How to Understand “Dual Circulation”?

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Abstract: While the share of China’s economy in the world has significantly increased over the past four decades, the construction of its domestic market is still insufficient. In addition, the continuously changing domestic and international situations, particularly the outbreak of the COVID-19 and the escalation of China-US tensions this year, have brought significant negative impact on external demand and global supply chain. Against such a backdrop, Chinese government has further extended the vision of “economic circulation” by emphasizing a new development pattern in which domestic and international markets can boost each other, with domestic market as the mainstay. It is also anticipated that such a “dual circulation” strategy will be guiding China’s economic policy making in mid- and long-term and have significant impact on the 14th Five-Year Plan.

A philosopher once said that (paraphrase) “if discussion is soil, then a new vocabulary is like a seed.” The term "dual circulation" has sparked many guesses, heated discussions as well as interpretations in recent days. Anything that is public must be said clearly. The concept of "dual circulation" is also one that can be put clearly. To understand this new expression, it is necessary to review the changes in China’s domestic and international situations as well as the evolution of China’s economic policy thinking in recent years.

In an effort to reduce conjecture, this article attempts to review and comb the

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background under which the policy of "dual circulation" was put forward based on textual analysis.

I. The huge success of “great international circulation” and China’s coastal development strategy

At the end of October 1987, Wang Jian, then an associate researcher of the Economic Research Institute of the State Planning Commission, proposed to China’s central government the idea of the “great international circulation” economic development strategy. According to a report by Guangming Daily on December 30, 1987, Mr. Wang explained that the “great international circulation” strategy was to actively promote the export of labor-intensive products in exchange for foreign exchanges and to earn capital and technology needed by the development of heavy industries. Funds accumulated through the development of heavy industries would in turn support the development of agriculture. Through such an exchange mechanism in the international market, the circulation between agriculture and heavy industry would be formed.

The idea of "great international circulation" soon attracted the attention of China’s policy makers, which eventually foster the formation of China’s coastal development strategy.

From November 1987 to early January 1988, Zhao Ziyang, then general secretary of the Chinese Communist Party, who visited Jiangsu and Fujian provinces presented Deng Xiaoping an economic development strategy for China’s coastal areas. In the instructions to the report, Deng wrote that: "Fully agree. The plan should be implemented boldly and fast, and we should never fail any opportunity.”

On February 6, 1988, the Political Bureau of the CPC Central Committee adopted China's regional development strategy. In mid-March of the same year, the Second
Plenary Session of the 13th CPC Central Committee was held to discuss the implementation of China’s coastal development strategy (Li Shuqiao, “Decision-making Mechanism of Reform and Opening Up in the 1980s”, Economic and Management Digest, Vol. 11, 2008).

Specifically, China’s coastal development strategy conceived under the idea of “great international circulation” involved three key points (Tian Jiyun, “Formation and Implementation of China’s Coastal Development Strategy, Yanhuang Chunqiu, Vol. 3, 2015): First, develop labor-intensive industries by taking advantage of China's huge labor force; second, attract foreign direct investment and vigorously develop Sino-foreign contractual joint ventures; third, put both ends of the production process on the world market to expand China’s economic operation from domestic circulation to international circulation.

Since then, especially after Deng Xiaoping's southern tour in 1992, China's economy has been integrated into the world economy at an even faster pace with its degree of opening constantly improving. At the same time, capital and production capacities of developed countries began to transfer to developing countries, giving rise to the tide of globalization.

From 1992 to 2011, China's cumulative utilized foreign capital reached $1.14 trillion, making the country the most important investment destination in the world. During the same period, China grew rapidly from the world's 12th largest exporter to the largest one. China has also risen from a secondary role in the global production network to become the world's manufacturing hub.

This has helped China completely solve the "double gaps" problem facing many developing countries, namely, the foreign exchange gap and the savings gap. At the same time, China has further integrated into the global economic system from various dimensions including global value chain, international rules system and global
financial market. **China’s coastal economic development strategy formed under the idea of “great international circulation” has achieved great success.**

By November 2011, with the approval of the development plan for the coastal areas of Hebei province by the State Council, a comprehensive coastal development strategy and policy system covering both the southern and northern parts of China was formed.

**II. The ‘great international circulation’ strategy is facing increasing challenges**

While promoting the formation of the “great international circulation”, the policies of “putting both ends of the production process on the world market” and making export and investment the main drivers of China’s economy have also brought many side effects eventually: As the economy relied too much on investment and export, it has seen a series of problems such as severe imbalance of international payments, huge external pressure, widening gap in income distribution among different regions in China, bottlenecks in industrial upgrading and deterioration of ecological environment and so on.

In addition, as the “great international circulation” strategy had obvious export-oriented characteristics, China's trade dependence reached the peak of 64% at one time (in 2006), which was a rare economic structure for a large economy.

