

# The End of Western Economic Growth Theory

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## ABSTRACT

Economics is a science that studies how the economy grows, so the theory of economic growth is the most important theory of economics. In the real market economy society, people achieve the goal of economic growth through two kinds of economic activities: production and transaction. Then a correct economic growth theory must be one that can explain both production and transaction economic activities. Just like Newton's law of universal gravitation in physics, it can explain the motion law of all objects. For a long time, we have been dominated by the western economic growth theory of western mainstream economics. It is not difficult to find that it has a fatal defect, which can only explain production economic activities but not transaction economic activities. So it can't explain the Chinese economy, and it can't explain the western economy. The new economic growth theory proposed in this paper makes up for the defects of western economic growth theory, and it is the terminator of western economic growth theory. This is a revolution of new economics to traditional western economics.

## 1. Introduction

Economic growth theory is one of the most important theories in economics, which studies how economy grows. Because the significance of economic and social existence or the purpose of people engaged in economic activities is to pursue economic growth and increase wealth, so the theory of economic growth is very important. At present, we are dominated by the western economic growth theory of Western (mainstream) Economics. It has many theories, Professor Zhang Weiying pointed out: "so far, no one theory can make a complete explanation for the phenomenon of economic growth."<sup>[1]</sup> Professor Wei Xinghua also pointed out: "There is no consensus in Chinese academic circles on the exact connotation of market allocation of resources"<sup>[2]</sup>. Nevertheless, we have to admit the fact that in the past 200 years and more

than 40 years since the reform and opening up of China, the economic and social growth has never been seen in history. Professor Zhang Weiying said: "the only answer I can provide is that human beings have implemented a new economic system, namely market economy"<sup>[3]</sup>. This shows that economists have failed to grasp the law of economic growth (otherwise there will not be multiple economic growth theories), while people engaged in economic activities have mastered it (otherwise the economy will not grow at a high speed). This is an irrefutable fact, and this paper attempts to explain this phenomenon.

## 2. Overview of Economic Growth

To study the law of economic growth, we need to unify some concepts related to economic growth.

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## 2.1 The Contradiction between Economic Growth and Solving scarcity

There is a contradiction in economic society: natural resources are limited while human needs (desires) are unlimited. We call this contradiction scarcity contradiction. When people talk about economic growth, the essence is to talk about how to solve the contradiction of scarcity. People will not engage in economic activities related to non scarce resources, such as producing non scarce sunlight and air. People are engaged in economic activities to solve the problem of scarcity.

In the real market economy society, all countries called market economy are pursuing GDP. After the reform and opening up, China has taken the road of socialist market economy, and GDP is also taken as the measure of economic growth. So GDP is also the concept of economic growth. In this way, we link the following three concepts together: economic growth, solving the contradiction of scarcity and increasing GDP.

## 2.2 Law of Economic Growth

Regularity generally refers to repeated actions. For example, the sun rises in the east every day, and people are engaged in productive labor every day. These are the laws. Obviously, they are different laws. It is a natural law that the sun rises from the East, while it is an economic law that people engage in productive labor every day. What economists want to study is economic law.

The law of nature is formed by nature, which can not be changed by man, but can only be found and obeyed. For example, Newton discovered the law of universal gravitation. The law in economic society is called economic law. It is set by people. People can change it, but it is not easy to change.

One of the main differences between economic law and natural law is that economic law has a direction, that is, there is an economic goal, and the economic law moves towards the economic goal. But the natural law often does not have the natural goal. In economic society, people pursue economic growth, so we call economic goal or economic growth goal, which corresponds to the law of economic growth.

## 2.3 Economic Growth Theory

To study economic growth means to study the law of economic growth. The description of the law of economic growth is called economic growth theory. Furthermore, the law of economic growth described by natural language is called economic growth thought, while the law of economic growth described by mathematical language is called economic growth model. Economic growth theory includes

economic growth thought and economic growth model.

## 2.4 Phenomenon of Economic Activities

People know the world from appearance to essence. When we explore the law of economic growth, we should naturally begin with the appearance observed, that is, various economic activities in the economic society, also known as the phenomenon of economic activities. Like Newton in the physical world, he observed that Apple landing is not flying, and finally found the law of universal gravitation. Similarly, what we want to explore is the economic growth theory of economic society similar to the law of universal gravitation. In view of Newton's observation of the phenomena in the physical world, it is very necessary. What we want to observe is the phenomenon of economic activities in the economic society.

Through the above analysis, the economic law is different from the natural law, there is a growth problem, that is, there is an economic growth goal. What we want in the end is the law of economic growth to reach the goal of economic growth. The study of the law of economic growth must begin with the observation of economic activities. Therefore, let's first study "economic growth target" and "economic activity phenomenon". In order to explore the law of economic growth, they are the basis of our economic growth theory.

