

Challenges and Responses: A Discussion on the Concept of “Dual-Circulation” in Contemporary Chinese Academic Circles

ZHAO Junhui^[a]; SUN Jing^{[b],*}

^[a] Undergraduate of the School of Economics and Management, Nanjing Agricultural University, Nanjing, China.

^[b] Lecturer of the School of Liberal Arts, University of Jinan, Jinan, China.

*Corresponding author.

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Abstract

The “dual-circulation” development paradigm, as an important strategy for China’s economy in the new era, has had a great deal of repercussions in both academia and practice. However, many issues remain unanswered, such as: what is the design of the “dual-circulation” paradigm? What path should be taken to realize the “dual-circulation” paradigm? How to measure the “dual-circulation”? How far has the “dual-circulation” paradigm progressed? These are all questions that remain to be solved, and they have been studied and discussed mainly by Chinese scholars. This paper reviews and advances the existing research on these issues, aiming to clarify the research and development process of the “dual circulation” concept within Chinese academia.

Key words: Dual circulation; Domestic demand; Unified market

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INTRODUCTION

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Since China’s reform and opening up policies, especially since the accession to the WTO, through the soaring export levels, the economy has been rapid development,

and China has evolved into the world’s second-largest economy and holds a significant position in the international industrial chain. In the world trade paradigm, the production of many economies have even become reliant on China, such as the European Union and ASEAN, ASEAN has become China’s largest trading partner since 2020, according to the data from General Administration of Customs of China, in 2020, the total import and export volume of China and ASEAN reached 4.74 trillion yuan, of which the most prominent share of the trade is mechanical and electrical products, constituting more than half of this trade volume.

Despite these remarkable achievements in foreign trade, China faces substantial challenges in its domestic market, such as the lack of key technologies, regional development imbalance, urban-rural dual system, local protectionism, market barriers, etc. These factors distort resource allocation, preventing the optimal flow of goods and factors within the domestic market and impeding domestic market improvement. For example, Hong et al. (2023) found that the level of domestic macro-circulation in the central and western regions of China is lower than that in the eastern region. According to Krugman’s (1980) theory, if a country has a greater domestic demand for a certain commodity, its supply side is more likely to form a scale effect to reduce production costs and commodity prices, which enhances the competitiveness of the commodity in the international market, and thus leads to an increase in the export of that commodity. From this point of view, the circulation and improvement of the domestic market are also of great significance to China’s exports.

On the international front, China’s rapid development, especially its rising international trade position and its changing importance in the division of labor in the global production chain, has made China a strong competitor of the United States. China now accounts for nearly 30

percent of global manufacturing value added. If China really occupies a key position in the field of core science and technology, it is bound to seize the interests of other countries in the global value distribution. Therefore, some developed countries have taken a series of obvious technological blocking measures these years, especially in the field of core science and technology, such as semiconductors, in an attempt to curb China's scientific and technological development. In addition, China's application to join the CPTPP has been rejected two years ago, and the signing of the Indo-Pacific Economic Framework (IPEF) is also clearly detrimental to the development of China's trade, although there are no substantive moves in this agreement yet. This series of trade agreements is profoundly changing the global trade paradigm, and there is a tendency to marginalize China from the global value chain. Taking into account the above domestic and international aspects of the Chinese economy, there seems to be an urgent need to reform its supply and demand sides.

1. THE DEFINITION OF THE CONCEPT OF DUAL-CIRCULATION

The new development paradigm of "dual-circulation" was first proposed at the meeting of the Standing Committee of the Political Bureau of the Central Committee of the People's Republic of China on May 14, 2020, and on July 21 of the same year, it was proposed that "a new development paradigm in which the domestic macrocycle is the mainstay and the domestic and international circulation are mutually reinforcing will be gradually formed". "The first problem targeted by the "dual-circulation" is China's high dependence on foreign trade. According to the World Bank's public data, China's trade volume as a share of GDP reached a peak of 64% in 2006, and then gradually declined, stabilizing at 35% in recent years, although it is already lower than the world's average (63%), but still higher than that of the United States (27%), which shows that the domestic demand level of the United States is higher. At the same time, the international "de-sinicization" initiative, if effective, will also have an impact on China's economy, so the concept of "dual-circulation" has the goal of de-risking and stabilizing the economy. The main means are: expanding domestic demand, realizing supply-side reform, and establishing a modernized market system and industrial system. It is noteworthy that the initial statement of "dual-circulation" has the concept of "not relying on foreign markets while maintaining a certain degree of openness to the outside world", which was later adjusted to emphasize the mutual complementation and promotion of the domestic and foreign markets, but we can still see that the "dual-circulation" has the goal of de-