It was under such a background that the 11th Five-Year Plan released at the beginning of 2006 pointed out that China’s economic growth should be based on expanding domestic demand, especially consumption demand, to promote the transformation of economic growth model from an investment- and export-driven one to one mainly driven by the coordination between consumption and investment, and domestic and external demands.

The 12th Five-Year Plan released in early 2011, further stated that China should build
a long-term mechanism for expanding domestic demand and promote the shift of economic growth model to one driven by the coordination among consumption, investment and export. **It could be seen that the emphasis on the “great international circulation” had been gradually changing, with the focus of economic policy gradually shifting from international circulation to the coordination between domestic and international circulation.**

The Central Economic Work Conference at the end of 2014 pointed out nine characteristics of the “new normal”, two of which were: (1) in terms of factors of production, economic growth should rely more on the quality of human capital and technological progress, with increasingly aging population and decreasing agricultural population, and weakening driving effects of the scale of economic factors; (2) in terms of export and balance of payments, as global demand was sluggish while China's export remained competitiveness, import of high-end products and large-scale outbound investment were happening at the same time.

This meant that **China’s coastal economic development strategy formed under the idea of “great international circulation” was not only facing the above-mentioned increasingly obvious side effects, but also two major challenges under the new normal.** First, as the demographic dividend began declining, the international competitiveness of China’s labor-intensive industry in attracting foreign capital was gone; second, the global economy had been in secular stagnation, and the growth of export became dependent largely on competitive advantage rather than an expanding global market.

Later, China's export share in the global market peaked in 2015 and had since remained fairly stable until 2019.

However, the conditions for a development pattern dominated by international circulation still existed to some extent during this period, which was also reflected in
the characteristics of "new normal" to some extent, that is, high-end imports and large-scale outbound investments happened simultaneously. Through channels like foreign direct investment (FDI), China could introduce high-quality foreign capital and advanced technology, while making outbound direct investment and building extensive foreign economic and trade ties through programs like the Belt and Road Initiative.

III. Emphasis on “expediting the circulation of national economy” amid changing economic environment for the supply-side reform

The Central Economic Work Conference at the end of 2015 proposed the supply-side structural reform. Following that, China’s economic policy in 2016 and 2017 focused on cutting overcapacity, with a large part of the target completed ahead of schedule. In 2018, the target was fully completed as scheduled. Since the end of 2017 and the beginning of 2018, the focus of supply-side reform gradually shifted to deleveraging and risk prevention. By the end of 2019, the above work had achieved significant phased progress.

In the meantime, a lot of different views were proposed regarding the balance between the supply-side structural reform and the expansion of aggregate demand. Some believed that China should maintain policy stability and continue to promote structural reform, while avoiding monetary flooding; on the contrary, some held that the supply-side structural reform and the moderate expansion of aggregate demand did not conflict with each other. With continuously improving external demand in 2016 and 2017, the urgency to expand aggregate demand diminished to some extent, so the former view had a greater influence on economic policy in this period.

In late 2018, two changes in economic environment occurred. First, while the supply-side reform had achieved or was making significant progress in terms of
cutting overcapacity and deleveraging, the shortfalls and obstructions in economic and financial sectors became more prominent problems facing the supply-side reform. Second, the growth rate of investment continued to fall and external demand slowed significantly, while the China-US trade friction had increased uncertainty, making the moderate expansion in aggregate demand increasingly necessary.

In response to these two changes, the thinking behind economic policymaking also began to adjust. This was reflected in the Central Economic Work Conference in December 2018, which clearly proposed such policy actions as “expediting the circulation of national economy” and "promoting the formation of a strong domestic market”.

**On the one hand**, the meeting stressed the need to focus on "consolidating, strengthening, upgrading and ensuring unimpeded economic circulation" in terms of strengthening weak links in the supply side and ensuring the connection between supply and demand.

Specifically, the term "consolidating" confirmed the phased progress of the supply-side reform while pointing out the need for continuous efforts in promoting the supply-side reform regarding reducing costs and strengthening weak links.

In addition, the conference also highlighted expediting economic circulation. According to a brief of the conference, China would "expedite the circulation of national economy, speed up the construction of a unified, open, competitive and ordered modern market system, improve financial system’s ability to serve the real economy, and form virtuous circles between domestic market and production entities, economic growth and employment expansion, and finance and real economy ".

In its mention of the “circulation of national economy”, China’s economic policy
mainly focused on the circulation of domestic economy.

On the other hand, the conference proposed the policy action of "promoting the formation of a strong domestic market" for the second time in terms of expanding aggregate demand (it was mentioned for the first time at a meeting of the Political Bureau of the CPC Central Committee a week ago). Specifically, the meeting emphasized the need to enhance the capacity to consume and the key role of investment.