## 3. Analysis of Economic Growth Target and Economic Activity Phenomenon

### 3.1 Economic Growth Target

We already know that the real market economy pursues to solve the contradiction of scarcity or GDP, so solving the contradiction of scarcity or increasing GDP is the goal of economic growth. On this point, western economics also understands in this way. In economics, Samuelson defined economics as "economics studies how a society can use scarce resources to produce valuable goods and distribute them among different individuals" [4]. This proves that western economics also regards solving the contradiction of scarcity as the goal of economic growth. Of course, the economic society of non market economy may not pursue this goal of economic growth. The goal of economic growth is an important concept to study the law of economic growth. Because the goal is wrong, the law of economic growth is bound to go wrong.

### 3.2 Phenomenon of Economic Activities

We already know that people achieve economic growth

goals through economic activities. To study the law of economic growth is actually to study the phenomenon of economic activities and find out the logic behind the phenomenon of economic activities. It's the same logic as Newton's observation of apple and other things to find the law of gravity behind the landing.

It is easy to observe that there are many economic activities in the real market economy society. All activities in pursuit of the goal of economic growth are called economic activities. For example, manufacturing products, trading commodities, scientific and technological research and development, enterprise management, and even learning and looking for jobs can be regarded as economic activities. We may as well classify all economic activities into two categories, production economic activities and transaction economic activities. Every economic activity can be classified into one of these two categories.

With the goal of economic growth and the observed phenomena of production and trade, the following work is to explain the law of economic growth produced by these economic activities.

## 4. Western Economic Growth Theory

The following is the description of economic growth law in western economics, or the theoretical explanation of economic activity phenomenon in western economics. First of all, it depends on its understanding of economic growth goals.

### 4.1 Economic Growth Target

The goal of economic growth is the basis of forming the law of economic growth. In a real market economy society, there is only one goal for economic growth, not many. And western economics is just planted on this issue. It does not understand that there is only one economic growth goal in the real market economy, so it puts forward multiple economic growth goals.

We have given Samuelson's definition of economics. In the definition, western economics also takes solving the contradiction of scarcity as the goal of economic growth, but western economics has many goals. For example, the pursuit of "general equilibrium" is mentioned in many western economic theory literature. "Walras' general equilibrium theory states that the price mechanism can realize the optimal allocation of resources in the whole society"<sup>[5]</sup>. Therefore, general equilibrium is also the economic growth goal of western economics. In the textbooks of Western microeconomics, it studies the goal of profit maximization for producers and utility maximization for consumers<sup>[6]</sup>. It shows that western

economics has set many economic growth goals. Different economic growth goals will inevitably correspond to different laws of economic growth.

### 4.2 Law of Economic Growth

Leaving aside the multi-objective of western economics, we only study one objective of western economics, which is consistent with the reality of solving the contradiction of scarcity, to analyze the law of economic growth it gives us. It is described by economic growth thought and economic growth model respectively.

#### 4.2.1 Western Economic Growth Thought

The law of economic growth described by natural language is called economic growth thought. The following is the economic growth thought given by western economics.

In Samuelson's macroeconomics, Samuelson said: "in fact, economists who study economic growth have found that the engine of economic growth must be installed on four identical wheels in both rich and poor countries. These four wheels or the elements of economic growth are: human resources, natural resources, capital, technological change and innovation"<sup>[7]</sup>. Thus we can see that western economics adopts the direct observation method to understand the law of economic growth that reaches the goal of economic growth. And these four wheels are basically related to "production", so the western economic growth thought can be expressed as: "increasing the input of production factors and improving the level of productivity can achieve economic growth".

#### 4.2.2 Western Economic Growth Model

The western economic growth model is formed by transforming the economic growth thought described by natural language into mathematical language. The following is the general economic growth model given in Samuelson's textbook<sup>[7]</sup>.

$$Q=Af(K,L,R)$$

Where Q = output, K is capital, L is labor, R is natural resources, and A is technological progress. f is the production function.

Harold Domar model or Solow model commonly used by western economists is the evolution of this general model. There is no essential difference between western economic growth model and western economic growth thought.

### 4.3 The Defects of Western Economic Growth Theory

It is easy to find that the defect of western economic

growth theory is that it only explains the phenomenon of production economic activities, but not the phenomenon of transaction activities. Although Professor Zhang Weiying pointed out the problems of western economic growth theory, he himself failed to get out of the box. In essence, the “Smith-Schumpeter growth model” designed by him is still a model about production, only adding the entrepreneurship that should not be added. The same is true of Professor Lin Yifu’s understanding of economic growth in China. “In general, modern economic growth is based on the continuous growth of income level on the basis of the continuous improvement of labor productivity,” he said<sup>[8]</sup>.

