Theoretical connotation and main focus of "supply-side reform"

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Based on the comprehensive reform after the 18th National Congress of the Communist Party of China (CPC), the Fifth Plenary Session of the 18th CPC Central Committee proposed a systematized and modern strategy for development. This proposal regards innovative development as a primary driving force, and incorporates coordinated development, green development, and open development—ultimately converging on shared development. Subsequently, policymakers articulated the guiding opinion of "putting forth efforts in promoting supply-side structural reform", which elicited extensive attention and discussion. This paper mainly focuses on the theoretical connotation and suggestions of supply-side reform.

Keywords: supply-side reform, institutional supply

In the context of the 18th National Congress of CPC and the Third, Fourth, and Fifth Plenary Sessions of the 18th CPC Central Committee, a research group focused on New Supply-side Economics in China (comprised of the China Academy of New Supply-side Economics and China New Supply-side Economist 50 Forum, which I belong to) put forward a set of proposals on efforts that should be made on the supply-side to confront reality challenges and break through the current bottleneck in China's growth. The guidelines for comprehensively deepening reform at the Third Plenary Session, comprehensively advancing the rule of law at the Fourth Plenary Session, and the proposal on the 13th Five-Year Plan at the Fifth Plenary Session of the 18th CPC Central Committee further stimulated our research and also gave us a stronger sense of urgency on reform and transformation. As researchers, we strive to make a difference in this post-global financial crisis environment, to reflect on the theoretical framework of mainstream economics, and to form theoretical innovations to support China's modernization goals from the "three-step strategy" proposed by Deng Xiaoping to the "Chinese dream" expounded by Xi Jinping. The key to relevant understanding and progress is to determine whether to overthrow or further establish existing economics achievements. In order to attain the goal of building a society of initial prosperity in an all-around way at the crucial stage of the 13th Five-year Plan Period, and to embrace the opportunity to avoid the middle-income trap and realize the Chinese dream of

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modernization and the great rejuvenation of Chinese nation, we must tightly seize and successfully deal with the proposition of “rational supply management” and “supply-side structural reform”.

1. Modern reality demands for the rethinking of existing achievements of mainstream economics.

Demand management and supply management are a pair of concepts that have had set definitions in economics research. The equilibrium of aggregate demand and aggregate supply has been discussed for years, and it is especially necessary for the intensive study of institutional demand and institutional supply to catch up. Colleagues from the research community have asked, “What’s new about New Supply-side Economics?” While our research achievements are still preliminary, the new conception can be summarized as follows: firstly, the ‘new’ lies in “overthrowing”; secondly, the ‘new’ lies in “establishing”; thirdly, the new lies in our systematized policy views and approaches.

1.1. What to overthrow in new supply-side economics?

From the perspective of the global financial crisis and real-life experience of reform and opening up in China, people raise questions: Why did economists not make reliable predictions of the financial crisis that shocked the world at the turn of the millennium, nor come up with an effective economic interpretation or countermeasure framework? How do we interpret the remarkable development and arduous transformation in China with economic theories? Numerous researchers hold that the fundamental achievements of economic theory are in urgent need of reflection. As we see it, this reflection can be boiled down to “overthrowing”, which has been achieved in the research of New Supply-side Economics, and is concentrated on the following three aspects:

