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A Comparative Analysis of Western Supply-Side Economics and China's Supply-Side Structural Reform

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ABSTRACT
Supply-side structural reform is a vital initiative aimed at adapting to and guiding China's new economic normal. In recent years, this reform has achieved notable progress, injecting new momentum into China's sustainable economic development while contributing theoretical innovation to reform practice. Unlike a simple replication of Western supply-side economics, China's reform has surpassed it in terms of theoretical connotation, economic realities, institutional conditions, and policy orientation. This paper conducts a comparative analysis between the two from the perspectives of theoretical foundations, economic and institutional contexts, and policy propositions. It further summarizes the theoretical and practical innovations of China's reform and offers suggestions for its deepening.

KEYWORDS
Supply-Side School; Supply-Side Structural Reform; Differences; Implications

After China entered a new phase of economic development—referred to as the "new normal"—the Central Government timely proposed the strategy of supply-side structural reform, shifting the focus from demand-side management to the optimization of the supply structure. The key tasks include cutting excess capacity, reducing inventory, deleveraging, lowering costs, and addressing structural weaknesses. This reform is often compared to the Western supply-side school of thought, as they share certain policy tools such as tax cuts and deregulation. However, fundamental differences exist in terms of theoretical underpinnings, institutional frameworks, economic contexts, and policy objectives. Rooted in the institutional foundations of socialism with Chinese characteristics, China's reform emphasizes indigenous innovation in practice and aims to advance economic restructuring and achieve high-quality development. It represents a distinctively Chinese supply-side revolution.

1 Differences Between China's Supply-Side Structural Reform and Western Supply-Side Reform

1.1 Divergent Economic Contexts

1.1.1 Western Countries: Reform in Response to Stagflation

Prior to the 1960s, traditional economic theory—guided by the Phillips Curve—assumed a trade-off between inflation and unemployment. However, by the mid-1960s, major developed economies such as the United States began experiencing stagflation, a phenomenon characterized by the simultaneous rise in inflation and unemployment, rendering the Phillips Curve ineffective. Macroeconomic policy tools faced a dilemma: tightening to curb inflation worsened unemployment, while expansionary policies to boost employment exacerbated inflation. In the 1970s, the United States underwent three major episodes of stagflation. Following the deregulation of price controls in 1973, the inflation rate surged to 6.2% while unemployment remained elevated at 4.9%. The inconsistent macroeconomic responses under the Nixon, Ford, and Carter administrations further deteriorated the situation. The two oil crises of the decade intensified inflationary pressures. In 1979, the Federal Reserve initiated a series of sharp interest rate hikes to curb inflation. While this ultimately stabilized prices, it also triggered a severe recession, with GDP growth falling to -1.8% and unemployment rising to 10.8%. It was not until the Reagan administration's reform agenda—coordinated with Paul Volcker's monetary tightening—that the U.S. successfully emerged from stagflation.

During the same period, the United Kingdom also faced serious economic challenges. From 1974 to 1980, the UK's average annual GDP growth rate was only 1.0%, inflation reached 15.9%, and the unemployment rate climbed from 3.8% to 11.9%. State-owned enterprises, though dominant in the national economy, became increasingly inefficient and burdensome in the face of industrial decline and the oil crisis, squeezing out private sector vitality. Over-powerful trade unions exacerbated labor market rigidities, frequent strikes, and a decline in productivity. Rapid growth in welfare expenditures strained public finances, while high tax burdens discouraged labor participation and capital investment, leading to talent and capital flight. The Labour government adhered to Keynesian prescriptions, attempting to stimulate demand through expansionary fiscal and monetary policies. However, against the backdrop of rising oil prices, this approach only fueled inflation and deepened economic contraction. The root causes of the crisis lay in supply-side imbalances and systemic institutional weaknesses, rendering demand-side stimulus ineffective and plunging the UK into a decade-long stagflation trap.

