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Supply-side structural reform from the perspective of political economy

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Abstract

Purpose – Deepening supply-side structural reform is the main objective of the economic work since the Chinese economy entered a new stage of development. By adopting the fundamental principles and methodologies of Marxist political economy, the authors can provide clarifications on the three basic theoretical issues concerning the supply-side structural reform. The paper aims to discuss these issues.

Design/methodology/approach – First, the essential starting point for understanding the supply-side structural reform is the primacy of production, as well as the organic connection between production and consumption in social reproduction, rather than the supply and demand as superficially seen in exchanges. By identifying the right starting point, the authors can avoid alternating between demand and supply management, and between liberalism and interventionism.

Findings – Structural problems, which are closely related to the institutional structure of production and the purpose and nature of production, cannot be solely attributed to the imbalance caused by market failures. Chinese economy has suffered prolonged structural contradictions and structural problems.

Originality/value – To decide whether the financial and the real estate sectors are real economy or virtual economy, the key is to examine whether the monetary capital used in financial activities and real estate commodity (capital) go through the capital circulation process of from monetary capital to productive capital and further to commodity capital, and whether the capital gain is generated by the value appreciation of capital or the value transfer and distribution as a result of the transfer of ownership. With its emphasis on developing the real economy, the supply-side structural reform should foster both development of manufacturing, and parts of financial and real estate sectors that are the real economy.

Keywords Political economy of supply-side structural reform, Structural contradictions, Virtual economy

Paper type Research paper

1. Introduction

The supply-side structural reform is a major innovation designed by the Communist Party of China after its 18th National Congress. It enriches and develops the contemporary Chinese Marxist political economy in theory and has become the main task of economic work in the new era of socialism with Chinese characteristics and the new stage of economic development in practice.

The concept of “supply-side structural reform” was officially put forward for the first time and came into people’s attention at the meeting of the CPC Central Leading Group for Financial and Economic Affairs held on November 10, 2015. The CPC General Secretary Xi Jinping stressed that we will deepen structural reform as we increase aggregate demand by an appropriate degree, improve the quality and efficiency of the supply system, accelerate the fostering of new driving forces for development, thus achieving the overall improvement of China’s social productivity. In China’s 13th Five-Year Plan, supply-side structural reform has been identified as the “main task” of economic policy. The report



delivered at the 19th National Congress of the Communist Party of China pointed out that supply-side structural should be pursued as the main task for implementing the new development philosophy and developing a modernized economy. Strategic arrangements on deepening the supply-side structural reform were also outlined in the report.

Recent years have seen extensive theoretical discussions among intellectuals on what supply-side structural reform is, why such reform should be adopted, and how. We cannot come to proper conclusions without taking into consideration the features of China's economic development at this stage and the orientation and purpose of reform. The judgment on phased economic development features has shifted from "a mix of three simultaneous challenges[1]" to adapting to and leading the new normal of economic development, and further to entering the new era of socialism with Chinese characteristics since the 19th CPC National Congress. Although the specific expressions of the phases differ, and the orientation and direction of the supply-side structural reform have also been elevated from "an effective recipe for sustaining stable economic growth[2]" to "the main task of developing a modernized economy," the theoretical foundation, historical background and practical conditions for forming the important judgment remain the same.

As we have more accurate and in-depth comprehension of the features and laws governing the economic development stages, the theories about the supply-side structural reforms evolve as well. When the supply-side structural reform was initially put forward, it was regarded simply as a demand reduction policy by those with habitual thought of demand management. It was thought by some as a new kind of "planned economy[3]" that denies the decisive role of the market in the allocation of resources; Some scholars placed the reform in the category of macro-regulation and macroeconomic management (Jian, 2016; Kang, 2015) by identifying it as "new supply-side economics" or "supply regulation" with Chinese characteristics. Some scholars proposed that "from the perspective of theory development, the 'supply-side economics' is standing behind the theory of 'supply-side reform'" Zhifeng (2016). The list of theories goes on.

