

China's Dual Circulation Strategy: Origins and Progress

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At the start of the COVID-19 pandemic, China was undergoing a transformation in its thinking about the future of its economy, its drivers and its relation with the world economy. The early days of Covid-induced lockdowns had impacted demand everywhere and had created unforeseen challenges for governments across the world. For China, it was a double whammy since along with economic implications, Covid brought about questions regarding China's government and its tendency to suppress information and to cover up facts. Many believe that Covid could have been handled differently had China chosen transparency over information control in Wuhan in November and December 2019 (Buckley, 2020).

This form of questioning China's role and status as a responsible power happened during the ongoing US-China trade war that was the hallmark of bilateral relations during the Trump administration. China fears that deglobalization and protectionism are not short-term phenomena but are trends that are here to stay. The Trump era was not an exception in the US governments thus far and the realisation is dawning that America's hitherto strategic thinking that China would become a 'normal' power with economic prosperity was a failure. China is also acutely aware of the bipartisan agreement in Washington about this. There is a recognition that the global environment has turned negative and substantively so, thus, long-postponed plans of structural adjustments have to be implemented now.

Thus, China has sought to manage the economy in a way that recognizes the new external reality. The party leadership has been at pains to explain this to the stakeholders, to encourage the domestic actors to change course and to tell the world via recent speeches and official publications that China is not closing its doors. China began this process in the month of March in 2020. On various occasions since the start of 2020, Xi Jinping has used the phrase 'The world is undergoing profound changes unseen in a century' and that China must brace itself for the headwind by undertaking necessary changes and reforms. In fact, these reforms were long overdue (Xinhua, 2021).

Dual Circulation and other structural adjustments that China has undertaken in the last 4–5 years might have been undertaken in 2008 if it had not been for the global financial crisis. That was the time when the first major structural adjustment was initiated when it was realised that consumption rates were dropping once again after peaking for a few years since 2000. While China's economy grew rapidly since 2000 and its sale of consumer durables increased as a consequence, it experienced a slowdown once again between 2008 and 2012–13. Consequently, the pattern of large-scale, government-led growth, based on export-oriented industries, investments, and infrastructure construction continued to be the center stage of China's economy in the aftermath of the global financial crisis of 2008 (Tianyong Zhou, p.190). However, it resulted in income inequality as incomes in rural China did not grow as rapidly as in urban China. Alongside income inequalities, there was an imbalance in regional growth as well. Coastal areas south of Beijing grew rapidly while the interiors failed to obtain investments and northeastern China and resource-dependent provinces such as Shaanxi stagnated due to difficulties in transitioning to the service and high-tech sectors. China's Gini coefficient also worsened during this period.

To respond to these challenges, it was decided to focus on consumption-driven growth. Thus, the necessity of having a strategy such as dual circulation was first realised at least 15 years before it was implemented. This idea actually began in 2006 at the start of the 11th Five Year Plan with dedicated targets and plans to expand domestic demand and to upgrade the domestic

industry in order to achieve a more balanced economy (Su and Liang, 2021). However, consumption did not become as widespread as was expected; it was also followed by the 2008 global economic crisis. This prompted Beijing to continue its infrastructure-centric growth strategy, despite being aware of the unsustainability of it in the long run. This is how China came to build its vast network of railways and highways which would later become the face of China's power as well as increase the efficiency and ease of doing business.

There were also other factors which had indicated that without structural adjustments, the Chinese economy would face stagnation, or a hard landing. Others predicted this to be a middle-income trap (Islam 2015). The three impending crises to face the Chinese economy were already looming large—taken together, the fading of the demographic dividend, increasing labour costs and the appreciating yuan— and were taking away the competitive advantages enjoyed by the Chinese economy in the preceding decade. While China's economy had grown rapidly since 2000 and its sale of consumer durables increased as a consequence, it experienced a slowdown once more between 2008 and 2012–13. Thus, the pattern of large-scale, government-led growth, based on export-oriented industries, investments, and infrastructure construction continued to be the centre stage of China's economy in the aftermath of the global financial crisis of 2008. It was well-known that this was not sustainable and in 2007, then Premier Wen Jiabao warned that China's economic structure had become 'unstable, unbalanced, uncoordinated and unsustainable' (Xinhua, 2007). Correcting this economic structure was thus one of the motives of the Xi-Li regime that took over in 2012–13.