According to the World Bank, by the early 1970s, the seven major European economies, including West Germany, were all experiencing stagflation. Average annual GDP growth was limited to 2.4%, with unemployment at 5.3% and consumer prices rising at an average annual rate of 9.4%. In response, German Economy Minister Karl Schiller introduced the Law for the Promotion of Economic Stability and Growth, advocating counter-cyclical fiscal policies and cooperative economic planning. In 1967, two stimulus packages totaling 7.8 billion Deutsche Marks were launched, helping GDP growth rebound above 5% between 1968 and 1970. However, due to the absence of clear boundaries for government intervention, these expansionary policies were gradually overused, resulting in welfare over-expansion and a surge in fiscal deficits. The dollar crisis and speculative attacks on the Deutsche Mark constrained the effectiveness of German monetary policy, culminating in the closure of foreign exchange markets in 1973. Although the collapse of the Bretton Woods system granted the Bundesbank monetary independence, its actions remained subject to government influence. Expansionary fiscal policy, uncontrolled wage growth, and external shocks such as oil crises and currency instability prolonged the inflationary spiral. Nevertheless, due to the traumatic experience of hyperinflation after World War I, the Bundesbank adopted a more prudent monetary stance from the 1980s onward, refraining from using money creation to cover fiscal shortfalls. As a result, the severity of stagflation in West Germany was comparatively milder than in other Western economies.

1.1.2 The Background of China's Supply-Side Structural Reform: Structural Imbalances in the Economy

Chinese scholars generally agree that China's economy has entered a new stage of development, often referred to as the "new normal," in which the traditional model driven primarily by demand-side stimulus is no longer sufficient to support high-quality growth. Structural reforms must be advanced from the supply side. Following the 2008 global financial crisis, the world economy fell into stagnation, external demand declined, and China's economic growth slowed while unemployment rose. The macroeconomy began facing both aggregate and structural imbalances. With the advancement of productive capacity, supply continued to increase, resulting in increasingly serious overcapacity beginning in 2011. By 2012, sectors such as heavy industry, photovoltaics, wind energy, and polysilicon—considered strategic emerging industries—also experienced overcapacity. What began as sector-specific surplus evolved into a widespread issue across industries, becoming a long-term and persistent problem under the backdrop of the fourth global wave of manufacturing relocation.

This transformation coincided with China's transition from a planned economy to a market economy, wherein a shortage-based system gradually evolved into a pervasive state of excess supply. Fundamentally, this reflects a structural imbalance on the supply side. Overcapacity has shown a progressive shift from downstream consumer goods to midstream and even high-end sectors. Currently, excess capacity is primarily concentrated in the midstream industries, where capacity utilization remains low. Enterprises are burdened with high inventories and declining profits, and in some cases, large-scale bankruptcies have occurred. This has led to distortions in the real economy and diminished the efficiency of fixed capital investment, posing a major bottleneck to sustained economic growth. While moderate overcapacity may stimulate technological progress, severe overcapacity tends to trigger vicious competition, waste of resources, product quality deterioration, and even economic crises. China's long-standing reliance on low-cost, extensive growth models has resulted in the accumulation of inefficient capacity and environmental degradation, severely constraining sustainable development.

At the same time, there exists a “double gap” and structural mismatch in public service supply and demand. Fiscal expenditures are insufficient to meet the growing need for high-quality public goods and services. As the economy advances and household incomes rise, consumption patterns in both urban and rural areas have shifted from survival-oriented to enjoyment-oriented structures. There is increasing demand for diversified service-oriented consumption—such as healthcare, education, and cultural services—yet the supply structure has not kept pace. This has led to an oversupply of low-end goods and a shortage of high-end products, many of which depend on imports, resulting in significant outbound consumption.

Moreover, rural-urban disparities have further exacerbated structural contradictions. In the process of urbanization, the transformation of migrant workers into urban residents has generated new demands for housing, transportation, and public services, but urban supply capacity has not fully adjusted to these needs. In rural markets, low-priced and low-quality products still dominate, falling short of rising consumer expectations. For instance, there remains a significant unmet demand for high-quality, efficient small-scale agricultural machinery, highlighting the persistent structural supply-demand imbalances in rural areas. Overall, in the face of upgraded consumer demand, both the manufacturing and service sectors must continue to optimize their supply structures to enhance the quality of effective supply and meet the developmental requirements of this new stage.

1.2 Theoretical Foundations Differ

1.2.1 Western Supply-Side Reform Is Grounded in Supply-Side Economics

Supply-side economics posits that supply determines demand and is the key driver of economic growth. According to this theory, economic expansion relies on entrepreneurs continually innovating and expanding production to provide marketable goods that stimulate consumer demand. Unlike Keynesian economics, which advocates government-led demand stimulation, supply-side economists emphasize that market demand originates from production. They oppose speculative activities and argue that supply should guide the market to avoid overproduction caused by diminishing marginal utility. In the political realm, they likewise assert that "supply determines demand," wherein elected officials propose political agendas and the electorate passively accepts them. Supply-side economists argue that economic crises caused by overproduction result not from insufficient demand but from a lack of high-quality, innovative supply. Therefore, the solution lies in fostering entrepreneurship to generate new supply continuously, thus sustaining economic growth.

