

CHINA'S NEW EMPHASIS ON SUPPLY-SIDE REFORMS

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EAI Background Brief No. 1163

Executive Summary

1. The so-called supply-side structural reforms has become a new catchphrase in China since late 2015, with its first official appearance in November 2015 and its significance reiterated numerous times.
2. While the shift from credit-driven stimulus towards structural reforms is evident, it remains unclear what these reforms entail. The government seems to place its hope on formulating policies that can address both short-term problems such as production overcapacity and long-term issues like cultivating growth engines for sustainable development.
3. The shift towards supply-side reforms is sensible. China's policy priorities have been on the demand side in recent years, especially since late 2008. A large stimulus package was announced to provide fiscal and financial support for investment and consumption.
4. The stimulus, an effective tool that had supported China's growth for the last few years, resulted in several undesired consequences, such as production overcapacity in certain industries, rising overall debt, declining returns on investment and worsening local government finances. It also distracted efforts for economic restructuring and enfeebled China's long-term growth prospect.
5. As growth has started to decelerate since 2012 and the various stimulating tools became ineffective, the Xi leadership began to recognise that the economy is in a difficult and critical stage and a policy reorientation is needed.
6. Although the government has sensibly identified the limitations of the past policies and stressed the importance of structural reforms, formulating coherent and effective policies remains tricky.
7. Conceptually, supply-side reforms emphasise market-based reforms to enhance efficiency in the use of production factors, technological capability and long-term

development prospect. In practice, different people may emphasise on different aspects of the reforms, including promoting innovation, taxation reforms, reform of state-owned enterprise (SOEs) and administrative streamlining.

8. The government identified several major tasks, with some falling clearly in the realm of supply-side reforms, including reducing production overcapacity and lowering corporate cost. Its emphasis on administrative streamlining and boosting the country's innovative capabilities is also for this end.
9. The outcome of this new round of reforms remains to be seen. Unlike the government-led, investment-driven demand-side stimulus, supply-side policies aim to incentivise desired economic activities through the market. Policy formulation is more difficult and the result takes time to materialise. Thus the reforms could be sidetracked by short-term worries over growth and social stability.
10. Supply-side reforms call for changes in areas beyond economics. There is growing emphasis on the consolidation of party leadership with the market playing second fiddle. The latest SOE reform plan seems to place Party authority over board of directors in SOEs' governance. Such moves cast serious doubts on the leadership's commitment to further reforms.