform of administrative system or the reform of economic system, the core is how to better handle the relationship between government and market. The establishment of the Shanghai Free Trade Zone, the first free trade pilot zone in China in 2013, announced China's major strategy to further expand reform and opening up. As the financial center of China, Shanghai has become a “test field” for China to implement new systems and make new attempts. In the same year, Premier Li Keqiang proposed the construction concept of the Three Lists system, which is the vane of China's system development. The practice of the Shanghai Free Trade Zone on the Three Lists system profoundly reflects the concept of the top-level establishment of China's reform and opening up, and at the same time demonstrates to the world that Chinese plan to deal with the relationship between government and market.

**Keywords**—Government and market; Free Trade Zone; Three lists; Reformation

## I. INTRODUCTION

The establishment of the Shanghai Free Trade Zone is a measure for China to further deepen the reform of the economic and financial system. It is a direct manifestation of China's compliance with globalization in a more open and inclusive manner. This initiative is to explore the new pattern of China's future reform and opening up, and to promote the reform of the government's administrative system and economic system. The establishment of the Shanghai Free Trade Zone coincides with the concept of system construction proposed by Premier Li Keqiang on Three Lists. Therefore, since the establishment of the Free Trade Zone, it has been deeply influenced by this concept. As a model for practicing these Three Lists, walking at the forefront of China's reform. The core behind the “Power List”, “Responsibility List” and “Negative List” is an inter-temporal attempt by the Chinese government to further improve the relationship between the government and the market in the new era.

## II. SHANGHAI MUNICIPAL GOVERNMENT IMPLEMENTS THREE LISTS

### A. Power List

The Power List is to clarify the boundaries of the government's power, to achieve “No law is not authorized,” to gradually reduce government power, let the government's powers exercise in the sun, and better play the role of market resource allocation. For the government, it can conform to the principle of simplicity, clarify the responsibilities of various departments, avoid overlapping or absenteeism, and better serve the market. For the market, the government's clear information on the power of various departments can make the market more efficient allocation of resources, and the handling of related procedures is more convenient, so that the enthusiasm and creativity of the market can be fully mobilized and the active competition in various industries in the market can be promoted.

The introduction of the Three Lists coincides with the establishment of the Shanghai Free Trade Zone, which gives the region a unique development opportunity, and the pilot of relevant government policies is also easier to implement in the new district. Since the Shanghai Free Trade Zone involves seven major regions and two major ports, the scope is large. Therefore, the reform of the government's institutions has been exerted in three aspects. First, at the municipal level, it is necessary to make great efforts to establish a Power List, clarify government rights, and clarify government work ideas. Municipal leading cadres have repeatedly proposed that the “legal government” should be established as soon as possible to publicize the government's Power List as soon as possible. Second, the district and county governments, in light of their own developmental reality, publish their respective Power Lists in batches. It is said that Yangpu District and Pudong New Area have played a leading role. Thirdly, each administrative unit in Shanghai has publicized its own right type and power name, and the right to be done depends on the specific law.

After the “three-level linkage” in Shanghai, the power list implementation has achieved remarkable results. On December 21, 2013, Shanghai Municipal Party Committee Secretary Han Zheng proposed to gradually establish Shanghai's Power List to make the government's rights more transparent and specific. At

the end of June 2014, the Shanghai Development and Reform Commission announced the Shanghai Municipal Government's first power list. It includes 41 rights of the government. As of the end of 2015, the list of powers of 34 municipal-level administrative units in Shanghai has been made public, and Shanghai has officially established the image of "transparent government". Although the publication of these rights does not immediately produce a significant positive effect, it provides information to market investors, and it is easier for foreign-invested enterprises to enter the Shanghai Free Trade Zone for commercial activities, thereby providing confidence to the entire market. It is an indispensable link to generate economic benefits.

### *B. Responsibility List*

Responsibility List is to clarify how the government should manage, "the statutory responsibilities must be", and the government department has certain responsibilities for each right. For the government, the meticulous implementation of responsibilities can greatly improve the efficiency of government departments and prevent the phenomenon of shirking responsibility. The management must be managed and managed well. For the market, the government clarifies its respective responsibilities. Simplifying a large number of administrative procedures allows market participants to handle matters from the government department more quickly, and can be responsible if there is a problem.

For Shanghai, whether it is a municipal government or a district or county government, the Responsibility List is released along with the Power List. Each right of the administrative unit corresponds to several items of responsibility, and each item has a clear form of responsibility from both the administrative agency and the staff. This reflects the Shanghai government's emphasis on the administrative reform of the Three Lists. Further, it is the sense of responsibility for the power of government agencies. The exercise of government rights is to better serve the people and serve the society. It is a benchmark to test whether the government serves the people and society.