Firstly, we point out frankly the asymmetry in the cognitive framework of mainstream economics theories. Classical economics, neoclassical economics, and Keynesian economics all have made great contributions, with their emphasis on different angles, but their common fault cannot go unnoticed: there is the common problem of neglecting supply-side and supply management. There are assumptions about the supply environment in their theoretical framework and they all emphasize deep analysis of the demand side, and policy views of “demand management” are formed in this respect. Washington Consensus, which has had great influence in the past few decades, uses “perfect competition” as an assumption for the economic laws in its theoretical framework; they fail to harmonize this effectively with reality, in practice refusing deep analysis on the supply-side, which is an obvious shortcoming in this important field. In the economic practices of United States, the world's leading financial power, during the past few decades, supply-side economics has emerged in response to the pressures of stagflation. This policy innovation has produced visible positive effects in real life; however, we should mention that it is still lacking in theoretical soundness, as supply-side economists' proposition is still adept at stimulating the potential and vitality of supply for decentralized market entities' level, under the framework of Washington Consensus, but weak in deep understanding of structural analysis, institutional supply analysis, and government action analysis—the reason is that the United States does not have the same unavoidable objective need of resolving "transformation problems" and "structural problems" as economies like China do, so quite sensibly, it is difficult to further emphasize supply-side perspectives. Compared with demand side, with index values that are commensurable and fit for modeling, indexes on the supply-side are incommensurable and constantly changing; the fact that problems are more complicated and long-term, in combination with "slow variables," requires a higher level of structural analysis and structural solutions, thus making modeling more difficult. These inhibitors should not constitute a reason for economic theory's long-term tolerance for the asymmetry in its cognitive framework.

Secondly, we also frankly criticize the "inconsistency of words and actions" between mainstream textbooks and typical practices in economics. In dealing with crisis, developed economies, including the United States, amidst critical operations that are adequate to have an impact on the overall situation, will adopt operations with discriminative structural countermeasures and supply means which depart from mainstream economics textbooks. For instance, when dealing with certain crucial points in the financial crisis, the United States resorted to "discriminative" government investment, which has never been recognized or analyzed in textbooks. While regulatory authorities of the United States allowed the 150-year old Lehman Brothers company to collapse, after a struggle of whether to save them or not, they rendered help to Federal Home Loan Mortgage Corp., Freddie Mac., Citibank, and GM in real economy. Large amounts of public investment funds were injected selectively to specific entities in a typically discriminative supply-side operation by the government, and had a decisive impact on the overall situation of the economy and society. However, such important practices are still separated from classic economics literature and mainstream textbooks.

Thirdly, we point out that supply-side questions, including but not limited to government industrial policies, are weak and have lagged behind in existing economics research. In terms of "industrial policies", which are "visible and tangible" in economic development, while highly-esteemed economics literature and representative figures of the theoretical community in the United States seldom mention these policies, the practices of the United States are praiseworthy: a series of highlights and emphases, from the "industrial policies" stressed as the key to revitalizing the United

States in Lacocca's autobiography in 1980s, to the Information Highway created under the Clinton administration, to the oil shale revolution and 3D printers mentioned in Obama's State of the Union in recent years, to manufacturing moving back to the United States, and to discrimination among new immigrants and emerging economies, among others. These are not cognitive paradigms corresponding to textbooks, but are oriented to significant issues in reality and characterized by making efforts from the supply-side. To put it bluntly, in this field, the theoretical research of economics, which should have governed and benefited the society and people, is in an awkward "unqualified" situation that lags far behind practice.

1.2. What to establish in new supply-side economics?

With the above reflection on what to "overthrow", we emphasize that China must, on the basis of a combination of real needs and experience from other countries, consider what can and should be "established" with a broader innovation perspective of economic theories.

Firstly, special stress should be put on a fundamental economics framework to consolidate analysis and cognition on supply-side. This original proposition stimulated by the global financial crisis requires more distinctly the necessary steps and innovation orientation of contemporary scholars to "integrate theory with practice". At the level of basic theory, we emphasize: it should be pointed out clearly that with innovation, from long-term study, the main supporting factors of constant development of human society can be believed to be the response and guidance of balanced supply to demand. Definitive characteristics of a supply capacity response system and its mechanism at different stages constitute the divisions of different eras in the development of human society. The significance of demand in this respect is certainly not to be ignored—human beings are motivated by demands to pursue various available resources—but from the perspective of economics, the function of effective supply in guiding demand has not gotten enough recognition in the past. From the perspective of definitive characteristics of supply capacity at different stages, our emphasis on the division of different eras of development, supply capacity, and institutional supply related to "the formation of supply capacity" not only possesses universality, but also corresponds to prominent problems of how to achieve transformation and sustainable development in developing countries like China in particular. In fact, responding to and solving this issue of perspective also involves developed economies—such as how they can put theory to better service of practical needs after being hit by the economic crisis. In reality, the key is that, while demand-side problems of "producing products to satisfy demands" and "demand management" with aggregate control as essentials is being dealt with, supply-side problems of "what to produce" and "how to produce" need to be dealt with—the problem of "how to optimize institutional supply" needs to be dealt with in particular, as its strong structural characteristics of "supply management" cannot go unnoticed. This type of research, which closely connects demand and supply, is increasingly revealing its necessity and importance in the development of economy and society.