Several new measures aimed at course correction were undertaken. Supply-side reforms were intently focused on during 2015–16 for the commodities sector and for the domestic supply chains. China has since attempted to tighten the banking and housing sector as well and serious effort was made to control domestic protectionism. The Made in China 2025 policy, announced in 2015, was loosely based on Germany's industry 4.0 strategy. Its aim was to increase China's share in innovation and research and development and reduce dependence on external providers for key sectors such as semiconductors.

There are three schools of domestic thinking in China on the country's economy and the direction that it needs to take in the years to come. The first group argues that China should prioritise reducing dependency on external suppliers for critical components such as semiconductors and for commodities such as coal and food. It would also help China climb up the value-added chain and increase China's share in high-end manufacturing. The Made in China 2025 policy was a product of this line of thought. The second group supports the expansion of the service sector, which would also create jobs and would be a way to reduce dependence on exports as a primary driver of the economy. The third way of thinking supports creating strategies that would delink China's economy from external drivers so that hostile and unilateral actions such as trade wars do not create tremors for the economy. The dual circulation strategy is a product of this line of thought.

Policies Since COVID-19

In response to COVID-19 specifically, there were several economic policies that China put in place. Adjustments were made to reserve repo rates to help sustain the construction sector. Small and medium enterprises were offered deferred repayment plans alongside tax incentives if they retained their pre-covid workforce. A digitization incentives package was announced for SMEs. The Chinese government paid part of the insurance premiums for healthcare workers. The medical equipment production sector was supported with incentives in tax and loans. However, the zero covid policy since late 2021 has caused a significant social backlash due to the economic consequence of strict lockdowns. Similar to India, and unlike in the US and Europe, China did not undertake any direct cash transfers in response to COVID-19. However, given the fact that the average Chinese household has more liquid savings compared to the western counterparts would have helped them in responding to the pandemic. China's domestic policies have also hurt the interests of domestic and foreign university students who find it difficult to return even now. Moreover, the expat workers who were away during March 2020 for the Lunar year celebrations, also find it difficult to access their bank accounts in China now due to the regulations that require foreign nationals to share their visa and work documents annually.

Alongside global drivers such as deglobalization, China's economy was facing headwinds even before COVID-19. As a result, in the first quarter of 2020, its GDP was down by 6.8 percent and there was a significant decline in the retail sales at 19 percent. To counter these challenges, China came up with a 5-pronged strategy called the new development pattern at the start of 2020. The Dual Circulation Strategy was announced in May 2020. It aims to refocus China's economy towards prioritising domestic circulation, i.e. domestic economy instead of external circulation over the medium to long term. As a part of this strategy, China has aimed to undertake various specific programs in the fields of technological innovation, increasing domestic supply, improving financial services, increasing smarter urbanisation, and boosting employment and income. The 14th Five Year Plan was adopted in March 2021 and it included several policy initiatives that take the Dual Circulation strategy forward. This was followed by the Science and Technology Policy with its stress on 'indigenous innovation'. Within a short time, China also announced the China Standards 2035 policy. This policy has set up benchmarks for China's government and private sectors to achieve in the fields of artificial intelligence, data, and telecommunications among others. More recently in October 2021, Xi Jinping announced the goal of achieving Common Prosperity. This one is even trickier since in this, China hopes to limit 'unreasonable income' and reject 'the chaotic/disorderly expansion of capital' (Bloomberg, 2021). The policy objectives under Common Prosperity include increasing incomes in low income groups, promoting fairness in pricing, actively addressing regional imbalance, and encouraging ultra-rich individuals to contribute a share of their income to developing public welfare.

China's understanding of the meaning, as well as the necessity, of the dual circulation strategy, is also linked with the spread of COVID-19. In one of the publications on CGTN web, it is argued, 'Externally, the blow of the COVID-19 pandemic exposed the insufficiency of countries' local productivity, particularly in productions in emergency-responding goods such as protective masks and gowns. It caused countries to reevaluate domestic production capabilities and uncovered risks in the global supply chain. Compared with SARS, the COVID-19 pandemic is more infectious and persistent. It means the world may face a situation where the supply recovers faster than demand.' (CGTN, 2020).

