

## **Chapter 2**

# **Generation and Development of the Structural Reform on the Supply Side in the Global Perspective**

In the 1970s, the global environment changed and economic structural troubles brought major economies problems such as the economic stagnation, inflation, financial burden, budget imbalance, low productive efficiency, slow structural adjustment etc., which the Keynesian demand management could no longer handle. Since the late 1970s, with new leaders such as Thatcher, Reagan and Cole, those major economies had started their structural reforms on the supply side, confining the attention to the market and free competition. Economic growth became the primary goal and there were new relationships between the government and the market, the government and the enterprises, the government and the people, capital and labor, and unity and structure as well.

## **2.1 Historical Background of the Structural Reform on the Supply Side in Major Economies**

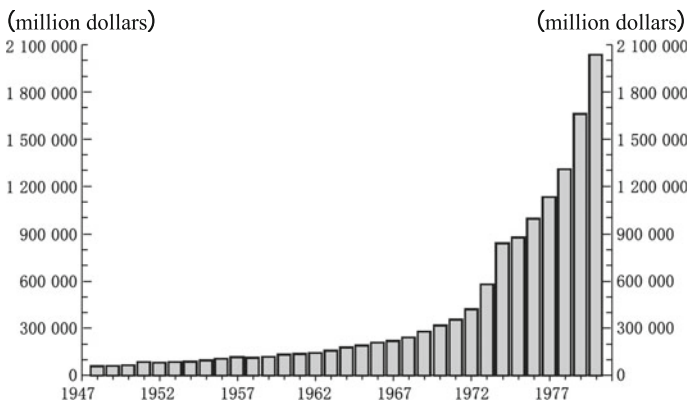
Since the 1970s, the economic globalization and the new technological revolution had been the powerful impetus for frequent and convenient communication, trade, capital exchange and technology transfer among major economies. The structure of supply and demand was globalized. Global economy surpassed the borders, with factors of production allocated freely across the globe. Economy was gradually interconnected and unified among a majority of countries and regions. Technological innovation caused the shifts among major economies in terms of competitive advantage rotary, the expansion of market economic system and the surge in the quantity of multinational companies. All these greatly influenced the adjustment of the worldwide supply and demand.

### 2.1.1 The Relationship of the Supply and Demand Broken by Globalization

Since the 1970s, economy had gradually been globalized. The closed supply and demand structure within a country had been broken and it was the new characteristic of the world economy that all countries depended on each other and developed together.

#### 2.1.1.1 The Fierce International Competition Breaks Internal Structure of the Economy

The implementation of Marshall Plan after the Second World War brought about the US assistance to EU and Japan in the rebuilding of basic industries. By the 1970s, Western Europe and Japan had already become competitive economic opponents to the US. By the end of the 1970s, EU had surpassed the US in economy, and Japan had become the second economic giant among capitalist countries. The rise of the Western Europe and Japan stimulated the world trade. Statistics show that from 1964 to 2005, the export volume of international trade annually increased by 11.2%, while the average annual growth rate of the world GDP in the period was only 3.6%. The rapid growth of the global trade brought a large number of cheap goods to the US. And the steel and automobile industries in Western Europe and Japan became a real threat to the US manufacturing industry. The demand for domestic manufacturing products was gradually shrinking in the US, causing a decrease in production enthusiasm among enterprises. Since 1976, import had exceeded export in the US and the gap has kept widening, reaching \$148.4 billion in 1985. By the end of the 1980s, US share of steel output in the world had fallen to more or less 10% (Fig. 2.1).



**Fig. 2.1** Global exports from 1948 to 1980 (million dollars). *Source* Wind Info

### **2.1.1.2 Globalization Disturbs Macro Control Policies**

Economic globalization synchronized the economic cycles of major economies. The domestic fiscal policies, monetary and other macroeconomic control policies were thus often seriously affected by other economies. Since the 1970s, trade and finance had been of top priority in global economy, and a multilateral trading system with free trade had been gradually formed. The monetary and capital markets in the world were interconnected through modern means of communication. There appeared growing number of financial services across borders in internationalized financial markets. All these added uncontrollable factors to one single economy, making it harder for domestic control policies to work when facing shocks from abroad.

### **2.1.1.3 The Impact of Price Fluctuation on Supply**

After the World War II, oil had replaced coal as the main energy source in the world. From 1950 to 1975, the proportion of oil and natural gas consumption in the world increased from 37.5 to 64.5%. Major economies imported a large amount of oil, which to a large extent promoted the economic development. The demand for oil in developed countries grew at an average annual rate of 7.1%, which was much faster than the average annual growth rate of industrial production and GDP. In 1973, OPEC carried out the “war for oil”, raising the price of oil from \$1.71 per barrel (1950) to \$5.11 (1973). The price reached \$34 in October, 1981. The rise of oil price triggered a global supply shock by pushing up the price and reducing the consumers’ demand, forcing major economies to adjust the internal economic structures. In Japan, for example, the oil crisis had a serious impact on a large number of energy consuming industries such as iron and steel, aluminum, petrochemical etc. These industries went into structural depression due to the over-dependence on oil import.

## ***2.1.2 Advantages Brought by Technological Innovation in Competitions***

Since the mid-19th century, enormous revolution in technology had taken place. The application of new technology had boosted the production and reduced the cost. Economies with advanced technology became powerful rivals for others.

### **2.1.2.1 Changes Brought by Technological Innovation on the Competition Structure**

In the 1970s, technological innovation played a primary role in international competition. Innovation often took place in one economy and was then introduced to others, which resulted in huge technological gaps among different countries.

There appeared forerunners in various fields in the global competition. For instance, during the period from the 1950s to the 1960s, Japan made great efforts to introduce and implement advanced science and technology from the U.S. By the 1970s, the competitiveness of iron, steel and auto industries in Japan had indeed been a real pressure on the U.S. But in 1980, the U.S. exerted close control over technology transfer and information drain, leading to a sharp conversion in its competition with Japan and the Federal Republic of Germany. Due to its neglect of basic research and the lack of technical reserve, Japan encountered huge obstacles in its subsequent development and thus became less competitive with the United States. In 1980, Japan implemented a new development strategy by encouraging basic research and innovation to improve its science and technology.

### **2.1.2.2 Domestic Development Promoted by Technological Innovation**

Since the 1970s, the industrial structure had been transformed due to the use of a wide range of innovative products such as computers, automation, jet engines, synthetic polymer materials, atomic power generation, ultra large scale integrated circuits, man-made satellites and so on. A series of new industries have emerged while the traditional ones are forced to change their industrial structures so as to transform from the labor-intensive type to the knowledge-and-technology-intensive one. Meanwhile, the transformation of industrial structures of major economies has further promoted the technological innovation. In 1982, the separation of AT&T was the starting point of the information revolution in the 1980s. Competition had since heated up in the telecommunications industry. In the U.S., for instance, the emerging network and mobile phone industries had recovered its economy.

### **2.1.2.3 International Industries and Resources Restructured by Technological Innovation**

The invention, application and popularization of new technologies had reduced the cost and expanded the scope in terms of transaction. Take the computer as an example. With interconnected information terminals and the global network of communication and information, small, personalized computers had become increasingly popular, directly changing the mode of production and resource organization. These technologies were utilized multinationally to arrange production, operation and sales as well as to distribute surplus worldwide. Additionally, technological innovation had reduced the time for commodity circulation and the economic cycle. Major economies gradually followed the same economic cycle through business activities among transnational corporations, multinational banks and other institutions.

#### **2.1.2.4 Opportunities for Capital Accumulation Created by Technological Innovation**

Investment is essential for economic development while the accumulation of capital is the basis for investment. The accumulation of capital through the reduction of wage and the extension of working hours could no longer be accepted after the World War II. Major economies in the world were gradually relying on technological innovation, which helped to improve productivity and multiplies the surplus value so that the capital could be accumulated. After the war, the surplus value in Japan and the Federal Republic of Germany went up thanks to the rapidly rising productivity. From 1955 to 1970, the surplus value rate of Japanese manufacturing increased from 314 to 443%, leading to a huge amount of capital accumulation. From 1964 to 1973, the proportion of capital accumulation to gross national product in Japan and the Federal Republic of Germany were 38.4 and 27% respectively.