Secondly, we emphasize the effectiveness and pertinence of facing up to reality and consolidating supporting points of fundamental economic theory. For instance, "imperfect competition" should be established as a premise of future research, as this is the real environment of resource allocation and involves large numbers of problems on the supply-side. While the assumed "perfect competition" in economics in the past brought plenty of theoretical enlightenment, it can only be referred to as a version 1.0 model. When we discuss problems now, we should further build on the foundation of imperfect competition, which can both better reflect the real environment of resource allocation and cover a wider variety of monopoly and competition issues. This will upgrade and expand the model and gain scholars insight into reality. Demand analysis mainly deals with aggregate problems, and its indexes are homogeneous, monotonous, and commensurable, but supply analysis is much more, in that it deals with structural problems, institution building problems, and so on, and its indexes are non-monotonous and incommensurable. Supply-side analysis involves the core problem of the fundamental relationship between government and market, which inevitably brings about obvious challenges and unusual difficulties. Nonetheless, this is a significant problem which cannot be circumvented in the innovation and development of economics. A larger number of medium-to-long-term problems and "slow variable" problems are inevitably becoming difficult issues that supply-side study is supposed to cope with. Economics studies used to dismiss these with a sentence such as "'general equilibrium' or 'counter-cyclical' regulation can naturally solve structural problems", but we believe it is necessary to upgrade this "sentence" to a "grand article" that contains a series of considerations on imperfect natural evolution on the pivot of imperfect competition, and this requires further exploration with the addition of initiative factors on the supply-side.

Thirdly, we hold that market, government, and non-profit organizations should all perform their own tasks and seek to cooperate, which is also the objective requirement of optimizing resource allocation. On the premise of clearly identifying the market's decisive role in resource allocation in general, we need to discuss, with clear targets, and different entities i.e. market, government, and "the third sector" (non-government organizations, volunteers, public interest groups, etc.), about how each can and should divide work, cooperate, and interact in optimizing resource allocation. The choices and characteristics of division of work, cooperation, and interaction are bound to differ at different stages and in different fields. The process from division of work to substitution between government and market, and then again from substitution to cooperation with emphasis on public-private partnership (PPP), reflects the new characteristics and new trends that diverse relationships among entities in human society possess with economic development and civilization advancement.

Fourthly, we stress that institutional supply should bring in supply analysis to form a cognitive system with a synergistic relationship, i.e., the two perspectives of material and human being should be connected on the supply-side; the supply of various material factors and the institutional supply, which are in essence an interpersonal relationship should be incorporated in one system; research findings regarding different concepts of development economics, institutional economics, transition economics, behavioral economics, and so on, need to be integrated and fused. We should respond to the needs of economic transformation and China's reality by "establishing", and the core concept formed is that we must pay more attention to "rational supply management" in establishing theory and integrating theory with practice. To resolve the challenging historic task of attaining goals of modernization in China, we must stress efforts on supply-side with promoting institutional innovation and mechanism innovation as entry point. We need to keep in mind structural optimization as a focus, and unconventional long-term process of "catching up and surpassing".