As socialism with Chinese characteristics enters a new era and economic development reaches a new stage, the theoretical system of socialist political economy with Chinese characteristics must be constantly developed and improved to address new challenges in the new era and provide new explanations that are in line with the basic principles and methods of Marxism, and also conforms with the phased features and laws of China's economic development. As a major reform measure for building socialist economy with Chinese characteristics in the new era, supply-side structural reform plays an important role in the theoretical system of socialist political economy with Chinese characteristics and thus explicit theoretical explanation and argumentation are required. The fundamental questions to be answered include: can political economy serves as a starting point and provides theoretical foundation for supply-side structural reform? Is it possible to explain the fundamental nature of the reform? Is it possible to go beyond the existing theories and policies and innovate?

This paper applies the basic principles and methods of Marxist political economy to answer the three fundamental questions concerning the supply-side structural reform. First, how supply and demand are analyzed in political economy. Second, how are structural contradictions and structural problems are viewed by political economy. Third, how are real economy and virtual economy distinguished in political economy. It is imperative and necessary to search for answers to these questions. Only by understanding these issues can we understand the fundamental purpose, nature and tasks of supply-side structural reform and distinguish it from western macroeconomic management theories and policies.

2. Supply and demand from the perspective of political economy

The "supply side" and the "demand side" are seen as standing *vis-à-vis* each other in the supply-side structural reform, which makes it difficult to prioritize between the two and thus

lean toward either in policy making. Therefore, it is necessary, as the first step, to examine the seemingly simple relationship between supply and demand from the perspective of political economy.

Supply and demand, as the two sides conducting exchange, is the basic components of market economy. It is a plain fact that market exchange cannot be completed without either the supplier or the demander. Theoretically speaking, the relationship between supply and demand can be quite complex. On the one hand, both supply and demand happen at a price level. Supply refers to the actual products and services that producers provide to the market at a certain price level in a specified period of time. And demand refers to the number of products and services that consumers can purchase at any given price level in a specified period of time. Without the price parameter, there will be no supply or demand. On the other hand, the theory of price as defined in western economics suggests that the market price of products and services is determined by supply and demand, meaning that only when supply equals to demand can the market have an equilibrium price. Therefore, a dilemma exists in the theoretical argumentation of supply and demand analysis and price formation. To solve the dilemma, we need to employ the concept of equilibrium which requires that supply and demand as well as price are simultaneously determined. By doing so, we ensure to “arrive at” equilibrium price in theory.

However, such solution suffers from certain “sequela” that may well lead to the division between western microeconomics and macroeconomics. When analyzing the supply–demand relations at the micro level, the focus is on price formation mechanism and factors deciding the price level. Simply speaking, the task is to explain the price level through the supply–demand relationship and its changes. However, when it comes to the macro level, the focus is the opposite, on explaining whether the price mechanism is efficient enough to ensure equilibrium between supply and demand. If only taking into consideration of exchanges between individuals at the micro level, there will never be any imbalance between supply and demand. When given economic entities receive market price signals, rational buyers and sellers only reach a deal at a “desirable” price level. This price is determined by the buyers and sellers, or by supply and demand *per se*. However, at the macro level, the market price “desirable” for individuals may not necessarily lead to the equilibrium between aggregate supply and aggregate demand. When imbalance arises between aggregate supply and demand, either employment fails to reach full employment and the gross output fails to reach the potential gross output; or the market price goes up to cause inflation.

Government intervention is a measure of macroeconomic management aiming to achieve the balance between aggregate market supply and demand. Both supply-side management and the demand-side management are viewed from the perspective of aggregate or macro management. Whether intervention or management is needed depends on the capacity of the market to strike a balance between aggregate supply and demand. Say’s Law of market, a classic economic rule stands as a tradition of market liberalism, states that “production necessarily creates demand” and that the market can automatically reach the balance between supply and demand (Say, 1997). Keynesianism, denying the Say’s Law and advocating government intervention, has opened up a new space for modern macroeconomics. Keynes wrote in his work the *General Theory of Employment, Interest and Money*: “In some kind of non-exchange Robinson Crusoe economy, the income which individuals consume or retain as a result of their productive activity is, actually and exclusively, the output in specie of that activity. The classical school has been deceived to take the story as the real world [...]. Such an assumption may be the reason why the classical school was wrong (Keynes, 1999).” By introducing such concepts as diminishing marginal propensity to consume, diminishing marginal efficiency of capital, and preference to hold money, Keynes demonstrated that the actual economy in the capitalist world might lack effective demand, which prevented the production from satisfying potential aggregate supply and led to involuntary unemployment. To avoid the overproduction and economic

depression caused by this, it is necessary for the government to intervene to increase effective demand.