#### **2.1.3 *The Extension of Market Economy as the Foundation for the Global System of Supply and Demand***

The extension of the market system is the essential foundation of economic globalization. Various kinds of modern systems such as the property system, contract system, monetary system, trade system, competition system etc. were extended with the globalization of production and circulation. The rules of the market became the rules of the global market.

##### **2.1.3.1 The Market Economy System Expanded by Two Parallel Global Markets**

In the 20th century, the world was divided into two: capitalism and socialism. The confrontation between the two worlds involved the confrontation of economy. In the late 1970s, China implemented the policy of the reform and opening-up and pursued the socialist market economy. In the early 1980s, Latin America suffered a debt crisis and was forced to take a free structural reform. In the 1990s, with the economic transition of former Soviet Union and socialist countries in Eastern Europe, the former two parallel markets gradually disappeared and a kind of economy oriented by the market became the first choice among a majority of countries in the world. The market economy had thus become the basis for global economy. And economic systems and rules in different countries were becoming consistent, gradually forming a unified economic and trading system without any barriers for cross-border transactions.

### **2.1.3.2 Establishment of Rules for Global Market Transaction**

Under the leadership of the international economic organizations, international rules and regulations regarding monetary, financial, trade, investment and other aspects have been gradually established. Take the financial sector as a typical example. In 1988, the Basel Accords were issued by the committee on banking supervision of the Bank for International Settlements. The accords have played a positive role in regulating multinational banks, forming basic international rules and supervision standards in the field of finance. On the other hand, the settings, investment and strategies of multinational companies and regulations of global financial market are scarcely decided by one economy. The original adjustment and management within a single economy has to conform to the rules set by international organizations. In other words, the individual economy has lost its power in the global market.

### **2.1.3.3 The Establishment of Supranational Organizations and Their Roles**

Since the 1970s, the influence of a series of supranational organizations of politics and economy has been exercised and expanded. These organizations include IMF, the World Bank, GATT, G7, OECD, EC and beyond. There are often contradictions regarding the concept of sovereignty in supranational organizations and traditional countries. The global capital flow is in need of a breakthrough in territory and sovereignty. Once the requirements of territory and sovereignty clash with those of global capital flow, supranational organizations will subordinate sovereignty to capital expansion. The growing impact of those organizations, especially on the politics and economy within a country, even surpasses boundaries between the sovereign states.

### **2.1.4 *Multinational Corporations as the Leading Force in the Adjustment of Aggregate Supply and Demand***

Multinational corporations, as the major carrier of global trade and investment, have directly influenced aggregate supply and demand in the world since the 1970s.

#### **2.1.4.1 Capital Flow Propelled**

In the 1970s, major economies in the world encouraged running companies in multiple countries. The number of multinational corporations has markedly increased ever since. In 1976, according to the statistics from the U.N., multinational companies with sales over \$1 billion numbered 422, more than half of which were America-based. The total number of multinational corporations increased from

about 11,000 in 1980 to 45,000 in 1997. The amount and stock of direct international investment have been increased to a large extent. According to the world investment report issued by UNCTAD in 2006, the global foreign direct investment reached \$59 billion in 1982, and the investment stock was \$600 billion and the total number of employees in the world reached 19 million. During the decade from 1986 to 1995, the foreign investment in the world maintained an average annual growth rate of 20%. During the latter 5 years in the 1990s, the growth rate reached 40%, far higher than the growth rate of GDP in the same period. At the same time, the foreign investment stock also grew at double-digit rates.

#### **2.1.4.2 The Development of Corporations Promoted by Incorporation in Terms of Scale and Competitiveness**

In the 1970s, the cooperation and even transnational merger and acquisitions of renowned multinational corporations became more and more popular. Most of the single M&A amount was over 1 billion dollars. Till 1990, the total M&A amount in the world had reached 160 billion dollars, which was about 7.8 times that in 1980 (18.3 billion). Incorporation can be both intra-industrial and inter-industrial. For instance, the inter-industrial Disney and ABC, the intra-industrial Daimler AG and Chrysler. Those strategic allies, take the Boeing and McDonnell-Douglas as examples, help the companies avoid fierce competition within the field and advance together.

#### **2.1.4.3 Multinational Corporations as the Main Forces in Global Economy**

Since the 1970s, multinational corporations have begun allocating resources globally in order to minimize the cost of transaction and to adapt to the complex market, the diverse products and different preference in various regions. This is a change in the way of production, research and development within a single country. Investment, raw material purchasing, organization, production, business activities etc. are all globally distributed, forming a network to which every country belongs. In this situation, multinational corporations serve the main role of regulating and controlling the aggregate supply and demand in the world.

### **2.2 Development Dilemma of the Structural Reform on the Supply Side in Major Economies**

After the World War II, there was a long period of economic growth in major economies which pursued the Keynesian theory of demand management. But with the oil crisis starting in the 1970s, major economies began to suffer economic

stagnation and inflation. There were no more methods to promote economic growth. Problems of economy, society and other aspects began to emerge.

### ***2.2.1 The Coexistence of Economic Stagnation and Inflation***

Before the 1970s, short-term stimulation policies instead of macroeconomic ones were applied in the Keynesian demand management to eliminate the economic fluctuation. That resulted in a negative circulation in which the economy grew and stopped. The major economies had a kind of ‘stagflation crisis’ with economic stagnation, inflation and unemployment.

#### **2.2.1.1 Slow and Negative Economic Growth**

Economic growth gradually declined and even became negative. During the period from the 1970s to 1980s, the U.S. economy suffered “stagflation”. Despite its adjustment policies, measures for income distribution and the government’s macro adjustment gained from the great crisis in the 1930s, the country could not avoid the economic crisis. From the end of the World War II to the beginning of the 1980s, the U.S. had suffered eight economic crises in all. And from the year 1970 to 1980, the U.S. had suffered stagnation with an annual growth of GNP of about 3.8%, less than that during the first two decades after the war. Among all the crises, the eighth one, from July 1981 to November 1982, was the longest, during which industrial production had kept declining for 17 consecutive months. The GNP had dropped by 2.5%, and the unemployment rate had reached 10.8%. That crisis was subject to the second oil shock. Restrictive monetary policies were implemented in order to control inflation, resulting in high interest rates. Meanwhile, the slow production growth restricted the capacity to produce, making the industrial structure difficult to be adjusted (Table 2.1 and Fig. 2.2).

Britain’s economy growth became negative. From 1964 to 1970 and 1974 to 1979, the British Labor Cabinet devoted considerable effort to create a wealthy working class and to establish an ideally socialistic society by following policies based on socialization and high welfare. The specific measures involved implementing a planned economy system (including nationalization of iron and steel, coal, railway, aviation, ports, postal services, telecommunications, automobile, ship-building, aerospace and other industries), raising taxes and cutting military spending (through disarmament, canceling new national defense research projects, raising the level of wages and benefits etc.) But the growth of GDP, against the good wishes of the Labor Party, became negative during its administration (Fig. 2.3).