Certainly, the above discussion does not mean we can ignore demand. Understanding of "demand management" is relatively sufficient in the existing theoretical achievements of economics, and we hope to improve the symmetry of the cognitive framework from supply-side economics in a more enriched and targeted way. Such an understanding, combined with the reality that Chinese economists are facing, will logically lay special stress on "centering on reform", on pushing forward institutional transformation and innovation in an age of a new-round of "comprehensive reform" from the supply-side. This is "a crucial step" that can effectively resolve conflict accumulation and the risks of "stagflation", the "middle-income trap", the "welfare trap", and the "Tacitus trap", and create a growth model of sustainable development, so China can realize "Chinese dream". Our research intention and possible contributions lie in the hope of urging all the maneuverable positive energy to focus on the impending issue of "how to advance the new round of reform substantially after the Third and Fourth Plenary Sessions of the 18th CPC Central Committee" in China, and seeking to outperform the accumulation of risk factors and break through the bottleneck in long-term economic growth and structural adjustment through comprehensive reform and rational supply management, so as to widen and smooth the path to Chinese dream.

In brief, after the global financial crisis, reflection on the traditional economics theory framework and practical experience of macro-control with focus on "demand management", combined with the innovation efforts of "integrating theory with practice", has logically raised unprecedented emphasis on theoretical innovation of "New Supply-side Economics", "supply management" regulation and supply-side structural reform. China is pressed to construct new mechanisms of driving forces for economic growth while adapting to and guiding the New Normal. Under the framework of traditional demand management with "three carriages", only when the respective perception in the aspects of consumption, investment, and export are connected to consumption supply, investment supply, and export supply, can the three perceptions reach the satisfactory state of their respective demand. This incorporates supply-side response and adaptive mechanisms triggered by "primary driving forces" on the demand side, i.e., relevant optimization of factor allocation and dynamic mechanisms of institutional arrangement, all of which must fit into the overall deployment of comprehensive reform and comprehensive governing in accordance with the law after the 18th National Congress of the Communist Party of China.

2. Core connotation of supply-side reform is effective institutional supply: ideas and proposals formed on the basis of theoretical innovation

Based on the above-mentioned analysis, we hold that the core connotation of supply-side reform in China is "emancipating productive forces with further deepening reform", which should command overall arrangements. This requires overcoming difficulties and further advancing economic and social transformation and upgrading in deep-water zones of reform under the orientation of marketization, globalization, democratization, and rule of law. In a word, the core connotation lies in supporting structural optimization with effective institutional supply, invigorating total factor productivity, connecting to "comprehensive well-off ", and linking with the Chinese dream.

The basic policy proposals from research groups of New Supply-side Economics elicited by the fundamental understanding of theoretical innovation are the "eight doubles" under the guidance of reform and "five equal emphases," which face the historical task of "two centenary goals". Here we give a brief introduction as follows.

The main points of "eight doubles" are:

No. 1 "double creation"—creation of an innovative nation and massive entrepreneurship.

No. 2 "double promotion"—promotion of new urbanization and industrial optimization.

No. 3 "double reduction"—speeding up the implementation of tax and fee reform with a focus on structural tax reduction, and substantial reduction in required administrative approval.

No. 4 "double enlargement"—in the new landscape of opening up and international competition, enlarging China's integration with Asia, Africa, and Latin America, and enlarging the size of "effective investment" based on quality and structural benefit in economic growth (boosting consumption is certainly important, and there are quite a few research findings and obvious increases in attention in that respect, but we hold that further understanding of investment also deserves emphasis, so we put it under this concept of "double enlargement").

No. 5 "double transition"—implementing as soon as possible the transition of population policy from releasing urban "one child" control to gradually and moderately encouraging childbirth, and actively promoting the transition of returns and stock of state-owned assets to social insurance and public service sectors.