The Government Work Report of 2019 basically inherited the gist of the Central Economic Work Conference in December 2018, by stressing again "expediting the circulation of domestic economy", and "promoting the formation of a strong domestic market" from such perspectives as "continuously unleashing domestic demand potential", "promoting the stable growth of consumption", and "promoting the reasonable expansion of effective investment." In early 2019, the mention of a "strong domestic market" attracted wide attention and heated discussions in the market.

Deleveraging was no longer mentioned at the Central Economic Working Conference in December 2019. The focus of supply-side structural reforms was officially shifted to overcoming weak links. The conference started with remedying shortcomings in the fields of people’s livelihood, infrastructure, and industrial upgrading, and then linked up “unlocking domestic demand potential” and “remedying shortcomings in supply-side structural reform”, providing policy support for “expediting the circulation of national economy.”

Judging from the evolution of the aforementioned policies proposed from late 2018 to 2019, the proposition of “expanding domestic market" had balanced the supply-side reform from the demand amid a series of major changes in the external environment. At the same time, "expediting the circulation of national economy" has become a continuation of the supply-side reform and takes into account both supply and demand.
IV. What has and has not changed amid the COVID-19 pandemic and China-US tension

Before 2020, policies of "expediting the circulation of national economy" and "expanding domestic market" mainly corresponds to the "cyclical, structural, and institutional problems" in China's economic operation. Since the beginning of 2020, the outbreak of the COVID-19 pandemic and the escalation of Sino-US tension have further given a blow to external demand and international supply chains. The proposition of "expediting the circulation of national economy" has also undergone important adjustments both from perspectives of time and space.

The epidemic broke out in early 2020. The Politburo meeting in late February 2020 made arrangements about epidemic prevention and control as well as the resumption of production. At that time, logistics, the flow of people, and capital were all impacted to a certain extent. The "stimulating economic and social circulations” far went beyond the scope of supply-side reform and became an urgent task of outstanding importance.

After that, the disease spread on a larger scale around the world, and it began to widely spread in the United States in mid to late March. Due to various reasons, the China-US tension has increased significantly during the same period, which has brought a new and greater impact on the stability of China’s supply chain.

After April, the US Department of Commerce announced new export control regulations (EAR) against China and upgraded sanctions on Huawei, restricting Huawei from using US technology and software to design and manufacture semifabrics outside the United States. The Bureau of Industry and Security has further expanded its entity list for China's export controls.

In May, the US government issued the "United States Strategic Approach to The People's Republic of China", announcing that it would adopt "principled realism" as its guide and adopt a policy of competition with China.
In June, with the advancement of Hong Kong's national security legislation, the United States further tightened its export controls to China. At the same time, the international environment also changed on a larger scale.

**On this basis, from making up for shortcomings in the fields of people's livelihood, infrastructure, and industrial upgrading, the supply side reform also touched upon supply chain security.**

**On the whole, the epidemic and the tension between China and the United States have further differentiated domestic and international environments from the following three aspects:**

First, “the COVID-19 pandemic has plunged the global economy into a deep recession with a sharp decline in international trade and investment. It caused turmoil in the international financial market, and reduced international exchanges.” Moreover, since the disease will not be eliminated in a short time, the economy will suffer from its blow for some time.

Second, “economic globalization has encountered resistance, protectionism and unilateralism have prevailed in some countries, and geopolitical risks rise. China now is facing more uncertainties from the external environment.”

Third, though Chinese economy is facing much pressure, the fundamentals of the economy are stable. Chinese economy boasts great potential, strong resilience and flexibility, and has multiple policy tools.

The above three points are exactly what President Xi Jinping made when visiting members of the CPPCC on May 23, 2020.

**V. National economic circulation evolves into the dual circulation from time and space**
It should be noted that the foregoing discussion on the challenges facing the Chinese economy is based on the “systematic, structural, and cyclical issues” before 2020, plus the ongoing global pandemic and the new international situation.

These analyses reveal that the current changes are from the external environment, while the domestic fundamentals have remained stable. This distinguishes domestic and international markets, and different focuses for the idea of “expediting the circulation of national economy”. This is the first time when the idea of “creating a new development pattern where domestic and foreign markets can boost each other, with domestic market as the mainstay” was raised.

Then the Politburo Standing Committee meeting held on May 14, 2020 put forward the concept of "dual circulation" for the first time from perspectives of supply and demand: "We must deepen supply-side structural reforms and give full play to the advantages of China's ultra-large-scale market and the great potential of domestic demand so as to build a new development pattern in which the domestic and international markets can boost each other."

On July 21, 2020, President Xi Jinping had a discussion with entrepreneurs and further pointed out the following three points:

First, "China will not close its door, but will only open it wider and wider. That with the domestic circulation as the main body does not mean it will isolate itself from the world.