risking and stabilizing the economy. However, we can still see that the "dual-circulation" development strategy still emphasizes more on the circulation of the domestic market, and its core idea is to drive the external circulation with the internal circulation, to expand the level of domestic demand, to make the various aspects of market circulation, such as production, distribution, circulation, consumption, etc., rely more on the domestic market to complete, and to attract the entry of foreign investment with the domestic market. In terms of foreign investment, according to CEIC data, China's foreign investment in the past decade has been around 43% of GDP, down from 2012 and before. On August 17, 2024, China's Ministry of Commerce announced that the country attracted a total of 539.47 billion yuan of foreign investment from January to July, an increase of 11.4% year-on-year, which indicates that China's foreign investment has been increasing by 11.4% year-on-year since the introduction of the "dual-circulation" strategy. This indicates that the Chinese market's ability to attract foreign investment has improved since the "dual-circulation" strategy was put forward.

2. THE SIGNIFICANCE OF "DUAL-CIRCULATION"

One of the basic beliefs of the new development paradigm of the "dual-circulation" is that the unification and improvement of the domestic market is conducive to China's exports in the international market, which Han et al. (2023) empirically studied using China's national pilot cities for information consumption as a quasi-natural experiment, proving that expanding domestic demand improves enterprise productivity by attracting foreign investment and increasing the degree of regional and enterprise informatization, while the path described by the authors is basically the same as Krugman's theory, Attracting foreign investment and improving the informatization of regions and firms promotes firms' exports, and the path of action described by the authors is basically the same as that of Krugman's theory; at the same time, the domestic macro-circulation also attracts foreign factor endowments and connects domestic and foreign markets (Huang, 2021); in addition, Niu Mang et al. (2023) also use the chain structural decomposition analysis to get the conclusion that the growth of domestic demand is the main reason for the improvement of employment. the main reason for the improvement of employment rate, and Zhu Jinsheng et al. (2024) also confirmed that the internal circulation is the main driving force to pull the quantity and quality of employment under the general trade mode.

From a technological point of view, an increase in the size of domestic demand facilitates producer-consumer interactions and thus increases the level of

innovation in the country’s products, and although there are differences in the types of innovations demanded by domestic and foreign consumers, more innovations by domestic producers will always lead to more innovations that are demanded by foreign consumers (Beise-zee, 2006). Another subtle mechanism is that an increase in the size of the domestic market increases consumer price elasticity, which leads to larger firms, which have more funds to engage in research and innovation, improve the quality of their products, and increase exports (Desmet et al., 2010); Zhang Xiaoyun et al. (2023) find that technology spillovers from domestic intermediates are more important for the country’s manufacturing GVC position than technology spillovers from foreign intermediates, and this difference is amplified over time, while the growth rate of technology spillovers is higher in latecomer countries.

3. PATHS TO THE REALIZATION OF “DUAL-CIRCULATION” DEVELOPMENT PARADIGM

3.1 Expansion of Domestic Demand

The key to the construction of the “dual-circulation” development paradigm is the expansion domestic demand, so that the growth of domestic demand will stimulate the growth of China’s supply side; at the same time, the improvement of technology and quality on the supply side will also stimulate the level of demand in the country. Currently, most Chinese scholars believe that the elimination of local protection, industry monopolies and market segmentation will lead to the integration of China’s domestic market, thus ensuring the realization of the internal cycle (Zhao, 2024).

To boost domestic demand, a blend of fiscal and monetary policies can be employed to stimulate market demand by adopting loose monetary policies, such as lowering interest rates, government acquisition of treasury bonds, lowering the discount rate and other policy combinations. In addition, raising residents’ income, protecting citizens’ welfare, reducing taxes and fees, and increasing government transfer payments are also very effective means. In particular, the improvement of citizens’ healthcare, pension and other welfare protection will boost citizens’ confidence in consumption, forming a multiplier effect and stimulating market vitality. Especially in rural areas of the social security system problem, or should be as soon as possible to reform the urban-rural dual land system, to give rural residents more property rights, so that there is a safe bottom, so that they can have the confidence to consume. However, in view of the greater financial pressure on local governments in recent years, perhaps improving the financial pressure

on local governments should also be included in the outline for realizing the “dual-circulation” development paradigm.