No. 6 "double advancement"—in respect to state-owned economies and non-state-owned economies exerting their respective advantages and developing coordinately, common advancement is desirable, and the incompatible thinking of "either this or that" needs to be abandoned; under the key concept of "mixed ownership", realizing the modernization of the basic economic system of the socialist market economy, as characterized by a "win-win" scenario, is to be perfected.

No. 7 "double performance"—urging the government and market to play their respective role, fostering positive interaction, complementation, and cooperation based on high performance for both sides. Analysis and understanding in this respect should be expanded to the third sector, which is bound to develop in China, i.e., volunteer organizations, non-government organizations, and non-profit organizations in charity. Active organizations should give play to their potential in the interaction between social entities. We attach great importance to PPP, public-private partnership (officially paraphrased as "cooperation between government and social capital"), which has gained high recognition internationally, and seeking a win-win scenario should be its basic perspective.

No. 8 "double supporting reforms"—implementing a new round of "price, taxation, and finance" reform, and actively and substantially pushing forward financial supporting reform.

Among the above-mentioned basic considerations, "double creation" is the soul and forerunner of development; "double promotion" is the driving force of development and the catalyst of the upgrading process; "double reduction" represents the institutional foundation with an emphasis on promoting supply efficiency and optimizing supply structure to better adapt to and guide supply structure change; "double enlargement" aims to enlarge the market space of supply both domestically and internationally; "double transition" is to seize opportunity and keep pace with the times to accommodate the optimization of the supply structure and mechanisms in terms of two realistic issues of population policy and the state-owned asset allocation system, so as to support the opening up of a new situation; "double advancement" is to clarify the reasonable capital structure, function complementation, and win-win effects of market supply entities in the evolution of shareholding, modern enterprise system arrangement; "double performance" is to clarify the rational positioning of parties concerned on the core issues of the relationship between the government and market;

“double supporting reforms” is to promote with great determination and great wisdom a new round of imperative institutional reform and mechanism upgrading of the basic product price formation mechanism, the two macro-economic policy systems of fiscal and tax policy, and monetary policy, plus the administrative system.

The main points of “five equal emphases” are:

No. 1 equal emphasis on the “five-year plan” and “forty-year plan”—researching and formulating national medium-to-long-term development strategies from global perspective;

No. 2 equal emphasis on “economy under the rule of law” and “cultural economy”—attaching importance to actively and gradually building national “soft power”;

No. 3 equal emphasis on “Maritime Silk Road” and “Land Silk Road”—responding effectively to the change of global political and economic patterns;

No. 4 equal emphasis on flexible participation in TPP and independent negotiations about economic cooperation zones, actively participating in the formulation of international trade and investment rules;

No. 5 equal emphasis on a high-profile push of international monetary system reform and the low-profile push of internationalization of RMB.

The perspective of this “five equal emphases” is to help China in keeping with the trends of the world and seeking national rejuvenation, and to understand and grasp the comprehensive international landscape and related strategic issues.

The orientation of eliminating supply restraints and releasing supply restrictions elicited by the “eight doubles and five equal emphases” corresponds to the connotation of the institutional transition and mechanism optimization of the “national governance modernization” under the orientation of the continuing marketization reform since the 18th National Congress of the Communist Party of China.

3. Putting forth efforts in supply-side reform serves overall interests: emancipating the mind and innovative thinking is required.

The above principles and proposals that we believe to be necessary to “establish” are overtaking strategy that originated from exploration of economic laws and theories. They correspond to the summary of practices from both at home and abroad, and from ancient to modern times, but this strategy also focuses on China’s “characteristics” and background to specifically serve China’s modernization. The “three-step” modernization strategy stressed by Deng Xiaoping can be understood as a substantial overtaking strategy. The first few decades represented a catching up phase. The ultimate intention is undoubtedly directed at rejuvenation of the Chinese nation, as well as benefiting Chinese people and all mankind after lagging behind for two centuries, and ultimately “surpassing” other nations, which is the “Chinese dream” expounded by

General Secretary Xi Jinping. This Chinese dream is by no means ultranationalist, but merely takes into account the contribution that an old nation should make to the world and mankind—the proper contribution that a country with an ancient civilization of thousands of years should make in the development of a globalized world.