It is a fact that western economics does not study transaction. It assumes that transaction cost is zero. So much so that Coase failed to bring his transaction cost theory into the analysis of economic theory. He said with regret that western economics is “blackboard economics”<sup>[9]</sup>. There is no doubt that a perfect economic growth theory, if it can not explain all the phenomena of economic activities, must be defective.

## **5. New Economic Growth Theory**

The theory of new economic growth is based on the theory of new economics put forward in the Book Principles of new economics published by the author in 2019. It aims at the defects of western economic growth theory<sup>[10]</sup>.

### **5.1 (New) Economic Growth Target**

Similarly, we must first address the issue of economic growth targets. The economic growth goal of new economics is consistent with and unique to the real market economy. But the new economics classifies the contradiction of scarcity.

#### **5.1.1 Absolute Scarcity Contradiction**

The contradiction of absolute scarcity is the contradiction of scarcity that people usually understand, which means that resources can not meet people’s needs, that is, the cake is not big enough. So the way to solve the contradiction of absolute scarcity is to try to make the cake bigger and make the scarce resources meet the needs of people as much as possible.

#### **5.1.2 The Contradiction of Relative Scarcity**

In reality, we have observed another situation in which people have different needs for goods. For example, there is a person  $P_1$  who needs goods A but does not need goods B, while another person  $P_2$  needs goods B but does not

need goods A. Suppose that there are only two people and two goods in the world, then assign goods A to  $P_1$  and goods B to  $P_2$ , then there is no contradiction of relative scarcity. On the contrary, if A is assigned to  $P_2$  and B to  $P_1$ , there will be a contradiction of relative scarcity. The ancient Greek economist Xenophon said that the flute is undoubtedly a stone for those who can’t play<sup>[11]</sup>. There must be absolute scarcity contradiction in real economy and society. In theory, it can avoid relative scarcity contradiction. In fact, it can’t, which indicates that relative scarcity contradiction must exist. So the solution is to distribute all the goods to the people who need them most.

The two kinds of scarcity contradictions exist objectively. If they are not classified, it shows that the understanding of scarcity contradictions is insufficient. Through the classification, it constructs a new economic growth theory to solve the two kinds of scarcity contradiction.

## **5.2 New Economic Growth Law**

The law of new economic growth includes the law of solving two kinds of contradictions.

### **5.2.1 The Law of Solving the Contradiction of Absolute Scarcity**

Obviously, the western economic growth law corresponds to the economic law of solving the contradiction of absolute scarcity. Therefore, the new economics is the same as the western economics. It is also a theory to explain the phenomenon of productive economic activities.

### **5.2.2 The Law of Solving the Contradiction of Relative Scarcity**

There is no concept of relative scarcity contradiction in western economics, so this part is unique to new economics, which is the most important part to overcome the defects of western economic growth theory.

The meaning of the contradiction of relative scarcity is the unreasonable distribution of products. The solution is to distribute the products reasonably. On the surface, it seems that there are many ways to achieve reasonable distribution. In fact, as long as you accept the two conditions given below, you will find that there is only one method to implement.

When we consider the reasonable distribution of products, we need to consider the following two points. First, the demander puts forward the demand, that is, he “asks” for the products he needs from the society. Otherwise, no one knows what it needs; second, the



demanders must pay the “price”, otherwise he may have made a lot of non-point demands. Admitting the above two points actually means admitting that “reasonable distribution” mechanism is “trading mechanism”. “Demand + pay” is a kind of transaction. The demander pays the society for the products he owns and trades back the products he demands from the society. Of course, the usefulness of the products he traded must not be as useful as the products he traded back. And it’s exactly the same with the other side. So we get the method to solve the contradiction of relative scarcity, and use the “transaction” method to solve the contradiction of relative scarcity.

### 5.3 New Economic Growth Theory

The followings are the economic growth theories described in natural language and mathematical language respectively.

#### 5.3.1 New Economic Growth Thought

Using natural language to describe the above new economic growth law constitutes the new economic growth thought: using production mechanism to solve the contradiction of absolute scarcity, using transaction mechanism to solve the contradiction of relative scarcity. In other words, all economic activities related to production are solving the contradiction of absolute scarcity, while all economic activities related to transaction are solving the contradiction of relative scarcity. The thought of new economic growth fully explains the two kinds of economic activities of production and transaction in reality.