It shows that western economics examines supply and demand and price at both the micro and macro levels. Such opposite perspectives foreshadow the policy divisions between liberalism and interventionism.

Marx has long pointed out that political economy should not entangle itself in the relationship between supply and demand and price and criticized the “contradicting views that price is decided by supply and demand while supply and demand are determined by price.” We can see that “the supply-demand relation suggests the market price deviates from the market value and that tendency to offset the deviation is in the making to shift the supply and demand [...]. For example, when the market price drops as demand declines, capital is to be channeled away. As such, supply thus will fall [...]. If market price is determined by supply and demand, then the market price, or further the market value, determines supply and demand[4].” This paragraph suggests that, on the one hand, supply and demand determines the market price and leads to its fluctuations (deviations from value); on the other hand, price fluctuation is driving supply and demand to reach balance. Therefore, “until the basis on which the supply–demand relationship works is explained, the supply–demand relationship absolutely cannot stand as explanation for any problem.” In Marx’s view, the interplay between supply and demand and price is simply the manifestation of how the law of value works. Value thus serves as a common basis for analyzing supply and demand and price problems. Meanwhile, in a market economy, the only through exchange can production of value and the distribution of value be connected. In the market, such connection embodies itself in the relationship between supply and demand and price.

Political economy can effectively serve as a theoretical basis for interpreting the relationship between supply and demand and price, because of a methodology distinctive from the western economics. This methodology is the Marx-proposed basic principle on the relationship among production, distribution, exchange and consumption. In the preface for *A Critique of Political Economy* (later known as “*Das Kapital*”), Marx pointed out that production, distribution, exchange and consumption “constitute links of a whole [...]. A certain level of production determines consumption, distribution, exchange as well as the relationship among these elements. Production itself is also determined by other elements. For example, when market expands or exchanges expand, production scales up and becomes further divided. As distribution changes, for example, when capital is accumulated and distributed between the urban and rural population, production changes as well. Subsequently, the demand for consumption also determines production. Different elements interact as happens in each organic whole[5].” If we specifically examine the relationship between production and consumption, we will find they are a unity of opposites. Production determines the object to be consumed and the mode of consumption, while consumption provides the impetus and purpose for production. Besides, production and consumption can only be connected in the form of supply and demand through exchange.

The principles touch upon the primacy of productivity in political economy as well as point out the fundamental nature that production and the other three links interact as an organic whole in the process of social reproduction. This serves as the theoretical basis for political economy to approach the supply–demand relation, and as well as the starting point for the socialist political economy with Chinese characteristics to interpret the supply-side structural reform.

Proceeding from the primacy of productivity, supply-side structural reform is in line with the fundamental task of socialist emancipation and development of productivity. In his remarks addressing a workshop on implementing the guiding principles of the 5th Plenary Session of the 18th CPC Central Committee attended by senior provincial and ministerial officials, General Secretary Xi stressed that “a country’s development is fundamentally driven by the supply side.” Promoting supply-side structural reform must start with the

production so that the supply capacity and quality can meet people's growing needs for a better life, thus realizing the goal of socialist production. Meanwhile, the principles of political economy emphasize the inner relationships among production, consumption and other links as necessary conditions for steady social reproduction and economic development. General Secretary Xi Jinping pointed out explicitly that "our supply-side structural reform emphasizes both supply and demand" and "it is one-sided to ignore either demand-side or supply-side, since they do not replace each other but coordinate with each other. The key to supply-side structural reform is to "make supply structure more adaptive and flexible to changes in demand," and "push the supply-demand balance to a higher level," so as to realize a dynamic balance between supply and demand while providing impetus for sustained economic development[6]. The primacy of productivity and the inner unity of the four links provides the theoretical basis of Marxist supply-side structural reform and draws a solid line between the supply-side structural reform and the western supply-side economics[7]. Therefore, it fundamentally ensures that China's basic economic policies will not swing dramatically between liberalism and interventionism like the western economics does.