Germany’s economy was in trouble. After the World War II, the Federal Republic of Germany had been pursuing the theory of social market economy,

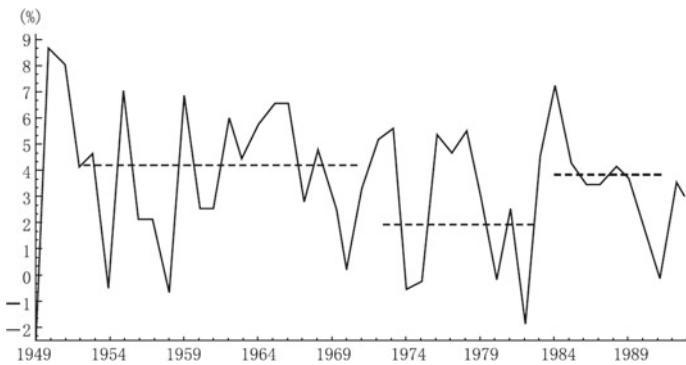


**Table 2.1** US index of industrial production during the economic crisis after the war

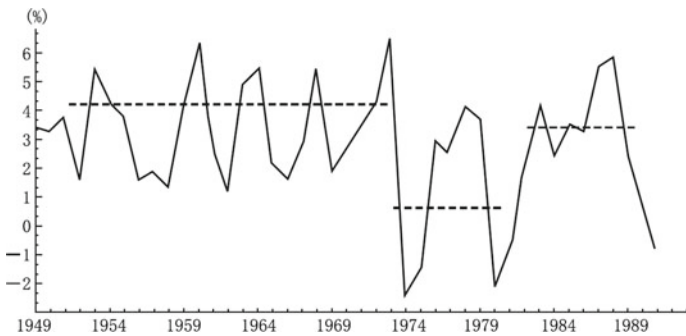
| Crisis period   | Length | Decrease in industrial production (%) | Highest unemployment rate (%) | GNP growth rate (%) | Cause of crisis                                                                                                                                                                                      |
|-----------------|--------|---------------------------------------|-------------------------------|---------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1948.8–1949.10  | 15     | 10.1                                  | 8.3                           | 0.02                | The buying craze of consumers faded away with the interest rate growing and the ration system cancelled                                                                                              |
| 1953.8–1954.4   | 9      | 9.4                                   | 3.2                           | −1.3                | There appeared contractionary fiscal and financial policies and military expenditure were reduced after the Korean War                                                                               |
| 1957.4–1958.4   | 13     | 13.5                                  | 7.5                           | −0.7                | The interest rate was increased and caused the monetary tightening                                                                                                                                   |
| 1960.2–1961.2   | 13     | 8.6                                   | 7.1                           | 2.6                 | Deflationary monetary policies were adopted to restrain the increasing inflation                                                                                                                     |
| 1969.11–1970.11 | 13     | 6.8                                   | 6.0                           | −0.3                | Deflationary financial policies were adopted to restrain the monopoly caused by the Korean War                                                                                                       |
| 1973.12–1975.3  | 16     | 15.1                                  | 8.9                           | −1.8                | The economy became worse due to the quadrupled oil price, deflationary financial and fiscal policies as well as the speculative add inventory in 1973                                                |
| 1980.1–1980.7   | 7      | 8.0                                   | 7.1                           | 1.9                 | The second oil crisis begot the recession in 1980. President Carter further controlled the credit on March, 1980 and implemented the deflationary financial policies, which deteriorated the economy |
| 1981.7–1982.11  | 17     | 12.4                                  | 10.8                          | −2.5                | The low growth of production brought a large amount of underutilized manpower. And the interest rate grew rapidly due to the second oil crisis and the inflation-oriented policies                   |

Resource Jonathan Hughes, Louis P. Cain. *American Economic History*. Shanghai: Truth and Wisdom Press, 2013

based on the Freiburg School, for a long time. A social market economy system was implemented and the ideas of free market were combined with that of social balance. Focus then was put on the social aspect of the market economy so that the market competition would exist together with a society in balance. Ludwig Erhard, the first Minister of Economics and the second Chancellor of the postwar Germany, described the system as a kind of conscientious capitalism that was different from the socialist planned economy and the autocratic Nazi economy. Germany was in its golden age during the 1960s to 1970s. But since the mid-1980s, the economic



**Fig. 2.2** Year-on-year growth of US GDP from 1949 to 1994. *Source* Wind Info



**Fig. 2.3** Actual growth of British GDP from 1949 to 1990. *Source* Wind Info

growth had gradually slowed down. There emerged more conflicts and less innovation. In the early 1990s, despite the unification, the growth rate of the economy was only 1.95%, the lowest ever since the World War II (Table 2.2).

The Japan’s economic growth was rapid at first but became slow thereafter. The economy had been growing fast in Japan since the mid-1950s and the growth rate in the 1960s remained over 10%. In the early 1970s, there appeared difficulties in export due to the appreciation of the yen. In addition, the oil crisis not only prevented the economy from growing at a high speed but also led to the most serious economic crisis after the World War II. The spectacular economic growth for two

**Table 2.2** Annual economic growth of the Federal Republic of Germany

|                 | 1951–1960 | 1961–1970 | 1971–1980 | 1981–1990 | 1990–2000 |
|-----------------|-----------|-----------|-----------|-----------|-----------|
| Growth rate (%) | 7.96      | 4.51      | 2.78      | 2.3       | 1.95      |

*Source* Institution of World Economy, Fudan University. *Institution Change and Structural Adjustment*. Shanxi: Shanxi Economic Publishing House, 2006

decades stopped and the growth has been sluggish ever since. The annual growth rate of 10% (from the 1950s to the 1960s) dropped to about 5% (from the 1970s to the 1980s). In the 1990s, the annual growth rate was close to 0.

2.2.1.2 Frequent Inflation

The 1970s witnessed a price spike concerning average goods and service. In the U.S., for example, the consumer price index rose fast in the late 1960s and even faster in the 1970s. The price doubled over a decade, from 38.8 in 1970 to 82.4 in 1980 (if we set 100 for the period from 1982 to 1984). In 1980, the inflation was close to 14% and the short-term interest rate surpassed 20%, the highest in its history (Figs. 2.4 and 2.5).

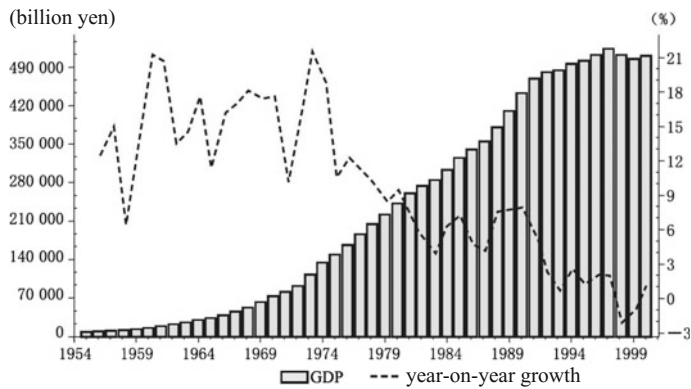


Fig. 2.4 GDP and its growth in Japan from 1954 to 2000. Source Wind Info

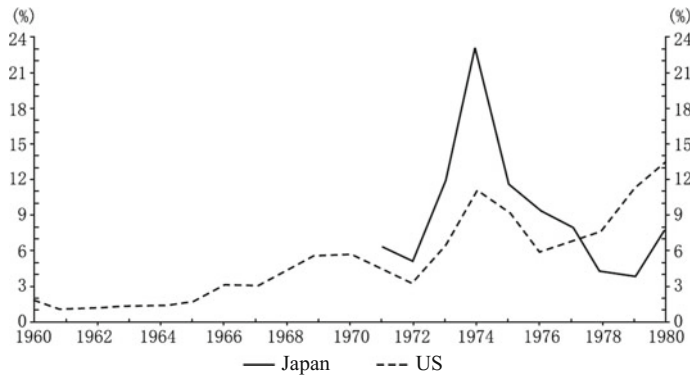


Fig. 2.5 CPI in Japan and US from 1960 to 1980. Source Wind Info

### ***2.2.2 Imbalance Between Financial Revenue and Expenditure***

Following Keynesian demand management, major economies generally implemented fiscal stimulus policies. Since the 1970s, the increasing social welfare, military expenditure and personnel cost in national agencies have increased fiscal burden and caused imbalance between income and expenses.

