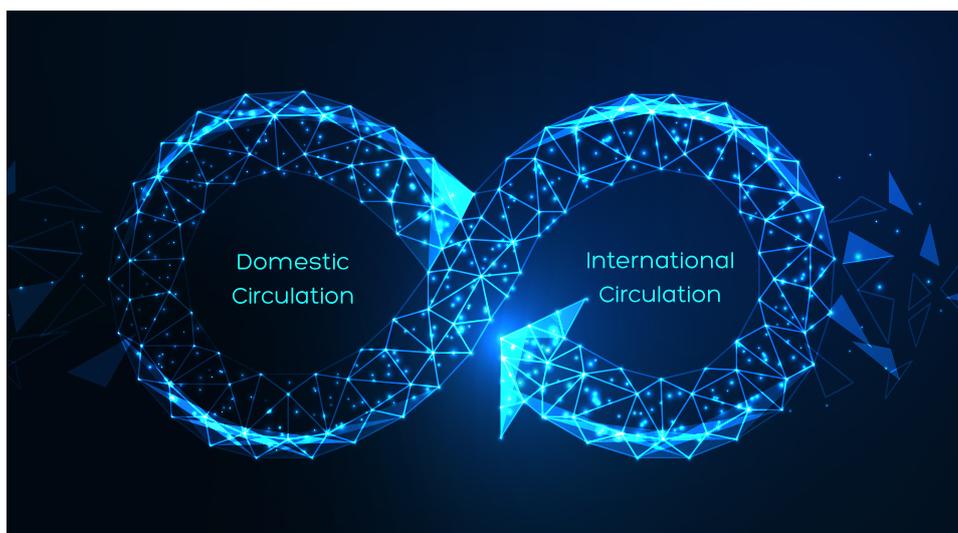


Dual Circulation Series

– Integrating domestic and foreign trade

Issue 1

Dual Circulation: Not just a buzzword



“Dual Circulation”, which is set to become the new economic framework for China’s medium and long-term development, has become one of the latest buzzwords in both the Chinese and international media. In this new series, Fung Business Intelligence will take a closer look at the latest policies, directions and areas of focus of “Dual Circulation”, and will be covering various topics relevant to the business community.

In this first issue, we seek to give our readers’ a general overview of what “Dual Circulation” actually means and the rationale behind it. In the future issues, we will be taking a look at various opportunities available to domestic and foreign businesses under “dual circulation”. Specifically, we will be looking at the government initiatives and policies that have recently been put in place to help export manufacturers overcome institutional barriers to sell in the domestic market, as well as policies to further open up the domestic market to foreign players, including the Hainan Free Trade Port, Greater Bay Area, etc.

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What is “Dual Circulation”?

“Dual circulation” is a new model of development, aiming at forming a development layout that “focuses on the domestic market as the foothold of economic growth, whilst letting the domestic and international markets boost each other”¹. The concept has been elaborated and emphasized by President Xi Jinping in multiple occasions since the Politburo Standing Committee meeting in May and has been elevated into China’s new mid- and long-term development strategy².

As its name suggests, “dual circulation” includes two circulations: 1) domestic circulation; and 2) international circulation. Taking into consideration the external and geopolitical environment, priority efforts will be focused on stimulating domestic demand and domestic drivers of growth to improve economic resiliency and self-sufficiency as a first step. Efforts will also be taken on deepening reform on the supply side through creating a unified and open domestic market and better matching capabilities and resources to the needs of the domestic market.

The strategy is not a closed-door policy. Government initiatives will work hand in hand with market forces to achieve an optimal balance between self-sufficiency (domestic circulation) and global cooperation (international circulation) to drive long-term sustainable growth. Policies targeted towards encouraging openness and strengthening engagement with global markets, as well as enhancing domestic economic growth, will be promoted.

The Background

The purpose of ‘dual circulation’ is to help China better position itself in the long run to withstand global uncertainty and an increasingly hostile external environment, characterized by a global economic downturn, rising protectionism, heightened geopolitical tensions, and a shrinking international market. In particular, the sharpening of geopolitical competition has caused a general retreat from globalization in the West. China has effectively entered a new paradigm in which it will have to deal with a global economic environment that is progressively less conducive to free trade, capital, and technology flows. To better address and manage these changes, China will more fully utilize resources to empower its domestic economy by stimulating domestic demand, upgrading consumption, and further investing in technology and innovation efforts. Notwithstanding the above, China remains a strong supporter of globalization and will continue to deepen its cooperation with foreign markets while opening up its own.