3. Aggregate and structure from the perspective of political economy

Supply-side structural reform aims to address the structural contradiction in China's economic development. Structural problems or contradictions have long been neglected in the traditional western market economy theories. The traditional market economy theory holds that the market economy mechanism composed of the competition mechanism and the price mechanism is able to automatically adjust to create supply-demand balance for the optimal allocation of resources. Only when there are internal limitations on the competition mechanism and price mechanism (such as monopoly and externality), effective supply will become insufficient in the sectors and fields suffering "market failure." In other words, the solution to address the root cause of structural problems in supply and demand is to remove the restrictive factors that stop the market to play its role.

The management policies of Keynesian economics were believed to result in the "stagflation" of Western economies in the 1970s. Upon such historical background, the supply-side economics, monetarism and rational expectations theory staged an "economic revolution" to overthrow the Keynesianism and revive the liberalism. What these economic theories share in common is to call for the reduction of government intervention in the market by maximally cutting government spending and limiting money supply, so that the government's fiscal and monetary policies impose the minimal impacts on the market.

For another, the "structuralism" in western development economics emerged to address the "market failure" in developing countries. Structuralist development economists believe that for developing countries to achieve the urgently needed economic take-off, they have to create market demand and increase market scale that adapt to the modern mode of industrial production. They also need to develop infrastructure that enjoys increasing returns to scale. However, as such investment in infrastructure is indivisible and non-tradable and has positive externalities, private investment may be insufficient in supply. To avoid being caught in the poverty trap, less developed countries have to depend on the government to formulate and implement industrial development plans and to make massive investments in various sectors of the national economy. "New structuralist economics" emphasizes the economic development as a natural and continuous dynamic process, and that every country enjoying comparative advantages should take the market mechanism as the basic mechanism to achieve effective allocation of resources at the corresponding development stage. However, the government should also play an active role in the face of the externalities caused by such structural adjustment as industrial upgrading (Lin, 2012). It thus shows that both the new and old structuralist economic development theories are based on the differences in factor endowments

and industrial structures between developing countries and developed market economies. Although government interventions are oriented toward different aims (e.g. whether follow the rules of comparative advantages), the intervention itself is targeted at “market failures” or coordination challenges caused by externalities. Compared with the traditional market economy theory, these theories mainly answer the question of whether the governments in developing countries need to intervene and how.

However, from the view of Marxist political economy, structural contradictions are not only unique to developing countries, nor are “market failures” the only cause for structural problems. They are the basic and intrinsic contradictions inherent social reproduction. Marx’s social reproduction theory provides us with the basic principles and analytical framework for analyzing the total amount and structural problems.

To analyze the conditions for smooth social reproduction, Marx divided the total social product into two subdivisions: means of production and means of consumption (subdivision one and two respectively). According to their respective value composition, the production structures of the two subdivisions are as follows:

$$c_1 + v_1 + m_1 = w,$$

$$c_2 + v_2 + m_2 = w_2.$$

Marx summed up the conditions for social reproduction into two aspects: material compensation and value compensation, and analyzed their balance conditions in aggregate and structure. Looking at the aggregate balance, the total supply of means of production all comes from subdivision one, the total supply of means of consumption all comes from subdivision two, and the supply and demand balance of the two subdivisions must meet the following conditions of the aggregate:

$$c_1 + c_2 = c_1 + v_1 + m_1,$$

$$v_1 + m_1 + v_2 + m_2 = c_2 + v_2 + m_2.$$

If it is simple reproduction, the above conditions then transform into a structural condition for market exchange in the two subdivisions:

$$c_2 = v_1 + m_1.$$

The expansion of reproduction is somewhat complicated, but the nature remains the same. To expand reproduction, the profits of capital (surplus value) m break into four parts: capitalist’s original consumption S_c and new consumption $S_{\Delta c}$, new investment in labor S_{av} and new investment in capital S_{ac} . At this time, the initial conditions for reproduction becomes the following:

$$c_1 + v_1 + S_{c1} + S_{\Delta c1} + S_{av1} + S_{ac1} = w_1,$$

$$c_2 + v_2 + S_{c2} + S_{\Delta c2} + S_{av2} + S_{ac2} = w_2.$$

To expand reproduction, the total supply and demand balance of means of consumption must meet the following conditions of the aggregate:

$$c_2 + S_{ac2} = v_1 + S_{c1} + S_{\Delta c1} + S_{av1}.$$

And as the condition to realize reproduction ($c_2 = v_1 + S_{c1}$) has also to be met at the same time, the above conditions transform into the structural conditions for market

exchange in the two subdivisions:

$$S_{ac2} = S_{\Delta c1} + S_{av1}.$$

Thus, the smooth social reproduction must meet both the conditions of total and structural balance. For the total, the means of production and the means of consumption in the form of products (in kind or use value) must achieve their respective balance of supply and demand, and meanwhile maintain the structural balance to realize the market exchange in the two subdivisions. Similarly, value compensation also means meeting both total and structural balance. Taking the condition for simple reproduction as an example, $c_2 = v_1 + S_{c1}$ means that the demand of subdivision one for the product form of means of consumption equals perfectly the demand of subdivision two for the product form of means of production. To realize the two sides' exchange, the value of the means of production provided to the market by subdivision one must be exactly the same as the value of the means of consumption provided to the market by subdivision two.

Undoubtedly, it is not easy to satisfy both total and structural balances at the same time in private production and decentralized decision making. Considering that expanding reproduction requires that the accumulation rates of the two subdivisions are mutually determined, it is even more difficult and uncertain to achieve the balances, making balance accidental, imbalance common, and the use value and value of different sectors possibly disproportionate. In addition, there is a second kind of structural contradiction and problem. Marx pointed out that because "certain social structures and social relations have been abstracted away, so have been all kinds of contradictions generated by them," "some economists like Ricardo take the self-expansion of production and capital simply as one thing, without considering the restriction of consumption or the restriction of circulation itself as it has to show equal value at all points, rather, they pay attention only to the development of productive forces, the growth of industrial population, and supply, leaving demand alone[8]."

However, the institutional structure of capitalist production already carries the potential of a structural crisis, as "the purpose of capital is not to meet the demands, but to produce profits. Capital achieves this goal by determining the output in the light of the scale of production, rather than the opposite, thus the inevitable and continuous inconsistencies between the limited consumption range based on the capitalist foundation and the constant efforts to break through the inherent limits of production. Moreover, capital consists of commodities, so the overproduction of capital comprises the overproduction of commodities [9]." The reason for the continuous inconsistency is that between production and consumption, total supply and total demand, "The first are only limited by the productive power of society, the latter by the proportional relation of the various branches of production and the consumer power of society. But this last-named is not determined either by the absolute productive power, or by the absolute consumer power, but by the consumer power based on antagonistic conditions of distribution, which reduce the consumption of the bulk of society to a minimum varying within more or less narrow limits. It is furthermore restricted by the tendency to accumulate, the drive to expand capital and produce surplus-value on an extended scale[10]."

Introducing or not the institutional structure of production into social reproduction analysis is a crucial difference between Marxist political economy and Western economics, which leads to two completely different answers to whether capitalist production is of a relative surplus nature and whether a structural crisis is possible. Limited by the private nature of capitalist production, Western economic theories, in the event of structural contradictions or even crises in the economy, can only turn to macro-management policies to achieve or maintain short-term aggregate balance and believe that the market will

automatically correct such deviations. However, the “stagflation” in the 1970s and the international financial crisis in 2008 have fully shown that the aggregate policy cannot solve the structural problems, be it stimulating the demand or loosening up the supply. It can at best only cover up those contradictions for a certain period of time. Since the financial crisis, many countries have seen the necessity for structural reforms, and international organizations such as the International Monetary Fund have repeatedly called on countries to implement such reforms.

From the perspective of political economy, promoting supply-side structural reform is a long-term task for China’s economic development, rather than a short-term regulatory measure. First, China’s market economic system is not yet full-fledged, uneven, uncoordinated and unsustainable development is acute, and structural contradictions and problems will exist for long. For example, China’s product structure and industrial structure in the international division of labor are still mainly at the middle and low end of the production value chain. Participating in the international division of labor, China is bound to be influenced by the accumulation rules of the world capitalist system with its economy entering the center of the world capitalist system from the periphery and move from the middle and low end of the value chain to the middle and high end (Arrighi, 2001). If necessary, reform measures are not taken, it will be a long and natural development process. An important part of the supply-side structural reform is to seize the opportunity during the period of incubating a new round of world scientific and technological revolution and industrial revolution, transform the development mode, optimize the economic structure, change the growth drivers, and promote economic development to achieve high quality, efficiency and driving force reform. Second, under diversified ownerships and the market economy, China’s major suppliers are mainly productive enterprises that pursue profits. If production and consumption, supply and demand are entirely connected by the market mechanism, the market disproportion and structural contradiction between supply and demand are inevitable. This makes the supply-side structural reform a long-term and imperative task, allowing the market to play a decisive role in allocating the resources, while the government functions better.