#### **2.2.2.1 Fiscal Deficit**

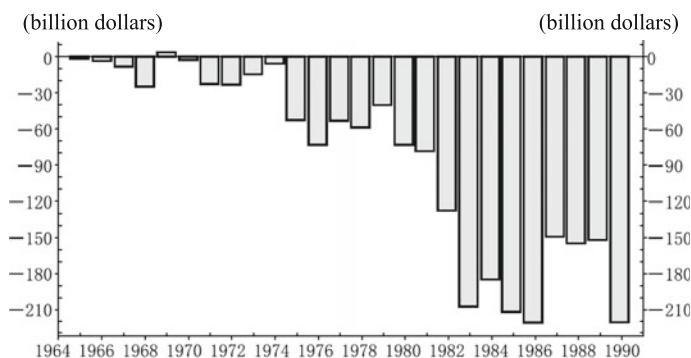
In the 1970s, fiscal deficit existed in major economies. In Germany, for instance, governments at all levels tried to make up the deficit through credit and issuance of bonds. The government debt in the 1970s, excluding certain years, maintained a double-digit growth rate. By the end of 1981, the total government debt had surpassed 240 billion Deutschmark, equivalent to the total fiscal expenditure in 1982. In the federal government budget in 1983, the interest payment for government bond amounted to 31 billion Deutschmark, accounting for 12.3% of the total budget as the third major expenditure in the country after the social expenditure and that of national defense. The proportion of the government debt in the total capital rose from 10.3% in 1969 to 37.6% in 1981. Government budget promoted risk-free investment, leaving alone other demands of enterprises and families. During the same period, the nationalization of enterprises, unification of salary and high welfare in Britain caused excessive spending of the government and worse relationship between financial revenue and expenditure.

#### **2.2.2.2 Imbalance Between Global Revenue and Expenditure**

In the 1970s, imbalance existed in all the major economies. There was negative trade balance in the U.S., Britain and Japan. Germany, with its manufacturing advantages, maintained a positive trade balance. But it was disturbed in the 1970s. From 1978 to 1980, Germany's foreign trade decreased and Deutschmark depreciated due to its loss of international confidence. In order to maintain the stability of the currency, the Federal Bank of Germany had to operate a tight monetary policy, which further limited the economic stimulation through the countercyclical monetary policies (Figs. 2.6, 2.7 and 2.8).

### ***2.2.3 Slow Structural Adjustment Leads to Low Production Efficiency***

The 1970s witnessed several declines in labor productivity among major economies in the world. Under the premise of full employment of Keynesian demand



**Fig. 2.6** US Federal Fiscal Surpluses from 1964 to 1990 (billion dollars). *Source* Wind Info

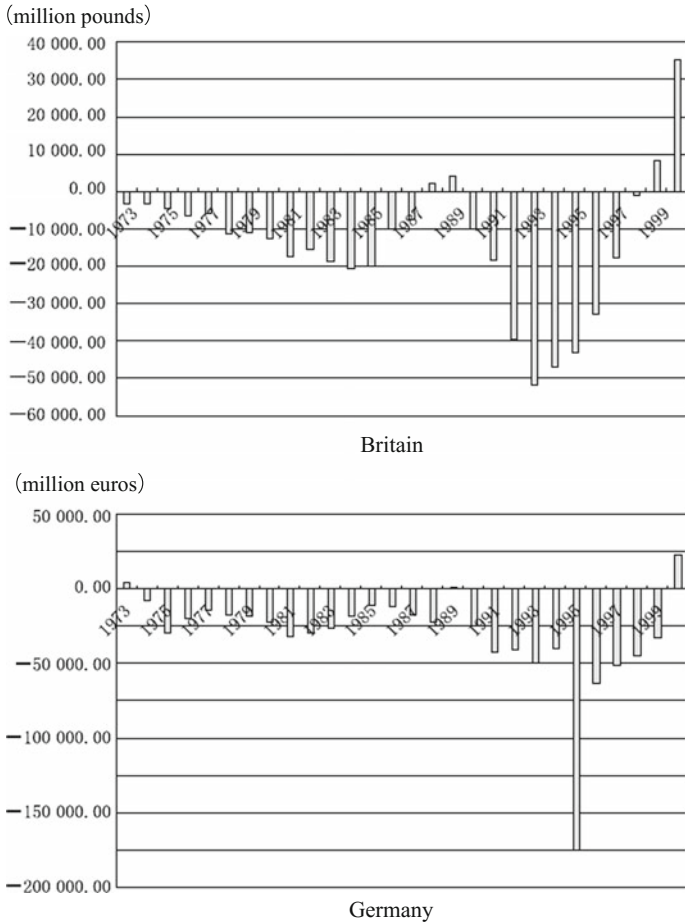
management, the real wage rate will be further increased if the labor productivity is low and the wage cost is high. And the cost for production of goods will be thus increased. At the same time, the traditional industries were confronted with over-capacity, tax burden and lack of vitality.

### 2.2.3.1 The Coexistence of “Stagflation” and Growth Decline in Labor Productivity

Take the U.S. as an example. The growth rate of labor productivity from the 1960s to the year 2005 was represented in a U-shaped curve. From the late 1960s to 1970s, there was a decline in growth rate along with the ‘stagflation’. From 1975 to 1980, the annual growth rate of U.S. manufacturing industries was only 1.7%, and that of all its industries was only 1.2%, much lower than that during the postwar period and that of trade rivals in Europe and Asia. It was not until the 1990s that there appeared a rising trend (Fig. 2.9).

### 2.2.3.2 Overcapacity

In the 1970s, a number of industries in the U.S. were confronted with excess capacity, which caused a sharp decline in capacity utilization ratio. In the early 1980s, there was serious overcapacity. The utilization ratio had been less than 80% since June, 1980. It reached the lowest point of 72% in the first quarter of 1983. After the ratio rose slowly but did not surpass 80% until 1987. The problem of overcapacity lied mainly in traditional industries such as minerals, steel, wood, leather, automobile, furniture, etc., especially in the iron and steel industry and the automotive industry, the ratios of which were 50 and 52% respectively. As for Japan on the other hand, there was a rapid increase in equipment investment during

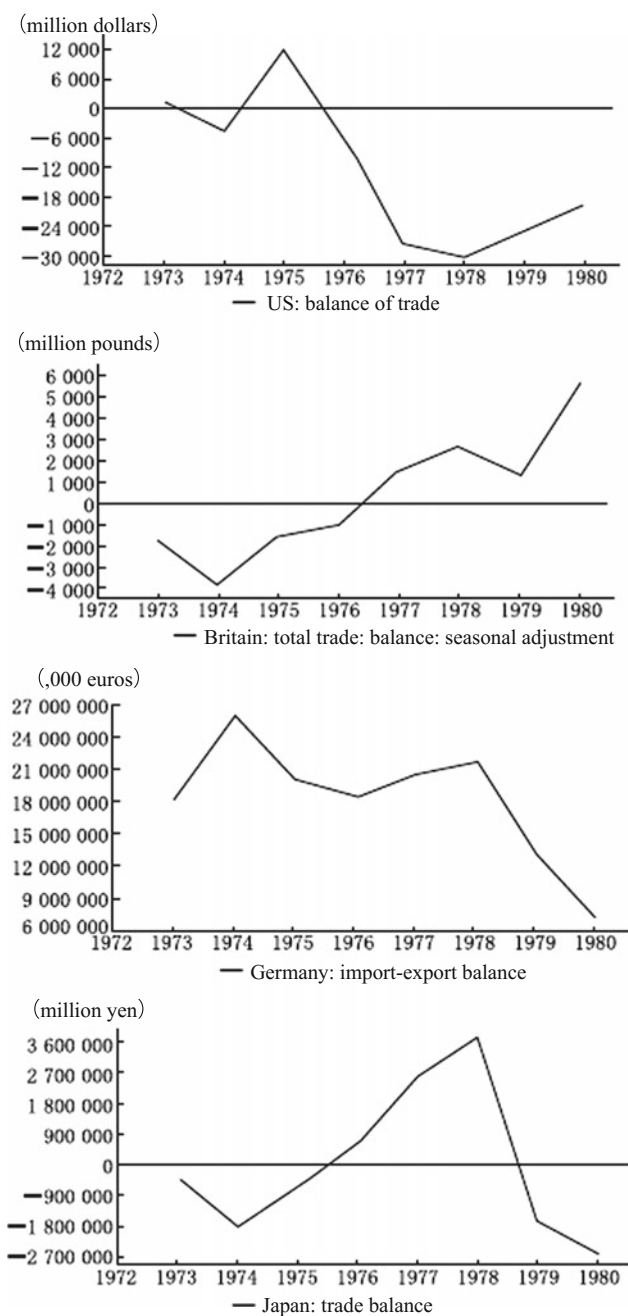


**Fig. 2.7** Fiscal Surpluses in Britain and Germany from 1973 to 2000 [(Million pounds) Britain, (million euros) Germany]. *Source* Wind Info

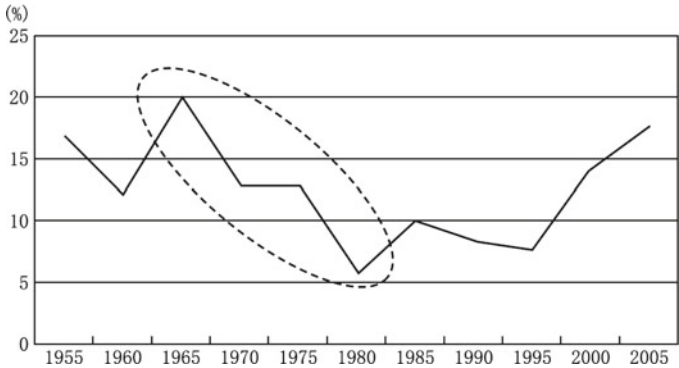
the bubble era. Equipment investment in 1990 amounted to 88.7 trillion yen, accounting for 19.5% of GNP. It increased by 58.6% compared with that in 1986. Affected by the false prosperity of the bubble era, large-scale production lines have been launched. The rapid increase in investment also resulted in serious overcapacity (Table 2.3).