The core theoretical pillar of supply-side economics is the Laffer Curve, which illustrates a nonlinear relationship between tax rates and government revenue. It suggests that beyond a certain threshold, increasing tax rates reduces overall tax revenue. At both extremes—0% and 100% tax rates—government revenue would be zero. This model underpins the supply-side policy of tax reduction, proposing that lowering tax rates can stimulate labor and investment incentives, thereby increasing production and supply, and ultimately, tax revenues. The Laffer Curve thus provides a theoretical foundation for the policy of "tax cuts leading to increased revenues" by encouraging productivity growth through enhanced economic activity.

1.2.2 China's Supply-Side Structural Reform Is Guided by Marxism and Rooted in National Conditions

Chinese scholars have explored supply-side structural reform through the lens of Marxist political economy. Some argue that Marxism should serve as the guiding ideology of such reforms in China to prevent neoliberal interpretations from distorting the policy framework (Qiu Haiping, 2023). Others highlight the differences and similarities between China's supply-side reform and Western supply-side economics, emphasizing the necessity of grounding Chinese reforms in Marxist theory (Liu Fengyi & Qu Jiabao, 2022).

Building on his critique of classical supply and demand theory, Marx established a scientific framework of supply and demand. He viewed supply as the total output provided by producers and sellers, while demand consisted of consumption backed by purchasing power—including both productive and personal consumption. In the process of social reproduction, production plays a dominant role but is also influenced by consumption. Thus, supply and demand are both contradictory and interdependent, jointly driving economic development. Marx asserted that supply-demand equilibrium is inherently dynamic and rarely achieved in practice, existing only as a long-run average. Market competition causes prices to fluctuate around value, functioning as a mechanism for supply-demand adjustment. Achieving balance requires not only quantitative equilibrium but also structural coordination, fostering a virtuous cycle between structural optimization and aggregate growth.

Furthermore, Marx contended that the root of overproduction crises lies not in the superficial imbalance of supply and demand, but in the class contradictions and systemic flaws of capitalism. The logic of capital accumulation inevitably results in generalized overcapacity and periodic economic crises. He advocated for a socialist system realized through proletarian revolution to alleviate these structural imbalances. In this context, Marxist political economy highlights the need for state intervention in resource allocation, rather than relying solely on market mechanisms.

In alignment with these principles, China adopts a socialist market economy in which public ownership remains the core, and macro-level government regulation complements market dynamics. Through the interplay of the "visible hand" of the government and the "invisible hand" of the market, China aims to enhance the alignment between supply and demand and maintain stable economic performance.

1.3 Divergent Reform Measures

1.3.1 Primary Measures of Supply-Side Reforms in Major Western Economies

In the late 1980s and early 1990s, numerous Western capitalist countries experienced weakened demand stimuli and insufficient growth momentum. Confronted with severe stagflation, nations such as the United Kingdom, the United States, Germany, and Japan adopted supply-side structural reforms to overcome economic challenges.

During the 1970s and 1980s, the United States grappled with significant stagflation, with inflation peaking at 13.5% in 1980 and GDP growth at -0.3%. Upon assuming office in 1981, President Reagan implemented the "Economic Recovery Plan," grounded in supply-side economics, commonly referred to as "Reaganomics." Key measures included: Substantial tax reductions, lowering personal and corporate income taxes to stimulate investment and production; Curtailment of fiscal expenditures, particularly in social welfare, to control deficits;Deregulation, reducing governmental constraints on enterprises;Implementation of tight monetary policies to strictly control money supply growth.These measures facilitated economic recovery, with GDP growth reaching 6.9% in 1984, inflation dropping below 5%, unemployment decreasing to 7.1%, and the U.S. share of global GDP rising from 23% in 1980 to 25.2% in 1986.

Simultaneously, the United Kingdom faced economic stagnation due to stagflation, with inflation reaching 21.9% in 1980. Prime Minister Margaret Thatcher initiated reforms centered on privatization, including:Advancing privatization of state-owned enterprises across sectors like energy, telecommunications, and water supply to enhance efficiency; Controlling money supply through a medium-term financial strategy to curb inflation;Reducing welfare expenditures and limiting trade union powers to invigorate market dynamics. Despite initial challenges, these reforms successfully controlled inflation and revitalized the private sector, culminating in the "Thatcher economic miracle."