4. Real economy and virtual economy in the view of political economy

General Secretary Xi pointed out at the Central Economic Working Conference on December 14, 2016 that the prominent contradictions and root causes of the problems in China’s economic operations are major structural imbalances, mainly three kinds of them: first, the structural supply and demand imbalance in the real economy; second, the imbalance between finance and real economy; third, the imbalance between real estate and real economy. Among them, the latter two indicate the fact that the economy is moving away from real to virtual, that is, a large amount of capital leaves the real economy and circulate itself in the financial system or the real estate market to obtain excess returns. In this case, “Simply expanding demand will not only fail to redress the structural imbalance, but will aggravate overcapacity, and elevate leverage ratio and enterprises’ costs, thus intensifying this imbalance. Considering the above, we emphasize on finding ways and formulating policies from the supply side and through structural reforms[11].” Deepening the supply-side structural reform should start from production and focus the development efforts on the real economy.

Developing the real economy has become a common trend throughout all countries in the world today. Since the US sub-prime mortgage crisis triggered international financial crisis in 2008, developed countries have rolled out the “re-industrialization” and “re-manufacturing” strategies one after another, in an attempt to correct the mistake of over-development of the virtual economy separated from the real economy. However, what on earth is the real economy, what is the virtual economy, and how the two relates to each other, are still controversial in theory.

Some people simply equate the financial sector and the real estate market with the virtual economic sector. Some people, seeing more and more “online” transactions replacing “offline” transactions in traditional physical stores, compare the internet economy to virtual economy. These views are both wrong. We cannot confuse the division of real and virtual economies with the division of different sectors and industries in the national economy, let alone dividing by the space where economic activities take place. The fundamental difference between the two does not lie in the industrial form and transaction form. Different industrial forms are interrelated within national economic activities, and different transaction forms are subordinate to the market transaction demand, distinguishing the real from virtual by industry and transaction forms will artificially split the internal connections between different industrial sectors of the national economy and is not conducive to the prosperity of market transactions through the development and innovation of new industrial forms.

In fact, the difference between real economy and virtual economy is sufficiently clear in the view of political economy. Virtual economy is developed from the concept of “virtual capital,” which is an important theoretical category put forward by Marx when he analyzed “the overall process of capitalist production.” Virtual capital and real capital are antagonistic to each other. The fundamental difference between the two lies in their completely different operation modes and movement laws, which are embodied in the entirely different ways of value determination and price movements of the trading objects in the real economy and those in the virtual economy.

Following the basic principles of Marxist political economy, real capital or real economy gains returns based on the capitalist production process in which the laboring process and value increase process are unified. Real capital displays different forms of monetary capital, production capital and commodity capital in this production process. For certain capital circulation, the three capital forms are successive in time, but for total social capital, the three capital forms coexist in space, which gives commodity capital and monetary capital the possible chance to be independent of production capital and capitalist production process. On the surface, the capitalist production process seems to be continuously “precipitating” commodity capital and monetary capital all the time. These commodity capital and monetary capital complete their own independent movements in the place and space separated from the production process (the movement place and space of production capital).

The relatively independent movements of commodity capital and monetary capital provides the possibility for the movement of virtual capital, while commercial capital and credit system turn this possibility into reality. However, whether commodity capital and monetary capital are separated from the capitalist production process or not, they are still only the means to realize value increase for capital owners. Once commodity capital and monetary capital are only seen as the source of income, regardless of their actual form and the relationship with production process and production capital, they become the capitalized embodiment of income in the eyes of capital owners. “The formation of a fictitious capital is called capitalization. Every periodic income is capitalized by calculating it on the basis of the average rate of interest, as an income which would be realized by a capital loaned at this rate of interest. For the person who buys this title of ownership, the annual income of £100 represents indeed the interest on his capital invested at 5 percent. All connection with the actual expansion process of capital is thus completely lost, and the conception of capital as something with automatic self-expansion properties is thereby strengthened[12].”