#### 5.3.2 New Economic Growth Model

Using mathematical language to describe the law of new economic growth constitutes a new economic growth model, which is actually a transaction mechanism model added to the western economic growth model. We already know that the western economic growth model is:

$$Q_1 = Af(K, L, R)$$

Where  $Q_1$  = output, K is capital, L is labor, R is natural resources, and A is technological progress. f is the production function.

This paper gives a new economic growth model to solve the contradiction of relative scarcity:  $Q_2 = Rf(T, C)$ .

Where  $Q_2$  is the output, T is the price paid, C is the return received, and f is a function of the transaction. R is the state of man.

Then, the new economic growth model is as follows:

$$Q = Q_1 + Q_2.$$

From this, we can see that economic growth depends

on production and trade, and both of them are creating value.

## 6. The Significance of New Economic Growth Theory

### 6.1 Replace the Western Economic Growth Theory

For a long time, western economic growth theory has dominated us. Through the analysis of this paper, we can see that the western economic growth theory only explains one kind of economic activity, while the new economic growth theory explains two kinds of economic activities at the same time. So the new economic growth theory is the correct and complete economic growth theory. Undoubtedly, it is a new theory to replace the western economic growth theory, and it is the terminator of the western economic growth theory.

### 6.2 Correctly Explain China’s Economic Development

More than 40 years of reform and opening up, China’s rapid economic growth has created a “Chinese miracle”. Xia Bin, counsellor of the State Council of China, once pointed out in a long article: “Up to now, the discussion of China’s miracle can not be well explained in theory, and it is difficult to reach a consensus due to the disunity of understanding.” As Nobel laureate Milton Friedman once said, “those who can interpret China’s economic reform should be awarded the Nobel Prize.”<sup>[12]</sup> Their view shows that the western economic growth theory can not explain the Chinese economy, in fact, it can not explain the western countries’ economy.

With the new economic growth theory, it is easy to explain the miracle of China’s economic growth. The reason is very simple. From the perspective of western economic growth theory (leading economists’ thinking), we can see that economic growth depends on “production”, and it is difficult to explain the data released by China’s National Bureau of statistics by production alone. China’s GDP has grown by 33.5 times in 40 years of reform and opening up, with an average annual growth of 9.5%<sup>[13]</sup>. The new economic growth theory tells us that economic growth depends not only on the “production” mechanism, but also on the “transaction” mechanism. Everyone can personally realize that the biggest change in China after the reform and opening up is trading. If we say that the production has increased several times or more than ten times, the trade has increased dozens or even tens of thousands of times from scratch. Detailed analysis is not carried out here. The new economic growth theory strongly explains how the miracle of China came into being.

### 6.3 Guiding Role for China's Economic Growth

Just as Newton's law of gravitation plays an important role in guiding the real society, the theory of economic growth plays a very important role in guiding the real market economy. According to the western economic growth theory, we only know how to rely on production to promote economic growth, investment pull is a way to increase the input of production factors, and we can't see the transaction to promote economic growth. According to the new economic growth theory, trade can promote economic growth, so the country should realize that economic growth can not only rely on production, but also rely on trade. The essence of transaction creating value is to optimize the allocation of resources. In China, there is a serious situation of resources not optimal allocation. As long as we solve the following problems, we can promote the national economic growth. First, the tradable resources that are not allowed to be traded should be allowed to trade. Typically, enterprise property rights and rural land resources are not tradable resources restricted by policies in China.

Second, we should solve the problem of tradable resources that cannot be traded technically as soon as possible. The typical is the resources of scientific and technological achievements. So far, China has not been able to solve the problem of scientific and technological achievements trading, leading to the lag of national science and technology development<sup>[14]</sup>. Western countries do not have three major resources can not trade, which also shows that this is China's unique economic growth opportunity. When the path of economic growth does not go, it is a kind of begging with a golden rice bowl, which of course needs the support of the new economic growth theory.

### 7. Concluding Remarks

This paper introduces the theory of new economic growth, which is based on the principle of new economics. The new economic growth theory retains the production part of the western economic growth theory and increases its missing transaction part. This is the reason why the western economic growth theory mentioned by Professor Zhang Weiyong can not give a complete explanation for the phenomenon of economic growth. Western economic growth theory is not a wrong theory, but an incomplete theory. It is not that it cannot be explained, but that it can only be explained one sidedly. This makes economists have to use it, but they feel that there is always a problem in using it. Therefore, it is inevitable for the new economic growth theory to replace the western economic growth theory, which is the terminator of the western economic growth theory.

It should be noted that due to the limited space, two important issues related to the new economic growth theory are not involved here. One is the utility value theory, which is the basic theory supporting the new economic growth theory; the other is the analysis of the role of man, who is the main body of creating wealth. The new economic growth theory includes the analysis of the role of human beings, which is omitted in this paper.

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