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Evaluation and Implications of China's Supply-side Structural Reform

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I. Introduction

Starting from 2012, the Chinese economy has slowed down to enter the era of "New Normal," where medium-paced growth has become the new norm. This means that the Chinese economy has reached the limits of its quantitative growth driven by investment and exports over the last 30 years, and now needs to transition toward a new growth model. In response, the Chinese government has proposed "Supply-side Structural Reform" (SSSR) as a new economic development strategy in the era of New Normal.

SSSR signifies a shift away from demand-side quantitative growth toward supply-side qualitative development by upgrading the economy and industry. It means to transform into an innovative economic growth method by raising total factor productivity (TFP) through improvements in the technology level, forsaking the previous economic growth method dependent on large-scale input of labor and capital which the Chinese economy has engaged in for 30 years since its reform and opening. The Chinese government plans to overcome the so-called middle income trap through supply-side reforms and lay the foundations for China to rise as a superpower by 2050. SSSR was proposed by Chinese President Xi JinPing in November 2015 and the year of 2019 is the fourth year of its implementation. In order to predict whether the Chinese economy is being transformed into a sustainable development model and what impact it will have on Korea, it is necessary to review and evaluate the progress of China's SSSR at this time.

II. Short-term Response to Solve Overcapacity and Financial Risk of State-owned Enterprises

China's supply side structural reforms are divided into the four major areas of cutting industrial overcapacity, deleveraging corporate debts, lowering corporate costs, and promoting new growth engines. The former two are short-term issues related to the restructuring of the state-owned sector, while the latter two are mid- to long-term issues related to the development of private enterprises.

The Chinese government is taking strong steps to solve the problem of overcapacity, which the

Chinese government has put forward as a top priority. The Chinese government has been implementing various overcapacity-related policies since 2009, but these failed to have any significant effect. Various SSSR measures were proposed coming into 2016, leading to intense restructuring by the central government and rapid recovery of excess capacity in the steel and coal industries, also elevating the profitability of companies rapidly. During this process of relieving overcapacity, the Chinese government encouraged the reduction of facilities through the integration and consolidation of large state-owned enterprises. A typical case for reducing overcapacity by the Chinese government can be seen with the merger of Baoshan Steel and Wuhan Steel. The merger of the two large state-owned enterprises was effective in reducing the excessive competition caused by overcapacity by restructuring and lowering production to a reasonable level. The decrease in production led to higher steel prices and improved corporate profits. At the same time, the measure has expanded and promoted investment in steel technology and the platform to improve the Chinese steel industry.

Another short-term issue that needs to be solved through China's SSSR is the reduction of corporate debt, which is considered a major risk for the Chinese economy. According to BIS data, China's corporate debt has increased at a rapid pace since 2008. An analysis of Chinese corporate debt by company ownership, industry, and time period, shows that China's corporate debt is highly focused in state-owned enterprises, real estate and infrastructure, and long-term bonds. The Chinese government has implemented various deleveraging and financial risk management policies to reduce corporate debt, but the measures taken to reduce corporate debt in 2016 - 17 instead had a negative effect on the financing of private companies rather than reducing debt at state-owned enterprises.

Since 2018, the Chinese government has begun to implement "a structural corporate deleveraging policy" which emphasizes the reduction of state-owned enterprise debt to minimize the adverse effects of deleveraging. Upon analysis of data on China's credit gap, credit strength and ICR, it seems unlikely that China's corporate debt will develop into a financial risk. The rate of change will be controlled and corporate debt will remain within a level manageable by the Chinese government, and thus the possibility of a financial crisis occurring or spreading to the real economy is low.

III. Mid-to-long Term Response to Development of the Private Economy and New Growth Engines

From a mid- to long-term perspective, the biggest problem of the Chinese economy lies in the long period of time required to develop private enterprises with technological competitiveness. To solve these problems, the Chinese government is implementing policies to encourage the private economy and create new economic growth engines as part of SSSR.