### 2.2.3.3 Scarce Technological and Industrial Innovation

Two-thirds of the research funding in Germany in the 1980s was from enterprises. Aiming at short-term interests, world leading enterprises of chemical, machinery



**Fig. 2.8** Trade balance of major economies from 1972 to 1980 [(million dollars) US: balance of trade, (million pounds) Britain: total trade: balance: seasonal adjustment, (000 euros) Germany: import-export balance, (million yen) Japan: trade balance]. *Source* Wind Info



**Fig. 2.9** The total labor productivity growth rate of the US Enterprises from 1955 to 2005. *Source* Jonathan Hughes, Louis P. Cain. *American Economic History*. Shanghai: Truth and Wisdom Press, 2013

**Table 2.3** Productivity Index of US from 1950 to 2005

| Year | All enterprises    |            | Non-agricultural enterprises |            | Manufacturing business |            |
|------|--------------------|------------|------------------------------|------------|------------------------|------------|
|      | Labor productivity | Growth (%) | Labor productivity           | Growth (%) | Labor productivity     | Growth (%) |
| 1950 | 37.3               |            | 41.9                         |            | 34                     |            |
| 1955 | 43.6               | 16.89      | 47.5                         | 13.37      | 38.8                   | 14.12      |
| 1960 | 48.9               | 12.16      | 51.9                         | 9.26       | 41.8                   | 7.73       |
| 1965 | 58.8               | 20.25      | 61.4                         | 18.30      | 48.5                   | 16.03      |
| 1970 | 66.3               | 12.76      | 68                           | 10.75      | 54.2                   | 11.75      |
| 1975 | 74.8               | 12.82      | 76.2                         | 12.06      | 64.3                   | 18.63      |
| 1980 | 79.1               | 5.75       | 80.6                         | 5.77       | 70.1                   | 9.02       |
| 1985 | 87.1               | 10.11      | 87.4                         | 8.44       | 82.3                   | 17.40      |
| 1990 | 94.5               | 8.50       | 94.5                         | 8.12       | 92.9                   | 12.88      |
| 1995 | 101.6              | 7.51       | 102.1                        | 8.04       | 110                    | 18.41      |
| 2000 | 116.1              | 14.27      | 115.6                        | 13.22      | 134.4                  | 22.18      |
| 2005 | 136.5              | 17.57      | 135.9                        | 17.56      | 170.6                  | 26.93      |

Labor productivity refers to the productivity within 1 h, which was 100 in 1992  
*Source* Jonathan Hughes, Louis P. Cain. *American Economic History*. Shanghai: Truth and Wisdom Press 2013

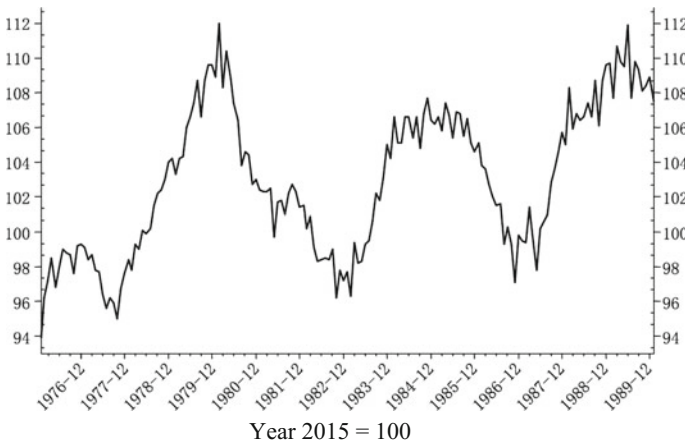
manufacturing and automobile etc. focused their research on mature fields related to technical improvement. The lack of scientific research and innovation widened the gap between Germany and the U.S. in the field of information technology in the 1990s. During the first half of the 1990s, the proportion of German research





**Fig. 2.10** The capacity utilization rate of US manufacturing business from 1976 to 1990. *Source* Wind Info

investment in GDP was less than 2%. Though the proportion had started to rise from 1996 and reached 2.15% in 2001, it rose rather slowly compared with other countries. In 2002, the research investment dropped to 1.75%, ranking seven in the world after Sweden, Finland, Japan, Switzerland, US, and South Korea (Figs. 2.10 and 2.11).



**Fig. 2.11** The capacity utilization index of Japan from 1976 to 1990. *Source* Wind Info

#### **2.2.3.4 Enterprises with a Lack of Vitality Due to Heavy Tax**

In the 1970s, enterprises lost their vitality with the heavy tax burden. In Japan, for example, the corporate tax rate was 37.5% before 1998. But if the local tax and cost were taken into account, the actual tax rate went up to 49.98%, the highest among the developed countries. Large enterprises with good benefit accounted for less than 1% in the country and one-third among the rest 99% were efficient small and medium-sized enterprises (SMEs) which enjoyed the tax relief. As for the two-thirds, they were enterprises running at a loss and therefore they did not pay taxes.

### ***2.2.4 Social Conflicts and Structural Problems***

#### **2.2.4.1 The Widening Gap Between Regions**

After the World War II, the state intervention through regional policies was encouraged by the Keynesian demand management. State intervention was widely believed to narrow the gap of unemployment between regions. The unemployed labor force could also be used to develop the macro economy without inflation. Therefore, major economies frequently exercised fiscal and financial policies and even directly intervened in the administration of declining areas, encouraging large enterprises to assist those regions by investing and building factories to create job opportunities and those regions would keep up. But in the late 1970s, new problems and disputes occurred despite the existence of the older ones. In Britain, for example, before Thatcher's reign, the expansion of the "recipient" regions added financial burden to the government. The British government's spending on regional policies increased from 20 million pounds (from 1962 to 1963) to 324 million pounds (from 1969 to 1970). By the end of the 1970s, the annual spending had been as high as about 1 billion pounds. Unfortunately, government intervention did not realize the goal of recipient regional development. Worse still, it caused industry hollowing in the prosperous southern regions. "Inner crises" such as the urban environmental problems and deteriorating order were also becoming increasingly serious.

#### **2.2.4.2 Deteriorating Labor and Capital Relationship**

Trade unions, with their legal status affirmed after the World War II, were encouraged to participate in political and economic decision-making. In the 1970s, as the power of trade unions gradually grew, the labor market and capital investment was hindered by high salary and frequent strikes. Labor unions became the bottleneck in economic development and even led to political turmoils in major economies. In Britain, more and more people in the 1970s believed that the country was suffering from the unions' extortion. From 1978 to 1979, a series of strikes had

broken out with growing dissatisfaction with the British government. In Germany, the power of trade unions was described as a mystery by the economic research center in Cologne. There was one in every five practitioners who belonged to trade unions in the country. Enterprises of all types had representatives of the trade union in both the executive committee and the business committee.