About the form of title of ownership, virtual capital has its purest. Taking the national debt as an example, Marx pointed out that the capital itself that was borrowed by the state has been consumed or expended. But for creditors, the title of ownership represented the future interest income, the capitalization of this income turned the title of ownership itself into the “illusory, fictitious capital” and developed a special movement independent of real capital – the transaction of titles of ownership. Marx pointed out: “The independent

movement of the value of these titles of ownership, not only of government bonds but also of stocks, adds weight to the illusion that they constitute real capital alongside of the capital or claim to which they may have title. For they become commodities, whose price has its own characteristic movements and is established in its own way [...] The market-value of this paper is in part speculative, since it is determined not only by the actual income, but also by the anticipated income, which is calculated in advance [...] Their value is always merely capitalised income[13].”

The fundamentals of virtual capital in political economy provide a theoretical basis to distinguish real economy from virtual economy. Real economy is the movement of real capital and its results, including that of different forms of capital such as monetary capital, production capital and commodity capital. Therefore, we cannot simply classify the place where monetary capital moves, namely the financial sector, as virtual economy. Whether financial activities belong to real economy or virtual economy depends on whether the monetary capital in financial activities is real capital or virtual capital, and whether monetary capital is part of the capital circulation process of “monetary capital-production capital-commodity capital” and realizes its own income from it. Similarly, whether commodities or commodity capital belong to virtual economy and virtual capital depends on whether commodities or commodity capital are part of the capital circulation process and hence realize income. Enterprises acquire monetary capital by issuing bonds or stocks and put it into production. This capital is used as real capital. But the trading of the title of ownership representing this monetary capital on the securities market is relatively independent of the actual use of the capital and is different from the real capital. No matter how many times this pure ownership transaction is repeated, it is still mere virtual capital. If the price gains from securities trading and ownership transfer is not related to the value increase of this real capital, then this market belongs to virtual economy. The production and consumption of real estate commodities are part of the real economy, since housing is a pure commodity for consumers and a commodity capital in the process of capital circulation for real estate enterprises, or real capital. But if the owners of real estate commodities trade their ownership in the market and use price gains as capitalized income, real estate commodities then become the virtual capital of “real estate speculators.”

From the above differences we can see that we cannot simply divide real capital and virtual capital according to the sectors and places where commodities or capital run. In the financial sector, there are not only monetary capital movements that belong to real economy and real capital, but also financial activities that are of virtual economy and virtual capital. And in the real estate market, there are not only commodity capital movements that belong to real economy and real capital, but also market transactions that are of virtual economy and virtual capital. For the same sector and market, a simple criterion to distinguish the components of real economy and virtual economy is the source and nature of capital gains. The income sources of real capital and virtual capital are utterly different in nature. The former comes from commodity and currency participating in capital circulation, which is a process of value increase. The latter is from the pure ownership (title) transfer of commodities and currencies, which is a process of value transfer or value distribution. Therefore, virtual capital’s “depreciation in times of crisis serves as a potent means of centralising fortunes,” and “to the extent that the depreciation or increase in value of this paper is independent of the movement of value of the actual capital that it represents, the wealth of the nation is just as great before as after its depreciation or increase in value[14].”

It can be seen from the above that the supply-side structural reform needs to develop the real economy, which is not only to develop the manufacturing industry but leave the financial industry and the real estate market behind. The part of the financial and real estate economy that belongs to the real economy also needs to be developed. The 19th CPC National Congress report made it clear that efforts should be made to speed up the construction of an industrial

system with coordinated development of real economy, scientific and technological innovation, modern finance and human resources. It also clearly stated that “houses are for living, not for speculation.” These are quite correct from the view of political economy on real economy and virtual economy. In the meantime, excess yields of the virtual economy attract the real capital away from the real economy to the virtual economy, and the redistribution of wealth brings instability to the economy and society, thus the government has to guard against the systematic risks existing in the virtual economy.