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China will more fully utilize resources to empower its domestic economy by stimulating domestic demand, upgrading consumption, and further investing in technology and innovation efforts. Meanwhile, China will continue to deepen its cooperation with foreign markets

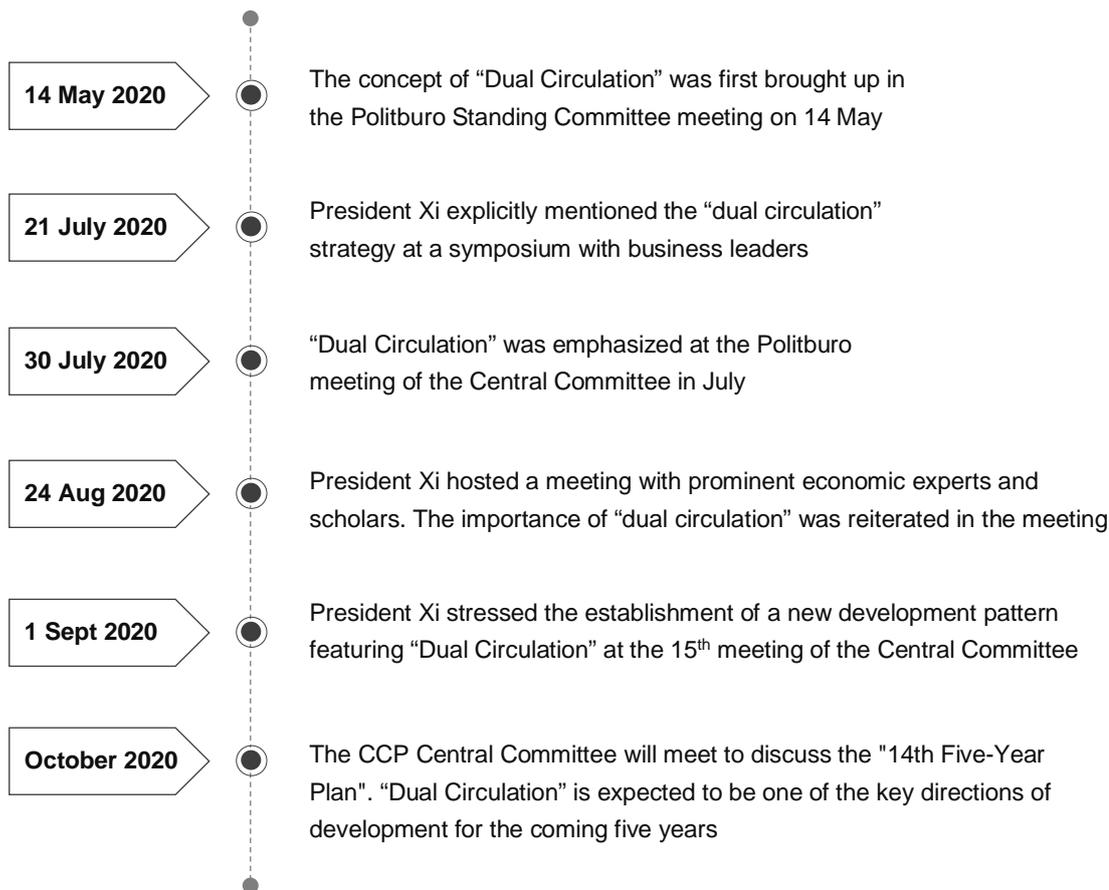
¹ http://english.www.gov.cn/news/topnews/202009/02/content_WS5f4efa48c6d0f7257693b6e7.html

² <https://www.chinadaily.com.cn/a/202008/14/WS5f35eff9a310834817260521.html>

When was it announced?

“Dual circulation” was first brought up by Chinese leaders at the Politburo Standing Committee meeting in May and has been further emphasized and elaborated by President Xi and the Central government in multiple subsequent high-level meetings.

Exhibit 1: Timeline of the “Dual Circulation” strategy

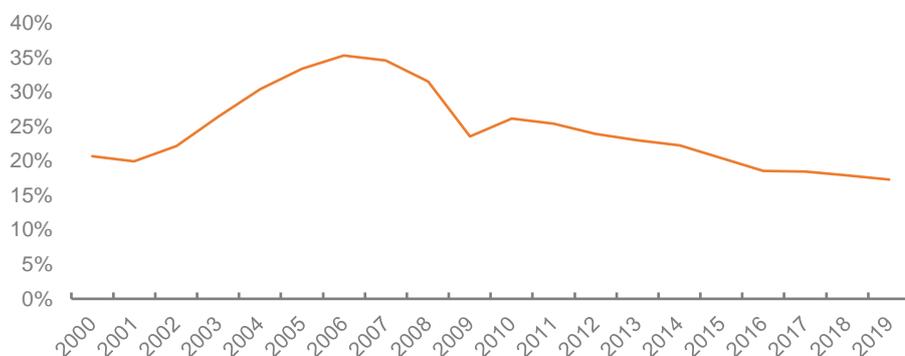


Dual circulation' reflects evolution of China's Economic Development Model

Since China opened its door to the world more than four decades ago, China has thrived as a manufacturing powerhouse. In the 1980s, external demand was the main driver of China's economic growth. The "processing trade development model" ("兩頭在外, 大進大出") kickstarted the global supply chains. Export-oriented manufacturers, imported raw materials, components, and other intermediate inputs from international markets, processed them locally, and then exported the final products back to western markets. This development model achieved great success. Up till the mid-2000s, exports accounted for a large proportion of China's GDP.