### **2.2.4.3 Welfare Systems as the Government Burden**

The Keynesian theory, the theoretical basis of the social welfare systems, holds that the fundamental way to avoid the crisis is to take various measures to stimulate the effective demand of the society. Since there is no mechanism for the effective demand in capitalist economies, this should be realized by the government, which, through the establishment of public utilities and the development of the social welfare and relief systems, can improve the social consumption trends, increase effective demand, achieve full employment, as well as alleviate the economic crisis. But in the 1970s, the drawbacks of welfare systems gradually appeared. They reduced the labor efficiency and destroyed the economy. Especially for the donors, they lowered their enthusiasm since they fostered laziness and decreased personal savings. By 1988, the British national health system (NHS) had been implemented for 40 years, second only to the pension insurance. The proportion of its spending in GDP rose from 4.4% in 1970 to 6.1% in 1980. Patients received over treatment in that there was scarcely cost worries among the doctors, nurses or even the managers. It was not the main goal to pursue efficiency and innovation. Resources were thus easily wasted.

## **2.3 Implementation of the Structural Reform on the Supply Side in Major Economies**

Since the 1980s, major economies have implemented structural reforms on the supply side. U.S. and Britain adjusted the macroeconomic management under the mode of market economy, transforming from the Keynesian demand management to the supply management, which focuses on market and free competition. In order to solve the problems exposed in the process of economic development, Germany also transformed to the supply management from the social market economy mode. It struggled to provide the economic basis for social welfare by limiting the government's intervention so that the market can develop freely. Japan launched a series of structural reforms on the supply side, trying to evolve into the market economy from the government dominated economy.

### ***2.3.1 The “New Right” as the Theoretical Foundation for the Structural Reform on the Supply Side***

To deal with different problems, various ideological trends emerged during the 1960s and the 1970s in the western society such as the New Left thoughts, radicalism, Neofascism etc. Among them, the most influential one was the “New Right”, composed of the “new liberalism” and the “conservatism”. The former had long emphasized market value while the latter social order. Although individualism in the new liberalism was often criticized by the conservatism, there was a tendency for the two to merge at the end of the 1970s. Both the British Thatcherism and the American Reagan economics manifested the ‘New Right’ trend. Germany also followed the trend and put focus on market and free competition.

#### **2.3.1.1 New Liberalism**

The new liberalism includes the monetarism school, the supply side school, the public choice school and the Austrian school. In addition, the new liberalism expands from the economic field to the field of politics and society. It has a system of its political views. New liberalism doesn’t allow too much government intervention in the economy. Government activities are thus limited so that the market can restore its self-regulation function. Private property and the freedom of personal choice, completely destroyed by collectivism and socialism, are highly inviolable. The government should establish law and order to maintain freedom and market order.

#### **2.3.1.2 Conservatism**

Conservatism, involving philosophy, politics, economy, culture and other fields, has a significant impact on politics, economy and social life. It advocates tradition as the backbone of social order. When there is a threat to personal freedom and social operation with the country’s gradual expansion, the conservatism will advocate freedom as a tradition that needs maintenance. Private property is also protected since the property right is linked to the family, whose reputation is manifested by the accumulation of property—savings. The social rank is regarded as a natural and necessary part to be maintained in the society while the hierarchy is bound to exist even in a family. An ideal government is one with strong but limited power so as to obtain both freedom and efficiency. The law and order are also emphasized. Additionally, reforms are not discouraged despite the respect for tradition.

### **2.3.1.3 The Merging of the New Liberalism and the Conservatism: The “New Right”**

Based on the tradition, order, authority, legal, private property and other basic concepts of the conservatism, the “New Right” absorbs the limited government intervention of the new liberalism and maximizes the market mechanism and the vitality of enterprises. The government, whose role is limited but necessary, serves as a tool to achieve economic freedom. The government’s macroeconomic control and management should be improved. The Keynesian effective demand management and full employment model are criticized. Individuals have the freedom to choose and the market has the freedom to automatically adjust itself and maintain its order under the legal system.

## ***2.3.2 The Prelude to the Structural Reform on the Supply Side***

### **2.3.2.1 President Reagan**

The U.S. structural reform started in the Kennedy era, flourished under the Reagan administration and continued to the Clinton years. In as early as the year 1964, the government of Kennedy had already taken measures to cut tax. On January 20, 1981, Reagan became the forty-ninth president and he put forward his economic recovery plan to the Congress on February 18. The plan includes the reduction of the personal income tax rate and the reduction or exemption of enterprise tax to stimulate employment, savings and investment. Cuts in the civil expenditure, especially welfare, were also included. National defense expenditure was supposed to be increased and the expansion and investment of enterprises were encouraged by canceling or loosening the regulations. The plan also suggested a tightening monetary supply to control inflation.

### **2.3.2.2 Mrs. Thatcher as Prime Minister**

The British structural reform had a significant turning point. After the World War II, the Labor Party and the Conservative Party agreed on the Keynesian demand management in order to restore the British economy. The year of 1979, when Mrs. Thatcher was elected Prime Minister, became the turning point for British macroeconomic management, for she advocated the structural reform on the supply side, bringing fundamental changes to all fields. Despite the economic and social ups and downs during the 11 years of her administration, what could not be denied was the fact that there was a distinct improvement on the previous economy with those reform policies, which were followed by the succeeding major government as well.

### 2.3.2.3 Kohl as Chancellor

The supply side structural reform in Germany began in 1982 when Helmut Kohl, the chairman of CDU, was elected the Chancellor. The reform had lasted for over 20 years until 2005, when Gerhard Schroder, SPD chairman, stood down. In October 1982, Kohl's political agenda indicated the new direction for the economic reform. The market economy was encouraged with less government intervention. Individuals were supposed to freely make achievements without any pressure from the group. The economic structure should be more flexible with the individual initiative and competitiveness. During the reform of over two decades, Germany aimed at stimulating the economy, increasing the employment and reducing the contribution rate of social insurance. It also struggled to reform the welfare system, emphasizing personal responsibility, reduction of benefits, stable contribution rate and cuts in cost. The investment of enterprises and individuals was promoted. Additionally, the policies of the labor market were adjusted so that more opportunities of employment, reemployment and entrepreneurship were created (Tables 2.4 and 2.5).

### 2.3.2.4 Reforms in Japan

Japan had long taken the mode of government-directed market economy. Hence, the government had intervened in the aggregate demand and aggregate supply for a long time. In 1978, Japan enacted a special law for the structural improvement of

**Table 2.4** The macroeconomic management measures taken by the previous British governments from 1945 to 1997

| Ruling period         | Prime Minister    | Party        | Macroeconomic management measures                         |
|-----------------------|-------------------|--------------|-----------------------------------------------------------|
| 1945.07.26–1951.10.26 | Clement Attlee    | Labor        | Keynesian effective demand management                     |
| 1951.10.26–1955.04.06 | Winston Churchill | Conservative |                                                           |
| 1955.04.06–1957.01.10 | Anthony Eden      | Conservative |                                                           |
| 1957.01.10–1963.10.19 | Harold Macmillan  | Conservative |                                                           |
| 1963.10.19–1964.10.16 | Douglas-Home      | Conservative |                                                           |
| 1964.10.16–1970.06.19 | Harold Wilson     | Labor        |                                                           |
| 1970.06.19–1974.03.04 | Edward Heath      | Conservative |                                                           |
| 1974.03.04–1976.04.05 | Harold Wilson     | Labor        |                                                           |
| 1976.04.05–1979.05.04 | James Callaghan   | Labor        |                                                           |
| 1979.05.04–1990.11.28 | Margaret Thatcher | Conservative | Supply management focusing on market and free competition |
| 1990.11.28–1997.05.02 | John Major        | Conservative |                                                           |