In the early 1980s, Germany confronted crises including expanding fiscal deficits, rising labor costs, industrial relocation, a 12% unemployment rate, overcapacity, and declining export competitiveness, with GDP growth plummeting to -1% in 1993. The German government, focusing on supply-side reforms, implemented measures such as:Optimizing industrial structure, promoting privatization of state-owned enterprises, reducing inefficient capacity, and supporting emerging industries and technological innovation;Enhancing human capital investment, implementing a dual vocational education system, relaxing dismissal restrictions, and reducing welfare to incentivize employment;Alleviating corporate tax burdens, reforming the tax system, increasing depreciation rates, and establishing innovation funds; Executing prudent monetary policies to maintain inflation below 2%.These reforms led to gradual economic recovery beginning in 1994.

1.3.2 Primary Measures of China's Supply-Side Structural Reform

China's supply-side structural reform centers on enhancing supply quality to meet diverse demands, promoting technological innovation, talent acquisition, and digital development. By optimizing supply structures and reallocating factors to emerging industries, the reform aims to cultivate new growth drivers, achieve higher outputs with optimized inputs, strengthen consumption's role in economic growth, and foster coordinated industrial development and efficient resource utilization.

Since 2015, the "Three Eliminations, One Reduction, and One Supplement" strategy has been established as the reform's focal tasks: Deleveraging: Aiming to reduce macro-level debt ratios and mitigate financial risks, necessitating coordinated fiscal and structural leveraging measures to ensure supply system security.Reducing Overcapacity: Focusing on phasing out obsolete capacities and optimizing industrial structures, revitalizing struggling enterprises through innovation, avoiding indiscriminate measures and market panic, and reinforcing government supervision alongside market mechanisms.Reducing Inventory: Primarily targeting the real estate market, implementing city-specific policies—expanding supply in first-tier cities and developing public rental housing in third- and fourth-tier cities—to effectively utilize existing stock and curb real estate bubbles.

Reducing Costs: Aiming to alleviate corporate burdens by lowering taxes and operational costs, reforming institutional processes, enhancing administrative efficiency, and stimulating market vitality. Addressing Weaknesses: Focusing on supply bottlenecks, tailoring efforts to regional and industrial specifics, including promoting technological innovation, improving product quality, refining innovation systems and business models, guiding consumption, strengthening governance systems and corporate culture, aligning supply of technological and application-oriented talents, and enhancing market regulation and credit systems to encourage healthy competition in quality and service, thereby advancing high-quality development.

2 Recommendations for Deepening China's Supply-Side Structural Reform

The theoretical insights and practical measures of Western supply-side economics offer valuable reference points for addressing challenges currently faced by China's economic development. Several key areas are particularly noteworthy:

2.1 Emphasizing the Guiding Role of Marx's Theory of Demand

Marx's supply and demand theoretical framework is characterized by its internal logical coherence and scientific rigor. Grounded in the realities of capitalist economies, and based on the dual nature of commodities and the labor theory of value, Marx employed historical materialism and dialectical methodology to systematically analyze the dynamics of supply-demand equilibrium within the process of social reproduction. He revealed the intrinsic tendency of large-scale production to generate overproduction and economic crises, and proposed the planned allocation of social labor time as a solution. This theoretical system provides a solid foundation for analyzing the supply-demand relationship in a socialist market economy. It is not only capable of explaining contemporary economic contradictions but also serves as a theoretical guide for implementing supply-side reforms and improving macroeconomic regulation.

2.2 Enhancing the Decisive Role of the Market in Resource Allocation

At the core of supply-side structural reform lies the necessity of correctly balancing the roles of government and market. The market should be allowed to play a decisive role in resource allocation, while the government should more effectively fulfill its functions. Specifically, the government ought to act as a rule-maker, guardian of fair competition, and enabler of market vitality, rather than directly participating in competitive market activities. Empirical evidence suggests that excessive intervention and fiscal subsidies can exacerbate structural imbalances and overcapacity. In contrast, indirect measures such as tax policy adjustments and investment in human capital can help enterprises reduce costs and improve efficiency, thereby strengthening their supply capacity. In this reform process, enterprises and entrepreneurs should occupy a central position. The government, for its part, should advance administrative streamlining, reduce intervention, and foster a fair, open, and competitive market environment to stimulate entrepreneurial spirit and innovation.

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