The Chinese government and policymakers have been encouraging the transition to move China from an investment and export-oriented based economy to a more balanced one driven by consumption, investment, and exports

Exhibit 2: China's export as % of GDP



Source: National Bureau of Statistics China

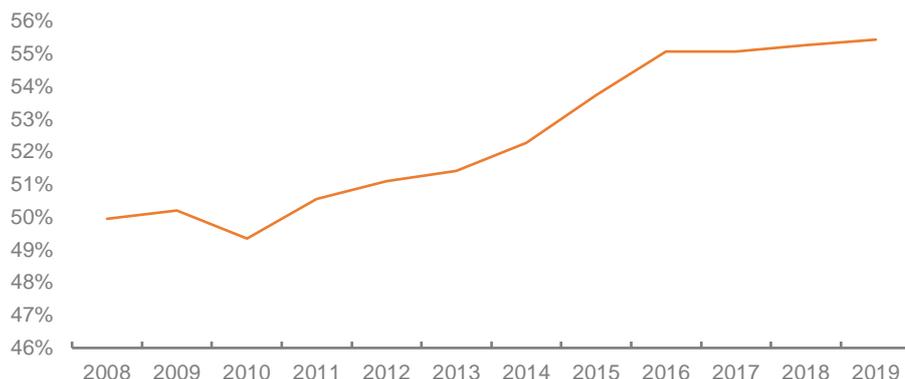
The Chinese government started to shift its export-oriented economy to one that is more domestically geared after the global financial crisis. Rising labour costs and the weakening of external economic conditions also meant that sustainable growth can no longer be achieved by an export-led model of growth alone. The Chinese government and policymakers have been encouraging the transition to move China from an investment and export-oriented based economy to a more balanced one driven by consumption, investment, and exports. In 2015, President Xi and the Chinese government introduced the supply-side structural reform (SSSR) to address the longer-term economic issues that China was facing at the time. A key component of the SSSR was to reduce excess industrial capacity on the supply side.

Following the outbreak of COVID-19 in December 2019, there has been a further weakening of global demand as global supply chains have been severely disrupted. Meanwhile, rising geopolitical tensions and protectionism/decoupling sentiments have led to a more inward facing economy, especially in the west.

On the other hand, China’s social-economic shift and its rising middle class continues to be a huge driver of growth for the domestic market. According to a recent report issued by China’s Development Research Centre under the State Council, China’s per capita GDP is predicted to reach US\$14,000 by 2024, and China’s market will be bigger than that of the United States by 2025, with at least 560 million middle-income consumers³.

China’s per capita GDP is predicted to reach US\$14,000 by 2024, with at least 560 million middle-income consumers

Exhibit 3: China’s Total Consumption as % of GDP



Source: National Bureau of Statistics China

In light of these circumstances, President Xi and the Chinese government announced the “dual circulation” strategy which will focus on fully utilizing domestic resources to empower the domestic economy. Meanwhile, China will not close its doors and will continue with its opening-up efforts and cooperation with global markets.

Exhibit 4: China’s evolution from an export-oriented development model to “dual circulation”



³ <https://finance.sina.com.cn/roll/2020-09-01/doc-ivhvpwy4162442.shtml>

Proposed areas of focus / Policy direction of “Dual Circulation”

The “dual circulation” strategy is widely seen as the most important policy direction in the coming years and will likely serve as the policy framework of the upcoming *14th Five-Year Plan (2021-25)*.

At present, the “dual circulation” strategy is still short on concrete details. President Xi, government officials and Chinese experts have proposed directions and recommendations to help facilitate both domestic and international circulation.