**Table 2.5** The macroeconomic management measures of Germany before and after the supply side structural reform

| Period          | Development model                                      | Economic system                                           | Macroeconomic management measures                         | Ruling party | Chancellor            |
|-----------------|--------------------------------------------------------|-----------------------------------------------------------|-----------------------------------------------------------|--------------|-----------------------|
| 1948.9–1982.10  | Rhineland capitalism                                   | Social market economy of the Freiburg school              | Keynesian effective demand management                     | CDU          | Konrad Adenauer       |
|                 |                                                        |                                                           |                                                           |              | Ludwig Wilhelm Erhard |
|                 |                                                        |                                                           |                                                           |              | Kurt Georg Kiesinger  |
|                 |                                                        |                                                           |                                                           | SPD          | Willy Brandt          |
|                 |                                                        |                                                           |                                                           |              | Helmut Schmidt        |
| 1982.10–2005.10 | Rhineland Capitalism transforming to Anglo Saxon model | Social market economy transforming to free market economy | Supply management focusing on market and free competition | CDU          | Helmut Kohl           |
|                 |                                                        |                                                           |                                                           | SPD          | Gerhard Schroder      |

specified industries, classifying 14 industries as underdeveloped, including steel, aluminum refining, shipbuilding, ammonia manufacturing and textile industries. According to the government's plan, these industries should discard excess equipment. In the early 1980s, influenced by the second oil crisis, tax deficiency led to the budget deficit, which stimulated administrative and fiscal reforms. During the administrative meetings from 1981 to 1983, it was proposed that the three major state enterprises (Japanese National Railways, Nippon Telegraph and Telephone Public Corporation, Japan Tobacco and Salt Public Corporation) be privatized through tax increase, fiscal reconstruction and reduction of health care costs. In the 1990s, there were the financial reform and the tax reform, including the "Big Bang" reform carried out by Ryutaro Hashimoto through raising the consumption tax and reducing the personal income tax. In 2001, the structural reform was initiated by the Koizumi cabinet, merging the urban banks to solve the non-performing loans and to attempt postal privatization.

### 2.3.3 Goals of Structural Reform on the Supply Side

Keynesian demand management aims at full employment, while the main objective of the supply side structural reform is economic growth. Additional goals of the reform are related to the political power, regime stability, social order etc.

### **2.3.3.1 Economic Growth**

Economic growth, conducive to democracy in the long term, has the top priority in the supply side structural reform. Tight-money policies are adopted to beat inflation and alleviate unemployment. The social conflicts are settled by providing the resources for reciprocal solution. The individuals, groups and governments will thus have surplus to support social welfare. Therefore, during the Reagan era, the primary goal of the supply side structural reform was to revitalize the U.S. economy, which was first presented in the Republican National Convention on July 15, 1980. The major goal was economic growth, with full employment but without inflation. In mid-1985, the British government also renounced its post-war goal—full employment.

### **2.3.3.2 Necessary Government Intervention**

Deregulation is an effective way to promote economic growth in the supply side structural reform. The role of the government is thus changed so that it cannot intervene the market. However, on the other hand, deregulation is not absolute. The government formulates and implements all the economic policies, “intervening” the market in a way that it cannot intervene. It is the government that serves as the guarantee of the free market and trade. Therefore, the so-called “deregulation” is optional, which is not applied to all areas. The government intervenes where needs to. The balance between the economic freedom and the government intervention is thus achieved.

### **2.3.3.3 Regime Stability**

Surely, the goal of the supply side structural reform is not mere economic growth. The stability of the government is also part of it. The British Conservative Thatcher, the US Republican Reagan or the German SPD Schroder, as the elected ones, their main objectives were to maintain the regime stability. The supply side structural reform is a perfect strategy to crack down on the competitive party. The ruling party which carries out the reform tends to be conservative, struggling to protect the private property as well as the existing social order. It hates and fears socialist reform and thus regards the labor movement and the labor union as the target to be banned.

## ***2.3.4 Characteristics of Structural Reform on the Supply Side***

As a whole, the practice of supply side structural reform is natural, systematic, comprehensive, flexible and progressive.



### **2.3.4.1 Naturalness**

Since the 1970s, the economic globalization and technological innovation have had a huge impact on the economic and social structures of the major economies in the world, which motivates the supply side structural reform. The saturation of the market made it difficult for large-scale production to make profit. Flexible, scattered, technology-intensive and specialized production has replaced the large-scale one to meet the growing personalized demand. That has also promoted the transformation of industrial structures, the adjustment of hierarchical structures, the diversification of social values as well as the gradual integration of the neo-liberalism and neo-conservatism. The Keynesian demand management, which depends too much on authoritarian and conventions, is challenged. The supply side structural reform is thus considered to be a natural response to the adjustment and changes of economic and social structures.

### **2.3.4.2 Systematization**

The tax reform of the Reagan administration has long been considered as tax cutting, while the reform of the Thatcher government is regarded as privatization. Notwithstanding, the measures taken have promoted the reform of the industrial restructuring, innovation system, financial system, multilateral trade, employee–employer relations, social security, streamlining administration, the government budget etc. These innovative and systematic measures have been implemented correspondingly, eliminating the structural and institutional barriers against the economic growth.

### **2.3.4.3 Comprehensiveness**

Some of the economic problems, caused by external shocks and internal imbalances, are temporary, while others are long-term, triggered by the Keynesian demand management policies. One single theory, however perfect, can hardly solve them all. As a result, the theories, policies and measures in the supply side structural reform are like a hotchpotch. Some are based on supply economics and some are developed from monetarism. In fact, with the “New Right” ideology as the theoretical core, the reform applies various theories and policies to solve different economic problems, emphasizing the supply management and the function of the free market and competition as well as the theories of the Keynesian demand management.

#### **2.3.4.4 Flexibility**

Despite the explicit policies of the supply side structural reform, its actual implementation encounters obstacles in dealing with disputes among different parties. In addition, there are widespread concerns about the adverse effects. Hence, the major economies adjust, amend and supplement the policies and even compromise or make a concession according to the changes of international and domestic situations. The flexibility of the policies adds the probability of success and plays a positive role in the reform.

#### **2.3.4.5 Progressiveness**

The reform is also progressive with certain areas prioritized. Take the privatization reform undertaken by the Thatcher government as an example. During her three consecutive terms, the reform was carried out from the specific to the overall, from the superficial to the core. Generally, the trade reform was ahead of that of the financial system, since a large number of trade inflows would to some extent lower the voice against the financial reform. Then the reform of product markets and the deregulation of products were gradually carried out. In the late 1980s and the early 1990s, the civil aviation was opened earlier than telecommunications, and the reform of electricity and gas had just started.

### **2.4 Major Tactics of the Structural Reform on the Supply Side in Major Economies**

All the economic policies of structural reforms on the supply side have been based on the “New Right” ideology since the 1970s. The ideas of the Keynesian demand management have been adjusted, and so have the relationships between the government and the market, the government and the enterprise, the government and the individuals, capital and labor, structure and the whole.

#### ***2.4.1 Readjustment of the Government-Market Relationship***

In order to sustain the economic growth, one major part of structural reform is to adjust the relationship between the government and the market through market improvement, role exchange, power limitation, objective resetting etc.

### **2.4.1.1 Expansion of the Scope of Market Adjustment**

The market adjustment is emphasized in the structural reform. The fluctuation of market price implies the changes in supply and demand, which can be further noticed by the producers and consumers in the market. The balance between the supply and demand can be achieved through the adjustment of the quantity. It is believed that economic turmoil is the result of wrong finance or financial policies, for the market can automatically reach equilibrium. Adequacy, fairness and effectiveness are the core qualities of competition and they can promote production, technology, management and efficiency. In competitions, the industrial structure can be adapted according to the consumers' demand and waste of resources can thus be avoided.

### **2.4.1.2 The New Role of the Government**

The government is not only a "calm arbitrator" in the structural reform but also a guide for structural adjustment. On the one hand, the government is supposed to limit its control over micro economy and social life so as to restore the market mechanism, encourage competition, and to create a market with free social order. The loss of efficiency caused by market failure can be thus avoided. On the other hand, a powerful and efficient government can ensure the success of the reform by removing the "shackles" of the market economy and maintaining its overall order.

### **2.4.1.3 Reduction of the Government Intervention**

In the structural reform, the bottleneck of economic growth is believed to be caused by the government intervention, which does not aim at the public interest but the benefit of some party or other. Therefore, the government intervention should be limited to the compensation of market efficiency loss only. The Thatcher administration, advocating the model of a "small government", made it extremely clear that the national borders should be put aside so that the economy and enterprises could develop freely. In his inaugural speech in January 1981, Reagan also pointed out that the government was not the solution of the problem but the problem itself. Reagan believed that the traditional excessive government intervention would affect the overall strength of the country and was therefore determined to limit it.