The Responsibility List of various departments in Shanghai has been generally formed in 2016 and is still being further optimized and improved. In terms of effectiveness, similar to the power list, although there is no direct economic benefit, it paves the way for efficient and convenient administration in the region. In the process of economic development, we can implement rectification plans against the Responsibility List, clarify responsibilities, strengthen supervision from within government agencies and the public, and build a service-oriented government.

### *C. Negative List*

The Negative List system is that the government clarifies which market industries or areas restrict investment, and those areas that are not prohibited can enter the market for investment operations. "Any law that is not prohibited can be carried out". Such a system is applicable not only to foreign investment but also to domestic investment, thus fully mobilizing the efficiency of the use of funds. Through the Negative List system, on the one hand, the government has

relaxed the investment field of capital, and on the other hand, it has made the market better play a decisive role in resource allocation.

On September 29, 2013, on the day of the unveiling of the Shanghai Free Trade Zone, a Negative List was issued, with a total of 190 regulatory measures, totaling 18 categories. At the same time, the approval system for foreign investment was changed to the filing system, and the Negative List became the core of the reform of the administrative mechanism of the Shanghai Free Trade Zone. In 2014, the Shanghai Free Trade Zone further adjusted the Negative List, relaxed market access, lowered the threshold, and further liberalized the market. In the future, the improvement trend of the Negative List is toward a more open and inclusive direction. For example, the regulatory measures have been reduced from the original 190 to the current 45. At the same time, the Power List and the Responsibility List have been released one after another. At the government level, conditions have been created for the further opening of the Shanghai Free Trade Zone. The government is also more sunny and transparent, and the administration is decentralized, making market investors more confident about investment projects in the region.

The Negative List system has produced direct and significant economic benefits for the Shanghai Free Trade Zone. Take Pudong New Area as an example, foreign trade in the Free Trade Zone accounted for 90.8% of the region in 2017. As of November 2018, the Shanghai Free Trade Zone has attracted more than 100 billion US dollars of foreign investment. In the next step, the country will unify the Negative List, allowing capital to flow more freely and conveniently in various regions. The free trade zone will further relax the investment field and expand the degree of openness. As China's financial center, Shanghai will focus on the service sector in the reform of the Negative List, giving full play to its great advantages in the core location of economy and finance.

### III. THE KEY TO THE SUCCESS OF THE THREE LISTS: DEALING WITH THE RELATIONSHIP BETWEEN THE GOVERNMENT AND THE MARKET

The practice of the Shanghai Free Trade Zone on the Three Lists is essentially a major adjustment to the relationship between the government and the market. The Power List clarifies the government's rights, simplifies administration and decentralization, transfers more rights to the market, gives full play to the market's creativity, and stimulates market potential. The Responsibility List is to implement the government's duties, publicize the obligations of the government, and accept public supervision, so that the government can manage the market more efficiently. The Negative List, the release of the industry or the field that the government is not allowed to engage in domestic and foreign investment, the rest are all liberalized, further expanding the scale of opening up, and further playing a decisive role in the allocation of resources. Today's China, Market openness needs to be further expanded, especially in the financial sector. If current financial institutions want to truly play the role of market players, they need not only the government's policy guidelines, but also the autonomy of business strategies. The Shanghai Free Trade

Zone, using the advantages of the financial center, through Three Lists system, to attract foreign financial institutions into the Chinese market, will inevitably generate fierce competition with domestic financial institutions. Under this circumstance, the reform and innovation of financial institutions is inevitable. Independent business decision-making, consciously raising the level of operation and taking on market risks are beneficial to the development of China's financial industry. Such competition can really make the financial sector play a decisive role in the allocation of resources.