3.2 Improvement of Infrastructure

For the construction of a unified domestic market in China, the construction of improved transportation infrastructure will reduce the transaction costs of production between localities, thus lowering production costs and increasing exports (Wu, 2021). Currently, China’s logistics costs have dropped significantly, to less than 15% by 2023, but there is still a significant gap compared to developed countries, where logistics costs are less than 10%. However, the construction of transportation facilities should also consider cost budgeting and other accounting, otherwise the construction of large-scale infrastructure, such as subways, will bring a great financial burden to local governments, or will distort the administrative behavior of local governments, preventing them from implementing the development of the local economy and boosting market confidence. Second, reducing local protection policies among local governments, changing incentives for promotion of government officials, and narrowing the gap between the rich and the poor in each region will also promote the unified development of China’s domestic market.

3.3 Digital Technology and Financial Regulation

Many scholars have argued that the digital economy has a catalytic effect on the construction of the “dual-circulation” paradigm (Zhang, 2022; Dai, 2024; Chen, 2023); and Li Yan et al. (2024) empirically found that the construction of digital infrastructure is also conducive to the development of the dual-circulation of China’s economy. More specifically, the digital economy may promote China’s innovation-driven high-quality development by increasing entrepreneurial activity (Zhao, et al., 2020), improving firms’ total factor productivity (Zhao, et al., 2021), and even helping China’s real industries to transform and upgrade (Xiujuan Tian).

On the financial side, it is also of great significance to strengthen financial supervision and maintain the normal and healthy operation of the stock market. The sharp fluctuations of the stock market will always affect the investment confidence of the stockholders, and the losses of the stockholders will reduce the income level of the citizens, which will cut down the national consumption with the multiplier effect. Therefore, regulators should strengthen supervision to reduce the existence of low-quality stocks and ensure the investment attributes of the financial market. Combined with the development of China’s digital economy, improving the level of financial innovation also has a positive impact on controlling financial risks, reducing transaction costs and increasing financial transparency. It should be noted that at present,

many enterprises in China have a tendency of “de-realization to virtualization”, that is, the investment of long-term capital in real enterprises has declined compared with the investment in financial assets, which may increase the risk of stock market crash, seriously affect the normal operation of the economy (Peng, et al., 2018), and have a run on the investment in real enterprises. (Orhangazi, 2008), and raise the financing costs of small and medium-sized enterprises, hindering the expansion of enterprise production scale, as well as the reduction of production costs, which is not conducive to the revitalization of the market. The reason why Chinese enterprises are “moving away from the real sector to the virtual sector” may be due to the relative decline in the return on investment of the real sector in China in the past two years, which may be mitigated by tax cuts and preferential policies (Peng, et al., 2017).

At the same time, many Chinese residents still have a high amount of housing loans, as well as higher repayment interest, while housing prices have declined compared to previous years, which also aggravates the pressure on residents’ lives and limits the level of consumption, if some concessions can be given to the residents in terms of loans, it will also have a great degree of increase in the level of consumption in China.

3.4 Increasing the Level of Innovation

In addition, increasing total factor productivity certainly had a positive impact on the realization of the “dual-circulation” paradigm, which also required more scientific and technological innovations from Chinese enterprises. Developing better products and providing better services not only enhances the competitiveness of products in the international market, but also makes domestic consumers more inclined to buy domestic products and increases their willingness to pay for domestic products. What the State can do to improve the level of science and innovation is perhaps to increase the investment in scientific research, to ensure the quality of university education, to reward innovation, to guarantee academic independence, to penalize academic corruption and so on.

4. MEASUREMENT OF THE “DUAL-CIRCULATION” DEVELOPMENT PARADIGM

4.1 Measurement of the “Inner Circulation”

If we want to study whether China’s “dual-circulation” paradigm has progressed, it also involves the question of how to measure the “dual-circulation”. The core issue of the domestic cycle is the expansion of domestic demand, which is often measured by the indicator of “domestic demand rate of final goods” (Huang, et al., 2021), which

can reflect the country’s dependence on both domestic and foreign markets in two ways. According to the research of related scholars, it is found that China’s primary and secondary industries have high domestic demand rate of final consumption, while the domestic demand rate of the tertiary industry is relatively low, especially in the field of high-tech products, Chinese consumers tend to prefer foreign products, and have insufficient consumption power of domestic products, and high-tech products made in China are often sold in large quantities to trading partners. The construction of the above indicators starts from the input-output table. Besides, some Chinese scholars have also measured and empirically researched the development of the dual-circulation paradigm from the perspectives of Marx’s political economy from the links of production, circulation, consumption, etc., but the results are not very influential, so I will not repeat them again.