### **2.4.1.4 Adjustment of the Objective of Government Intervention**

The objective of the government intervention is confirmed and is often limited within certain time and scope. In terms of time, the government will intervene only when the economic fluctuation range is large with recession so serious that the market itself can hardly recover. In terms of scope, the government is supposed to

be involved in macroeconomic policies with limited intervention into micro economy and social life.

### ***2.4.2 Readjustment of the Government-Enterprise Relationship***

A strong government, according to the core ideas of the supply side structural reform, cannot solve the problems caused by market failure. Instead, it will waste resources excessively and supervise the extension of the enterprise development that adds impetus for the economic growth. Enterprises under the protection of the government gradually degenerate, losing the capability of innovation. Worse still, they will get used to lobbying and bribing to enjoy administrative protection and to avoid competition. Therefore, the relationship between the government and the enterprises is adjusted through reduction of burden and regulations so that the potential of enterprises can be exploited.

#### **2.4.2.1 Less Burden**

Major economies take comprehensive measures to relieve the burden on enterprises. Reducing the tax and the cost is one of the direct ways to stimulate the economy from the supply side. Social security systems with the largest expenditure and rising deficit, such as the pension system, the medical insurance systems and the welfare system, are reformed to reduce the cost of indirect wages and to avoid high tax rates. The burden is also eased through encouraging entrepreneurship by relaxing the dismissal protection requirements and lowering the standards for entrepreneurship. In addition, the increase in civil technology investment and the priority of civil technology development will reduce the research cost and improve the competitiveness of enterprises if the government cooperates more with the enterprises.

#### **2.4.2.2 Deregulation**

Deregulation is necessary in the reform since the resolution of economic problems lies not in the demand but the supply. The increase in the production efficiency, which is on the supply side, can improve the competitiveness of their products and expand the market. The major economies have cancelled the inflexible rules and regulations on competition and expiration. Companies with natural monopoly can also compete in the free market. The productivity can be further promoted with the enterprises throwing off their “shackles”. Statistics show that the proportion of production over GDP was 17% in 1977 in the U.S., with industries under the

control of regulations. It fell to 6.6% in 1988, with an average annual rate of nearly 1%. On the other hand, the relaxation of rules does not equal laissez faire. In specific fields, such as finance, the regulations are specially strengthened.

### **2.4.2.3 Maximization of Potential**

In the Keynesian theory of demand management, the substitution of efficiency and equity promotes the growth of the public sectors at the expense of economic growth. As a result, one of the major strategies is privatization. Driven by the “New Right” ideology, privatization, as the main means of reducing the government intervention, shifts the public ownership to private ownership. The relationship between the government and the enterprises is thus changed. The outlook for entrepreneurship and private enterprises helps to inspire people’s confidence in the free market economy.

### **2.4.3 *Readjustment of the Government–Individual Relationship***

If individuals depend too much on the government welfare, they will gradually become lazy. Therefore, it is necessary to readjust the relationship between the government and the individual by strengthening the individual’s rights and responsibilities and reducing the excessive government spending.

#### **2.4.3.1 Property Rights Protection**

The amount of private property can more or less manifest the degree of concentration of the national power. And therefore the violations to personal freedom are avoided. If a market is established on private ownership and the pursuit of self-interest, it can benefit from the personal interest as a whole. Thus, the supply side structural reform focuses on property rights as the essential element to develop the supply side. The private property and the market mechanism are linked as the premise of market exchange. The protection of private property rights is the foundation of social stability.

#### **2.4.3.2 Opposition Against Material Equality**

Analyzing the substance of the supply side structural reforms of the major economies, one can easily find out that various types of policies, issued by the government of Thatcher or Reagan, are in favor of the equality in terms of politics

and business opportunities but are strongly against the material equality. In a market economy, people at an advantageous position will become much richer. However, because of the balance between the rich and poor, it is almost impossible for the poorer people to become very rich. That is why the pursuit of material equality will inevitably lead to repression and coercion.

#### **2.4.3.3 Welfare Cuts**

High welfare often leads to negative results such as high cost, high debt, high taxes, low competitiveness, decline in exports, low profit, high bankruptcy rate, low consumption and low domestic investment. This will form a vicious cycle and ultimately affect the welfare. Besides, high welfare hampers the economic and social development seriously due to its characteristic of being easy to increase but difficult to decrease. The major economies have modified the post-war social welfare policies, which have generally caused inefficiency, bureaucracy and excessive centralization, for the social welfare system has formed a special culture of dependency, undermining the family ties and destroying personal responsibilities, creativity and work ethic.

### ***2.4.4 Readjustment of the Labor-Capital Relationship***

The labor-capital relationship, which is also termed labor relationship or employment relationship in some countries, is an important part of social relations. Labor ideas and policies, consistent with the mainstream economic ideas, depend entirely on the needs of the social and economic development. The labor-capital relationship generally has a negative influence on economic development and its readjustment is necessary.

#### **2.4.4.1 Subject Clarification**

Economic interests are the everlasting subject in employee–employer relations. In a capitalist society, the interest of employees and that of employers always diverge. The former expects a better working environment with higher wages and benefits, while the latter hopes for higher efficiency and lower labor costs so that the profits can be maximized. Economy is closely related to politics, therefore the employee–employer relations are not just an economic problem but also a political one. Political rights and status have also become important parts in the employer–employee game. Influenced by the “New Right” ideology, any intervention in economic freedom is opposed in the supply side structural reform. As for the relationship between employees and employers, in their negotiations, the subject

should be limited to production and living conditions with neither political content nor threats or intervention of the government.

#### **2.4.4.2 Establishment of Regulations and Laws**

However, the government will intervene indirectly. Actually, the government depends more and more on laws, which have a stronger effect on the employee–employer relations. Unlike policies, laws have a long-term effect, which are also mandatory and authoritative. The government sets up laws and regulations to maintain social order and extend its power, which will affect the employers and employees as well as their relationship.

#### **2.4.4.3 Limitation of the Power of Labor Union**

Employers and employees are regarded as a unity in the supply side structural reform, which makes the labor union unnecessary. The role of labor union is not management. It is limited to the establishment of the employment clauses. Generally, the monopoly of the trade union in labor market can “distort” the price of labor, making it much higher than the market level, fix the mode of employment, investment and production, and hamper the adjustment and cause inflation and massive unemployment. It also obstructs job cuts and the adoption of labor-saving technologies, which impedes technological progress. Therefore, labor union is generally looked at as an obstacle against economic growth and its real power should be limited.

### ***2.4.5 Readjustment of the Macro and Micro Structures***

Strategies of the supply side structural reform include division of powers between the state and regions, the increasing of the efficiency of public services and the support of the real economy by the virtual economy.

#### **2.4.5.1 Proper Division of Powers Between the State and Regions**

Traditional regional policies are adjusted in the supply side structural reform. The market force substitutes the state intervention as one of the options to solve regional issues. Through encouraging self-sustaining development, the relevant policies, region-oriented rather than state-oriented, aim at equal employment opportunities among regions. The responsibilities and powers of public services are divided between the state and different regions. Fiscal transfer no longer takes place through

specific appropriation but a special “incentive grant” to stimulate competition according to specific development goals.

#### **2.4.5.2 The Efficiency of Public Services**

It will be difficult to carry out the supply side structural reform if there is no reform in the government administrative system. Public sectors have great benefits with little open competition. The efficiency of public services is increased by joining the private sectors in competition. The competitions between public and private sectors and inter-sector competitions are encouraged and the results-oriented systems take the place of the traditional rule-based ones so that the potential of civil servants can be developed.

#### **2.4.5.3 Real Economy Supported by Virtual Economy**

The virtual economy, represented by finance, is reformed in order to support the real economy. For instance, the central bank’s control of money is strengthened to guarantee the stabilization of price. To build a solid financial system, disintermediation is prevented and depository institutions (especially savings and loan associations) are developed. The interest rate liberalization, which provides the small depositors with equal interest, is also encouraged through flexible financial regulations along with efficient financial systems and depository institutions with a wider business scope.



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