We are aware that it is unavoidable and necessary to have debates about our theory and understanding, and it seems hard to escape from the tendency of simplified labelling among the current discussion in China. For example, in general comments, the space for mind emancipation and thought innovation is far from full realization, but restrictions tend to be set everywhere. Certain thinking and views are prone to be classified simply—some views are labeled neoliberal, some are considered to be advocating government intervention and "Big Government", and some are considered to be advocating the Third Way. Behind all this labelling are the extremism, simplification, and impetuousness of misunderstanding.

Our cognitive tendency is towards hope to surmount some of the labelling discussions of the past, and focus on reading less doctrines and discussing more problems, especially real problems and profound problems that impede on the pursuit of truth. With clear discussion about "real problems", "doctrines" are incidentally presented. In this economics framework, and in the cognitive field of economic law, there is no need to label viewpoints under discussion with ideological labels, or to distinguish between left and right, or between capitalism and socialism. New Supply-side Economics aims to inherit all achievements of human civilization in economics and relevant subjects, and to make progress, including supplementation, integration, and improvement in economics theories, by standing on the predecessors' shoulders.

We should attach greater importance to pragmatism in theoretical research. "To proceed from reality in handling all matters" requires full perception of China's tradition (including both positive and negative), full perception of conditions in China (including both variable and invariable), and special stress on how to respond to realistic needs. Some recognized needs are certainly real practical needs, but there are also illusions of realistic needs, so it is important to distinguish between these on the basis of pertinent and in-depth analysis of researchers. We need to proceed from reality to perceive various relevant matters and also pay attention to experiences and lessons of other developing and developed countries, including illustrating and adhering to universal common rules and values.

Establishing by overthrowing, and proceeding from theory to practice, requires that, in analysis, special emphasis should be put on the combination of the supply-side and demand side, an all-around deep study of the interaction among government, market, and the third sector, and study of their interrelationships, so as to achieve objectivity, relevance, a broad horizon, and an open mind. New Supply-side Economics is in no way innovating for the sake of innovation, but responding to challenges and innovating for sensible pursuits in order to live up to the times. China's counter-cyclical policy practices in macro-control since the 1990s have made great progress and remarkable achievements, but to keep following mainstream economics and developed countries' focus on demand management, and to continue implementing unvaried "counter-cyclical" operating lines has increasingly revealed its limitations with the accumulation and prominence of conflicts in recent years. In the future, with the "range" of acceptable operating conditions having been narrowed by the downtrend of the Chinese economy's potential growth rate, resource, and environment constraints, as well as interpersonal relationship constraints such as income distribution during the economic downturn, the room for replication of a "4-trillion Version 2.0" is already very narrow, so the effective application of a higher level of rational "supply management" has become imperative. The 5th Plenary Session of the 18th CPC Central Committee clearly put forward the requirement of "releasing new demands, creating new supply", and thereafter the leadership announced an unprecedented amount of attention to be paid to pushing forward "supply-side structural reform" and promoting the "quality and efficiency of the supply system". They also placed importance on directing the formation of an effective institutional supply, the "crucial step" in China's modernization, and the systematic project of eliminating supply constraints and releasing growth potential driven by innovation and structural optimization.

Regarding China's medium-to-long-term development, breaking through the current growth bottleneck and overcoming difficulties to comprehensively deepen reform and optimize structures is a significant historical test faced by all Chinese people. China should stand on predecessors' shoulders, maintain a rigorous academic spirit, and adhere to innovation principles in which theory is integrated with practice. It is crucial that policy makers and economists emancipate their minds and innovate with new ways of thinking, pursue the function of economics in governing and benefiting the people, focus more on putting forth efforts on the supply-side, break through bottlenecks in practice, and serve the overall situation.