First, large-scale tax cuts are being implemented to reduce production costs and enhance corporate vitality in the market economy. The status of China's corporate cost structure was analyzed by classifying costs into financing cost, labor cost, tax, energy and raw material cost, logistics cost, environmental cost, land cost, real estate admission cost and institutional transaction cost. China's corporate costs are increasing in general terms, with labor costs, social insurance costs, and funding costs posing a heavy burden on companies. In addition, as the Chinese government pursues more eco-friendly policies, the environmental protection agenda is likely to become a new burden. In order to reduce the cost burden of these companies, the Chinese government is implementing various tax cuts, and the most representative policy is the transition of business tax to value-added tax (VAT). The VAT transition measures relieve much of the burden on private companies engaged in service sectors such as construction, real estate, logistics, finance, and life services. In addition, the Chinese government is also supporting new strategic industries through various tax cuts and the streamlining of administrative procedures. While the transition toward VAT was successful in the development of the service industry, there were also evaluations that the simplification of administrative procedures and the reduction of the social insurance payment rate did not have a great effect. China has carried out large-scale tax cuts since the US-China trade disputes of 2018, and it is expected that more policy support will be implemented in order to promote industrial competitiveness and create new growth engines in preparation for the 4th industrial revolution era.

Lastly, the ultimate goal and mid- to long-term goal of SSSR is the creation of new growth engines. Innovation-related data such as the global innovation index, global manufacturing competitiveness index, R & D investment amount, and patent application data show that China's industrial and innovation competitiveness is rapidly improving. Policies related to the creation of new growth engines, such as China's Made in China 2025 and Internet Plus agenda, and its innovative start-up ecosystem policy, have been refined and pursued since before SSSR measures were proposed. Currently, the Chinese government's policies to foster various future industries are being pursued under the framework of SSSR. With the implementation of the various industrial policies of the Chinese government, private enterprises in China are developing rapidly, and in some new industries, leading and innovative companies are emerging such as BYD, an electric vehicle manufacturer, Baidu, which is developing its own autonomous vehicle platform “Apollo,” and DJI, a drone manufacturer, as the new engines of China’s economy.

IV. Evaluation and Implications of SSSR

China's SSSR is a creative development strategy that reflects the uniqueness of the Chinese economy, one which is difficult to find in conventional economic theory or macroeconomic policy as a development strategy for sustained and stable growth. This form of government-led total supply management is based on China's special economic conditions and aims to reconcile the contradictions within the Chinese socialist market economy. During the first four years of supply-side structural reform, the Chinese government has pursued excessive overcapacity and deleveraging, and this has resulted in many achievements. In particular, the excess profitability in the steel and coal industries has been eliminated, leading to higher profitability for companies which is now being expanded to other fields such as shipbuilding and automobiles. Deleveraging was successful in stabilizing the total amount of corporate debt, but the deleveraging process also had the side effect of triggering a funding squeeze in the private economy. While the policies of cutting taxes and nurturing new industries are showing some achievements, it is yet too early to properly assess the effect of these policies and they will have to be viewed from a longer-term perspective. However, the key to the success or failure of SSSR measures will be to minimize resistance on the part of local governments and state-owned enterprises and gain their cooperation in the process. In addition, there is a possibility that the speed and intensity of China's SSSR may be short-term adjusted depending on how the US-China trade conflict develops.

The policy implications of SSSR on the Korean economy are as follows. First, in order for the Korean economy to take another step beyond its current contradictions at this stage, it will need to balance aggregate demand and aggregate supply. Second, efforts should be made to balance the role played by the government and the market in a harmonious manner throughout the restructuring process and strengthening of competitiveness in overcapacity industries. Finally, in order to prepare for the 4th industrial revolution era, it will be necessary for the government to boldly push forward policies and present its vision through selection and concentration in creating new growth engines.