4.2 Measurement of the “Outer Circulation”

In terms of the external cycle, first of all, we can observe China’s export data, in July 2024, China’s total exports amounted to 300,556.5 million U.S. dollars, although this represents a decrease compared to June, it is still higher than the export levels in 2023. Overall, since the introduction of the “dual circulation” development pattern, China’s trade has experienced rapid growth in 2021 and 2022. In 2021, both imports and exports increased by approximately 20% compared to the previous year, and in 2022, exports rose by 10% compared to the previous year. However, in 2023, the import and export data showed minimal changes, with fluctuations of less than 1%. Before examining China’s trade data, it’s essential to clarify the question of whether or not trade growth benefits “dual-circulation” paradigm. According to the Chinese government’s formulation of the “dual-circulation”, China’s desired outcome is an increase in trade but a decrease in the dependence of the production chain on international demand. Taking into account the World Bank’s data on China’s trade as a share of GDP, we find that in the last two years China’s indicator has risen slightly since 2020, by around 1% per year, to 37% in 2023, which is still an increase compared to 2020. Although this indicator is not an accurate tool for measuring the “dual-circulation”, we can generally see that trade volume is still a very important driving force for China’s economic growth. To mitigate the risks associated with fluctuations in the international trade market, further development of a modernized domestic market system will be necessary.

CONCLUSION

Since China’s accession to the WTO, both trade and GDP had seen rapid growth, and it could be said that the

rapid growth of China’s GDP had also been driven by the growth in trade. However, with the drastic shifts in the international political dynamics and the challenges to globalization, countries have adopted a more conservative mentality, and the paradigm of economic globalization has a tendency to shift towards inter-regional economic liberalization. Against this backdrop, China has put forward a “dual-circulation” development paradigm, which focuses on strengthening the domestic market. The findings of Chinese scholars have proved that expanding the scale of demand in the domestic market is beneficial to trade, employment, and enterprise innovation, but this is based on the assumption that the scale of domestic demand has already been expanded. However, the key lies in how to really expand domestic demand, and this paper argues that this must be combined with the joint promotion and reform of many aspects. Overall, the development paradigm of the “dual-circulation” has the same relationship with China’s development strategy, so the construction of the “dual-circulation” paradigm depends on China’s other reform objectives. Therefore, the construction of the “dual-circulation” paradigm depends on the realization of China’s other reform goals. To what extent has the “dual-circulation” paradigm developed so far, which involves the measurement of the “inner cycle” and the “outer cycle”, While some scholars have proposed valuable measurement methods, the data used is often outdated (e.g., Huang Qunhui et al., whose data extends only to 2014) or the methods are not sufficiently rigorous. Therefore, further scholarly efforts are needed in this area.

In fact, the “dual-circulation” strategy profoundly aligns with China’s domestic and international circumstances, representing a necessary and crucial step in the process of China’s development. However, in order to achieve this goal, it is necessary to complete a series of reform tasks, such as the reform of the urban-rural dualism system, the enhancement of the scientific and technological innovation system, the strengthening of financial regulation, and the construction of a unified large domestic market, infrastructure soundness and so on, this series of reforms will undoubtedly revitalize China’s domestic demand, stimulate the vitality of the domestic market, and realize the breakthrough of economic development.

Based on the above discussion, this paper draws the following conclusions: first of all, the realization of the “dual-circulation” development paradigm can indeed bring huge economic benefits to China, improve domestic employment and foreign trade, and achieve the goal of lifting risks in the production chain and supply chain. However, the “dual-circulation” is a long-term objective, which will also be the comprehensive result of deepening reform across all domains. It cannot be accomplished overnight. Reforms in household registration, science and technology innovation, finance, market and other aspects

can fundamentally achieve this goal. In the short term, China may need to rely on the growth of trade volume to further enhance economic growth and employment improvement. China still needs to adhere to in-depth openness and seek broader international cooperation. Finally, in order to promote the realization of the double cycle strategy more scientifically and effectively, a more scientific and real-time measurement method will be essential. Only by constructing an objective, complete and profound measurement method for the proposition of “double cycle” can we test the effect of the reform in various aspects, form a more correct judgment on the situation and inform better decision-making. This requires further efforts by Chinese scholars.

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