Xi Jinping wrote a major piece in the party's policy journal Qiushi in July 2021. This was titled Understanding the New Development Stage, Applying the New Development Philosophy, and Creating a New Development Dynamic (Xi Jinping, 2021). Xi highlighted several issues in this

article and pointed out the details that others should undertake. Xi said that China ‘... needed to shift the focus to improving the quality and returns of economic growth, to promoting sustained and healthy economic development, and to pursuing genuine rather than inflated GDP growth and achieving high-quality, efficient, and sustainable development’. In China’s political system, language and communication are key and every idea and change is presented in a positive light. Thus, one can relook the Xi statement and reformulate it to understand China’s economic priorities and its urgency since the beginning of COVID-19.

The Qiushi journal is a party document and any publication in it carries the weight of a government order or a regulation in a democratic setup. The readership of this publication is the party cadre and the government bureaucracy (Ang, 2021). However, in China’s system, there is also freedom to reinterpret the ideas according to local conditions. Consequently, provinces with their compulsion to protect local interests may not be too keen to change, as it was seen in the case of the coal versus electricity sector debate .

Lastly, behind the search for new strategy is also a desire to have a Xi imprint on China’s economic and social development blueprint. Thus, if the first 30 years of the party were dominated by Mao outlook and the next 30 by the Deng perspective, Xi Jinping strongly desires to guide the policy discourse in China for the next 30 years.

What are the core drivers of the Dual Circulation Strategy?

There is a debate on whether the primary driving force for dual circulation is internal or external. The intention to re-examine the internal economy in order to encourage consumption has been on the agenda for several years now, however it has been postponed due to several reasons. Some of these include path dependency, resistance to change by profitable private companies as well as by state-owned enterprises and large infrastructure companies dependent on government projects and contracts. In particular, China's success in responding to the global financial crisis in 2008 led to it building a spectacular new model of growth by investing in high-quality infrastructure such as high-speed railways. This has become one of the reasons why structural adjustment policies that were advocated for in the 11th FYP were delayed infinitely despite several red-flags being present and despite pronouncements for said adjustments—the overall growth rendered these red flags as easy to miss. It is also assumed by some that Liu He, Vice-Premier and a Politburo member is the brainchild behind the dual Circulation strategy (Blanchett and Polk, 2020). He is a trade negotiator with the US and keeps a close eye on the external environment. China perceived that the US is not a reliable partner anymore and China cannot depend on external markets for its continued economic growth, hence the need for a new economic strategy that focuses on Science and Technology, domestic consumption, promotion of local brands and reinvestment of profits earned by MNCs.

While it is too early to predict either the success or failure of the dual circulation strategy, it is also important to discuss how this strategy would fare and the road-blocks that it faces. To begin with, structurally, China's policymaking and implementing structure still operates as Fragmented Authoritarianism as defined by Kenneth Lieberthal (1992). Thus, while Beijing may announce the most interesting and impressive policies, the success of the policies depends on how seriously the ministries and provincial governments implement such schemes. So far, based on the media statements and policy announcements there have been three kinds of responses from the provinces to the dual circulation strategy. The first kind comprises eager enthusiastic responses from provinces like Guangdong which have something to gain from this strategy, since 'indigenous innovation' helps the economically- developed provinces. The second kind is from provinces which stand to lose local protectionist strategies and their responses have been rather cold. The third kind is a radio silence—provinces with low local resources are unsure if Beijing is going to fund the newly-announced plans and thus, have not made any public announcements as of April 2022.

Conclusion

It can be argued that the events that have occurred since the announcement of the Dual Circulation policy indicate that the policy comes in too late. The first indicator was the bankruptcy of the Evergrande Group and the subsequent talk that it was only the tip of the iceberg as far as China's construction sector was concerned. The second was the continued falling demand and slowdown in the domestic economy. The third indicator was the Ukraine Crisis that has had its impact not only on China's status but also on global demand and on oil prices as well. This also slows down China's recovery. The ongoing new COVID-19 wave in China since March 2022 is the fourth indicator. Lastly, the global inflationary trend and the fears of a prolonged slowdown or even a recession do not augur well for a policy that intends to increase domestic consumption.

If it succeeds, the dual circulation strategy will propel China into becoming an innovation and research and development hub in the long run. However, there is a perception that Xi Jinping is trying to do too much and is chasing too many contradictory objectives, especially through the common prosperity policy as explained previously. Moreover, breaking down the resistance of the provinces and the ministries to change is a difficult game even in an authoritarian system like China's. This may ultimately decide the fate of this strategy.

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