China attaches importance to the relationship between the government and the market, constantly keeps pace with the times, and actively adjusts and improves the relationship between the two. From 1949 to the time of reform and opening up, China implemented a planned economic system. During this period, the shortcomings of the system continued to emerge. Gradually, the words "big plan, small market", "free market under the leadership of the state", "commodity economy", and "indirect plan" appeared. Market factors have emerged, but the overall situation is still a more strict planned economy. After the reform and opening up in 1978, the concept of the market was gradually taken seriously, and the scope of the planned economy was gradually narrowed. In 1979, Deng Xiaoping proposed that "socialism can also engage in a market economy". In 1981, the Sixth Plenary Session of the Eleventh Central Committee of the Party clearly proposed "the planned economy is the mainstay and the market regulation is the auxiliary". In 1993, the Third Plenary Session of the 14th CPC Central Committee proposed the establishment of a socialist market economic system. Let the market play a fundamental role in resource allocation. In 2013, the Third Plenary Session of the 18th CPC Central Committee proposed that economic system reform is the focus of comprehensive deepening reform. The core issue is to handle the relationship between the government and the market, so that the market plays a decisive role in resource allocation and better plays the role of the government. The government and the market are the two most important parts of the modern economic system. The government provides a relatively stable and orderly trading environment for the market economy. The good development of the market will increase the government's fiscal revenue and promote the progress of the whole society. Therefore, at present, whether it is the reform of the administrative system or the reform of the economic and financial fields, it is constantly exploring better relations between the government and the market, combining the current development of China, and constantly balance the relationship between the two in dynamic practice.

#### IV. WESTERN COUNTRIES' FISCAL THEORY AND GOVERNMENT MARKET RELATIONS

China is an ancient cultural country with more than 5,000 years of civilization. Whether it is a political system or an economic system, China's development path is different from that of the West. Because China has its own national conditions, China's population base is large, and financial markets and financial mechanisms are not mature, so it is not advisable to blindly copy the political and economic reforms of Western countries. However, the West has a more open and sound

financial market, and its development process is longer than that of China. Therefore, research and appropriate reference to Western political reforms, look at how these countries deal with the relationship between the government and the market at various times, and greatly benefit China's future development.

Western countries' financial theory has generally experienced three major stages: the period of mercantilism, the period of classical political economics and finance, and the period of contemporary fiscal theory. During the mercantilist period, the role of the government was emphasized, such as protectionist tariffs, government policies to expand exports, and restrictions on imports. Classical economics is contrary to mercantilism. It opposes state intervention in the economy, and the market can realize the optimal allocation of resources by itself. The most typical description of this is the "invisible hand" proposed by Adam Smith. Contemporary fiscal theory is divided into Keynes theory and New Classical Economics theory. In the context of the Great Depression from 1929 to 1933, the issue of "market failure" was exposed. Under this historical condition, Keynes emphasized the necessity of government intervention in the economy, and through state intervention to enhance effective demand and stabilize the economy. After the 1970s, there was a phenomenon of "stagflation" that Keynesianism could not explain. So the New Classical Economics School came into being. The school was divided into the Monetarism and the supply-siders. The commonality between the two schools is to oppose government intervention and emphasize the market's central position in resource allocation.

Looking at the history of Western finance development, it is not difficult to see that whenever there is a large-scale economic problem, the relationship between the government and the market will undergo a major adjustment. From the role of the government in the period of mercantilism, to the emphasis of the market by classical economics, from the state intervention economy proposed by Keynes, to the opposition of the New Classical Economics to government intervention. The innovation of theory is constantly adapting to the new type of government market relationship, and the relationship between the government and the market is constantly adjusting in the theoretical development.

#### V. CHINA'S ADVANTAGES IN PRACTICING BOTH HANDS ARE SIGNIFICANT

The government and the market itself are not contradictory, but a relationship of mutual promotion and coordinated development. President Xi has repeatedly stressed: To make the market play a decisive role in resource allocation and to give full play to the role of the government, the two are organically unified, not mutually negated, and cannot separate and oppose the two. It is impossible to replace or even negate the role of the government with the decisive role of the market in resource allocation, nor can it replace or even negate the role of the government to make the market play a decisive role in resource allocation. The Power List, Responsibility List and Negative List mentioned above address the government's excessive intervention in economic issues, government work supervision issues and market access issues. The Chinese government's approach is to grasp the "invisible hand" and

"tangible hand" at the same time, emphasizing the dialectical unity of things, that is, taking comprehensive development as a starting point and realizing the harmonious development of the government and the market. This is a Chinese-style plan to deal with the relationship between the government and the market, based on the experience of the Western financial theory development and transformation, combined with the philosophical concept of Marxist dialectics.

#### *A. Invisible hand – the market stimulates innovation*

In terms of the market, for China, the core of comprehensive deepening reform is economic system reform, and the key to economic system reform lies in the market, which needs to fully stimulate market vitality and innovation.