Second, “that with domestic circulation as the mainstay is to better connect domestic and international markets through unblocking domestic demand, and fully use domestic and international markets and resources so as to achieve more robust and sustainable development.”

Third, ”in the long run, economic globalization is still a historical trend. We must stand on the right side and persist in deepening reforms, expanding opening up, strengthening cooperation in the field of science and technology, and promoting the construction of an open global economy.”
"Concentrating our efforts to run our own affairs well" can also be regarded as another form of "taking domestic circulation as the mainstay."

On July 30, 2020, the Politburo meeting once again underlined the policy thinking of "dual circulation". The meeting pointed out that “the current economic situation is still complicated and troubled with great instability and uncertainty. Many of the problems we have encountered won’t be solved in a short time. We must fully recognize this and accelerate the formation of a new development pattern where domestic and foreign markets can boost each other, with domestic market as the mainstay. We also need to establish a medium and long term coordination mechanism concerning virus control as well as economic and social development.

This meeting further made clear the development pattern of “dual circulation”, which is a long-term strategy instead of a short-term issue.

So far, "expediting the circulation of national economy" has expanded to "dual circulation" in space and became a lasting, medium- and long-term task in time. This also means that the "dual circulation" will become the overall guiding idea for medium and long-term economic policies, and will have an important impact on the deployment of economic work during the 14th Five-Year Plan.

Looking back at the end of the 1980s, the concept of "shifting from domestic circulation to international circulation" promoted the implementation of the strategy of developing coastal economy, so the tenet of taking "domestic circulation as the mainstay" will also have important implications in the spatial layout of the economy.
VI. The dual circulation with domestic circulation as mainstay underlines proactive opening up

China has accelerated its pace of opening up since May 2020. In May, the government released “Opinions on Financial Support for the Construction of the Guangdong-Hong Kong-Macao Greater Bay Area”. In June, the “Overall Plan for the Construction of Hainan Free Trade Port” was issued. The negative list for foreign investment access was further reduced in 2020. This year, the restrictions on foreign shareholding in futures, funds, and securities companies have been or will be lifted gradually.

In mid-May, the Central Committee of the Communist Party of China and the State Council issued the "Opinions on Improving the Socialist Market Economy in the New Era", which also specifically pointed out: "implement a more proactive opening up strategy, and fully integrate with the international high-standard market rule system, so as to achieve a deeper level of opening up on a larger scale and covering more fields." Details were elaborated from four aspects, including the Belt and Road Initiative, pilot free trade zone and free trade port, guarantee mechanism for high-level opening up policy, and China’s participation in the reform of the global governance system. At the same time, China is also actively promoting the
negotiation of the China-EU bilateral investment agreement and the signing of the RCEP agreement.

However, the external environment is becoming "more unstable and uncertain" -- foreign supply chains on the supply side are unstable, protectionism on the demand side prevails, and the global economy is in deep recession. All these will make the international circulation encounter shocks, the effect of opening up will be affected, and even cause China to be in a passive situation in opening up.

From a domestic perspective, despite the blow from the epidemic, the economic fundamentals in China have not changed, the potential of development is huge, and domestic economic policies can do a lot in the future. **However, there are also outstanding structural problems in China, and it is necessary to “stimulate all links of production, distribution, circulation, and consumption” and "promote the integration of efficiency and fairness."** Among them, efficiency corresponds more to the production links and attaches more emphasis on high-quality development, while fairness corresponds more to the distribution link, and fair distribution will bring production and consumption a smoother circulation.

As opening up faces greater uncertainty and weakening of marginal benefits, taking the “domestic circulation as mainstay” means that domestic reforms and the circulation of national economy will become policy focus of the next phase. Whatever the outside world changes, China only needs to "concentrate its energy to get its own business done."

Facing an uncertain external environment, "we must give full play to the advantages of the domestic super-large-scale market, and add impetus to China's economic development by prospering the domestic economy and promoting the domestic circulation", thereby "cultivating China's new advantages in international cooperation and competition under the new situation," strengthening China's resilience and initiative in the process of opening up, and then forming a new development pattern where domestic and international markets can boost each other.
In the more than 40 years of reform and opening up, China has done a great job in developing foreign markets, but has not done enough in exploiting domestic markets. If the globalization of the past few decades has greatly promoted China’s opening up, then the countercurrent of economic globalization will prompt us to reflect more on the structural problems of the domestic economy and force China to accelerate domestic reforms.

In fact, many of the difficulties and obstacles faced in opening up often come from institutional and mechanism problems of China. At present, we have reached such a stage of development: Only by expediting domestic circulations can we better link up the domestic market and international market together, and fully utilize the two markets and resources to achieve more robust and sustainable development.