Proposed areas of focus on the domestic circulation side include:

1

Cementing China’s position as a manufacturing powerhouse by building modern, efficient, integrated end-to-end supply chains and industrial clusters, especially in the areas of high-tech and advanced manufacturing

2

Strengthening technology levels and speeding up innovation and breakthroughs in core technologies

3

Increasing investments in infrastructure, including rural amenities, urban subways and inter-city transit systems, high-speed expressways and railroads, 5G base stations and new and clean energy sources

4

Enhancing capabilities and reducing reliance on the global economy in key strategic areas, such as energy, technology, and food

5

Creating a level playing field by minimizing the government’s intervention in microeconomic activities and ensuring better integration of the roles of the market and the government in resource allocation

6

Improving the overall wealth of its peoples, enlarging and enriching the middle class, redistribution of wealth via policies and support measures, e.g. subsidies, social security reforms and tax cuts.

The “dual circulation” strategy will likely serve as the policy framework of the upcoming 14th Five-Year Plan

Proposed areas of focus on the international circulation side include:

1 Promoting trade and investment liberalization and facilitation, optimizing the business environment, and offering “national treatment” to foreign investors

2 Innovating and experimenting liberalization measures and preferential policies via pilot free trade zones and ports and special economic pilot zones, e.g. the Greater Bay Area, the Hainan Free Trade Port, etc.

3 Strengthening economic and trade cooperation with countries and regions along the “Belt and Road”, as well as engaging more deeply with ASEAN countries and other developing countries

4 Upholding the multilateral trading system and actively participating in the negotiation and formulation of international and regional economic and trade agreements, as well as steadily reducing tariff levels

5 Expanding the imports of high-quality goods and services to meet domestic demand

Meanwhile, the Chinese government has issued a few important regulations which are relevant to “Dual Circulation” this year. The policies reflect China’s determination to create a unified and open domestic market, as well as to further open up its market to foreign players. A brief summary of the key messages of the regulations can be found in Exhibit 5.

Exhibit 5: Key Regulations relevant to Dual Circulation issued in 2020

Regulation	Issuing Authority	Issuance Date	Key Messages
Opinions of the Central Committee of the Communist Party of China and the State Council on improving the Market-based Allocation Mechanism of Production Factors 中共中央 国务院关于构建更加完善的要素市场化配置体制机制的意见	Central Committee of the Communist Party of China and the State Council	March 30, 2020	Market to play a greater role in the allocation of resources and factors of production, including land, labour, capital, data and technology
Opinions of the Central Committee of the Communist Party of China and the State Council on Accelerating the Improvement of the Socialist Market Economy in the New Era 中共中央 国务院关于新时代加快完善社会主义市场经济体制的意见	Central Committee of the Communist Party of China and the State Council	May 11, 2020	China will build up a more open and unified market by minimizing the government's intervention in microeconomic activities. The opinion calls for granting equal treatment to companies with different types of ownerships, as well as further improving the legal, tax, and intellectual property systems. China will also accelerate the development of pilot free trade zones and ports and deepen its ties with countries along the Belt and Road amongst other measures
Implementation Opinions on supporting the domestic sales of export products 国务院办公厅关于支持出口产品转内销的实施意见	The General Office of the State Council	June 22, 2020	Outlined a series of measures to help export-oriented companies with their domestic sales endeavours
Special Administrative Measures (Negative List) for Foreign Investment Access (2020 Edition) 外商投资准入特别管理措施（负面清单）（2020年版） & Special Administrative Measures for Foreign Investment Access in Pilot Free Trade Zones (2020 Edition) (FTZ Negative List) 自由贸易试验区外商投资准入特别管理措施（负面清单）（2020年版）	National Development and Reform Commission & the Ministry of Commerce	June 23, 2020	Further opening up China's market by the relaxation of restrictions and prohibitions on foreign investment. The FTZ negative list offers a higher degree of opening up compared to that of the general negative list. Restrictions on foreign investment outside the negative list will be lifted
Opinions on Further Stabilizing Foreign Trade and Foreign Investment 国务院办公厅关于进一步做好稳外贸稳外资工作的意见	The General Office of the State Council	August 12, 2020	Proposed 15 policy measures, including strengthening fiscal and financial support, developing innovative business models, supporting export-oriented industries, etc. to further stabilize foreign trade and foreign investment amidst a challenging external environment exacerbated by COVID-19

It is hoped that, by building up a more resilient and robust domestic economy, whilst simultaneously integrating itself with global markets, China will be able to better develop and leverage its core competencies, move up the value ladder, better position itself strategically for long-term sustainable growth, and play a key role in orchestrating global supply chains.

* * *

China's ever-expanding consumption market presents huge opportunities for both domestic and foreign enterprises. In the next few issues, we will be taking a closer look at the transformation of China's exporting industry, the challenges and issues export-oriented businesses face, and what the government has been doing to support export manufacturers to sell into the domestic market.

Fung Business Intelligence

Fung Business Intelligence collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consulting services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

Fung Group

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including sourcing, logistics, distribution and retail. The Fung Group comprises over 34,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

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