

Policy Advice on China's Reform of the Supply Front

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On November 10th, 2015, President Xi Jinping stressed on the conference of the central leading group of financial and economic development that we should strengthen the reform of the supply front at the meantime of expanding aggregate demand. And Premiere Li Keqiang stressed once again on November 17th when presiding over the conference on which the 13th five-year plan was drawn out those efforts should be paid to both the supply and demand sides to promote the development of industries to a middle or even high level.

I. The Importance of Boosting Reform of the Supply Front

1. Resolve unmatched supply and demand to promote economic growth

Since the reform and opening up to the outside world, China has witnessed rapid economic growth in quite a long period of time. Resident incomes have increased by years, enabling China to join the group of middle countries, and the population proportion of middle class has also kept an annual growth, meaning that requirements on consumption level have been gradually enhanced. Actually, the advancement of consumption level means not only higher requirements on the quantity of consumption but also higher demands over its quality. But over a long term China has achieved its economic growth in an extensive way, paying more attention to the output value yet ignoring the advancement of the quality of products, and finally causing the disparity between the supply of social products and the residents' consumption demand. And this kind of disparity is mostly reflected in the quality of products. Domestic citizens have strong consumption demands which domestic enterprises cannot satisfy especially in the aspects of quality and variation, thus causing the mismatch of the supply and demand of products which displays as excess supply of low-end products and short supply of high-level ones. Therefore, promoting reforms of the supply front and reducing the disparity between supply and demand could further boost the economic growth of China.

2. Enhance the engineering level of enterprises and promote industrial upgrade

Though nowadays the proportion of China's service industry has exceeded

Maintaining healthy and stable growth in the "new normal" environment is a key issue confronting the economic development of China. Under such circumstances, the central economic decision-making institutions put forward new ideas of carrying out "Structural Reforms of the supply front" when exercising macroeconomic control, and thus reform of the supply front has become a hot issue in China's economic reform.

that of manufacturing industry, the latter one remains a major reflection of the core competitiveness of a country. Ensuring the idea of powerful manufacturing country and relevant policy orientation, transferring the extensive growth of manufacturing industry to advancement based on fine production, increasing the proportion of added value of products and moving toward the high-end of industry chain are the key points when carrying out reforms of the supply front. For quite a long term, insufficient research input and low innovation level of enterprises in China have always been synthesis results of various elements. It will not work if we try to change the equilibrium situation and enhance the innovation capacity of enterprises through carrying out reforms in one or several aspects. Thus the reform of the supply front is really a systematic project which involves various enterprises, government, citizens and some other various elements.

II. Policy Advice on the Reform of the Supply Front

1. Carry out the policy of uneven tax break and lead resources to efficient enterprises

Studies show that the macro tax burden of our country has been near to that of high-income countries since 2009. And in 2014 the proportion of the macro tax burden calculated in a comprehensive way has reached 37%. Under the circumstances where the speed of economic growth has decreased, tax reduction would help reduce the operating cost of enterprises and increase their return of investment. However, in order to better promote reforms of the supply front, the government should not reduce tax in a universal way. Tax system must serve to lead resources flow to efficient enterprises. First, reduce taxes when it is an innovation-oriented investment. As to encouraging independent innovation and technical progress of enterprises, the reduction of marginal tax rate could decrease the research input cost and thus encourage enterprises to invest more to enhance their innovation capacity. Second, reduce taxes when the enterprises are small and macro ones. Small and macro businesses have incomparable advantages over other kinds of enterprises in the aspect of increasing employment. Nowadays small and macro businesses with less than 300 thousand RMB in sales enjoy the privilege of tax reduction for 20% in China. This measure has reduced the survival pressure of small and micro businesses, yet there are still more space for our country to relax the restrictions and enable more businesses of this kind to enjoy the privilege. Although increasing the threshold of taxation may cause the decrease of fiscal revenue in a short term, this measure will finally benefit the growth of small and micro businesses and serve to cultivate the tax base in a long period of time.

2. Reduce government expenditure and create a system under which the central and local governments share financial risks.

The economic growth of the U.S. during the period when Reagan took power was an typical successful case of following the “Supply-front Economics” . Measures taken in that period mainly includes the reduction of tax rate, government intervention, and government expenditure. The decrease of individual income tax rate enabled the increase of disposable income and labor supply. And the decrease of corporate income tax enabled the increase of the return on investment of enterprises and boosts their investment inclination. Tax reduction would result in the decrease of fiscal revenue, which requires the government to cut government expenditure and thus reduce its financial risk. Nowadays, the local governments of China are faced with large financing gap and high financial risks which may get more severe when the policy of tax reduction is carried out. Under such circumstances, the Central government should share the risks with local governments to avoid their bankruptcy and keep the society sound and stable.

3. Weed out zombie companies and laggard enterprises with surplus productivity, and give support to small and micro businesses as well as service industry.

Zombie companies and laggard enterprises with surplus productivity occupy plenty of resources for production yet hardly carry out efficient production. Actually, the greatest resistance of changing the situation is that local governments refuse to let these enterprises go bankrupt because of the production value and jobs they could create in a short term. Under such circumstances, the Central government need to transfer its standards of evaluating local governments, changing the GDP-oriented evaluation mode of the old days. But weeding out zombie companies and releasing surplus productivity may be accompanied by layoff of employees. Thus the governments should increase employment through supporting small and micro businesses and developing service industry. Small and micro businesses and service industry are the main force in absorbing labor forces. According to the data from the Statistical Bureau, over 1 million jobs will be created with each 1% economic growth in the service industry, a ratio twice of that in the manufacturing industry. Therefore, small and micro industries as well as service industry will become the “job container” in the future. Thus the government should carry out reforms of the household registration system and accelerate urbanization, providing a channel for labors to flow freely among different districts. Serving as a major production input factor, labor force should really be given top priority when carrying out reforms. The implement of reforms