The establishment of Shanghai Free Trade Zone, the first economic and free trade area in China's inland areas, is a bold attempt by the Chinese government to better stimulate market vitality. It is a gesture of China's willingness to further reform and opening up, and a symbol of China's more inclusive welcome of foreign capital into the Chinese market. The establishment of the Free Trade Zone was the first batch of 11 financial enterprises, including five state-owned banks, three Chinese banks, Citibank and DBS Bank, which are among the top nine investment banks in the world, and a financial leasing company. After the establishment of the Shanghai Free Trade Zone, it will focus on expanding the openness of the service industry. A large number of service industry opening measures have been introduced one after another, giving full play to the location advantages of the Shanghai financial center. Relying on the financial district in the Free Trade Zone, the Shanghai Municipal Government is striving to build a headquarters economy, shipping finance, cultural sports tourism, and high-end service industry clusters.

China is implementing a socialist market economic system. Public ownership as the main body and the common development of multi-ownership economy are the basic economic systems. Public ownership economy can also participate in market competition, and also play a role in allocating all resources in market economy. Many state-owned enterprises can take private shares. All these reflect the government's determination to play a decisive role in the allocation of resources in the market. The Chinese government has the ability and confidence to do a good job in the socialist market economy. At the same time, it draws on the repeated emphasis of western countries on government or market to solve economic contradictions. This will make the development of China's market economy more stable and avoid the occurrence of economic crisis as far as possible.

#### *B. The visible hand – the government guarantees the orderly operation of the market*

The "tangible hand" is the role of the government in the process of economic development. General Secretary Xi emphasized that transforming government functions is the key to deepening economic system reform and administrative system reform. The transformation of "all-round government" into "service-oriented government" is the general trend.

Decentralization, strengthen market supervision, maintain fair and orderly market trading environment is the key to the future government to play the "visible hand".

The reason the government intervenes in the economy is market failure because the market is not omnipotent. There are seven major manifestations of market failure, and each performance will have a negative impact on society and the economy. First, the monopoly problem, which reduces the degree of competition in the market, the market determines that the price mechanism is thus broken, which may harm the interests of consumers, and is not conducive to the long-term development of the industry. Second, public goods issues, public goods are difficult to rely on the market to provide, most of which need to be provided by the public sector such as the government, resulting in free ride and supply shortages will reduce the efficiency of the market. Third, the external effect problem, the market cannot provide good incentives for positive external effects, and cannot effectively control and punish negative external effects. Fourth, the incomplete market and insufficient information, the incomplete market brings incomplete information, and the information asymmetry leads to the inefficiency and distortion of market resource allocation. This creates a problem of adverse selection. After the transaction occurs, the buyer's use of information asymmetry is easy to generate moral hazard problems, thereby damaging the seller's interests. Fifth, the instability of macroeconomic operations, the financial crisis, the bubble economy, and the Great Depression are the direct manifestations of this problem. Sixth, the problem of unfair income distribution, because each individual in society has different factors of production, resulting in a wide income gap between people, and the market is based on factors of production for income distribution, so market forces alone cannot solve this problem. Seventh, the issue of personal preference, the irrationality and self-interest of consumer preferences will distort the market. The Gresham's Law is a classic example.

Practice has proved that the government's reasonable intervention in the economy can solve the problem of market failure. The government and the market are not antagonistic, but complement each other and promote the relationship. The Power List and the Negative List concept reflect the efforts made by the government in decentralization. The concept of Responsibility List reflects the role of the government in strengthening market supervision and maintaining market order. An important part of the Chinese government's administrative reform is to create a "promising" government that maximizes market potential, safeguards market order, expands openness, and creates an environment that encourages innovation.

#### VI. PRACTICE AND PROSPECTS: DYNAMIC BALANCE, TIMELY ADJUSTMENT AND FOLLOW-UP OF GOVERNMENT POLICIES

In summary, the relationship between the government and the market is by no means antagonistic, but mutual promotion and mutual dependence. Whether the market can fully play the decisive role of resource allocation and whether the government can play a better role depends on whether the relationship between the two can be maintained. The key to the maintenance of this dynamic balance relationship lies in the timely adjustment and follow-up of government policies, and



the creation of “high-quality government” is the core of balancing this relationship. The essence of the practice of the three-list system in the Shanghai Free Trade Zone is to maintain the relationship between the government and the market in a dynamic and scientifically balanced position. It is a test field for exploring this relationship in the interior of China. The great achievements of the Shanghai Free Trade Zone fully demonstrate the importance of the relationship between the government and the market, and at the same time verify the significance of China's continuous innovation under the socialist market economy system with Chinese characteristics. This kind of innovation is a top-level design of the Chinese government based on China's national conditions, drawing on the development experience of Western countries, piloting from a small scale, and popularizing it.

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