5. Conclusion

The basic principles in Marxism about prioritizing production and that the four links including production and consumption are organically connected in social reproduction is the starting point of understanding the supply-side structural reform in socialist political economy with Chinese characteristics. From the primacy of production, the supply-side structural reform is highly unified with the fundamental task of socialist liberation and developing productive forces and is the specific way to realize socialist production purposes during economic development. And seeing the organic relationship between production and consumption in social reproduction, rather than just the superficial connection between supply and demand in the exchange process, is the basis for us to understand that supply-side structural reform is different from both demand-side management and the Western supply-side economics, which is fundamentally preventing our basic economic policies from swinging back and forth between liberalism and interventionism like western economics.

From Marx's theories of social reproduction, structural contradictions are intrinsic in social reproduction, while structural balance is an inherent requirement and essential condition for smooth social reproduction. The structural contradictions in economic development cannot be attributed solely to the imbalance caused by “market failures.” They are closely related to the institutional structure of production and the purposes and nature of production. Limited by the private nature of capitalist production, Western economic theories only adopt macro-management policies to achieve or maintain short-term aggregate balance in the event of structural contradictions or even crises in the economy and believe that the market will automatically correct these problems in the long run. But from the perspective of political economy, the structural contradictions and problems in China's economic development have been existing for a long time, especially with the international division of labor. If necessary, measures are not taken, China's economic development will inevitably be affected by the laws of accumulation in the world's capitalist system. This decides that promoting the supply-side structural reform is not only a necessity, but also a long-term mission, rather than short-term regulation and management.

The supply-side structural reform emphasizes on developing the real economy from the production end. The definition of virtual capital in political economy and its rationale are the theoretical basis to distinguish real economy from virtual economy. Real economy is the movement of real capital. Monetary capital, production capital and commodity capital are all different forms of real capital. We cannot simply equate the movement of monetary capital, namely financial activities and the market activities of real estate commodities (capital) with virtual economy. Whether they belong to real economy or virtual economy depends on whether monetary capital and real estate commodities (capital) in financial activities are real capital or virtual capital, whether they are part of the circulation process of “monetary capital-production capital-commodity capital,” and whether capital gains come from the value increase of capital or from the value transfer and value distribution by ownership transfer. For the supply-side structural reform to develop the real economy, it should develop the part of financial and real estate economy that belongs to the real economy in addition to promoting the manufacturing industry, and simultaneously take precautions against risks in the virtual economy.

Notes

1. "A mix of three simultaneous challenges" refers to simultaneously dealing with the slowdown in economic growth, making difficult structural adjustments, and countering the effects of previous economic stimulus policies.
2. *Xi Jinping's Discourses on the Construction of Socialist Economy (Extract)* (2017), Central Party Literature Press, Beijing, p. 105
3. "Seven Questions on Supply-side Structural Reform: Insiders' Opinions on Current Economy and Measures to Develop the Economy", *People's Daily*, 2nd Edition (January 4, 2016).
4. *Collected Works of Karl Marx and Friedrich Engels* (2009). Vol.7, People's Publishing House, Beijing, p. 212),.
5. *Collected Works of Karl Marx and Friedrich Engels* (2009). Vol. 8, People's Publishing House, Beijing, p. 23.
6. Promote Supply-side Structural Reform, *Xi Jinping: The Governance of China*, (2017). Vol. 2, Foreign Languages Press, Beijing, pp. 251-255.
7. General Secretary Xi Jinping specially stressed: "I want to make it clear that the supply-side structural reform we have raised is different from that of conventional Western supply-side economics, we cannot see it as another version of the latter." *Xi Jinping: The Governance of China*, Vol. 2, pp. 251.
8. *Marx and Engels Collected Works*, Vol 8, pp. 92-93.
9. *Marx and Engels Collected Works*, Vol 7, pp. 285.
10. *Marx and Engels Collected Works*, Vol 7, pp. 272-273.
11. *Xi Jinping's Discourses on the Construction of Socialist Economy (Extract)*, p. 115.
12. *Marx and Engels Collected Works*, Vol 7, pp. 528-529
13. *Marx and Engels Collected Works*, Vol 7, pp. 530-531
14. *Marx and Engels Collected Works*, Vol 7, p. 53

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