



# The Impacts of Dual Circulation on the Manufacturing Industry in China - A Case Study of Gree Electric Appliances Inc

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**Abstract.** China has proposed to build a new development pattern of domestic and international dual cycles. In the dual circulation, the export of China is given up by China's government. China tries to replace the external demand by increasing internal demand. China's dual cycle policy is bound to greatly affect China's foreign trade. Through literature review and qualitative analysis, this paper studies the impact of dual cycle on China's manufacturing industry. Taking the power of Gree Electric Appliance as an example, this paper discusses the specific impact of double cycle on the enterprise and the Countermeasures of the enterprise. On the whole, the double cycle will have a great negative impact on China's manufacturing enterprises.

**Keywords:** Dual Circulation · case study · China

## 1 Introduction

On May 14, 2020, the meeting of the Standing Committee of the Political Bureau of the CPC Central Committee clearly put forward “building a new development pattern of mutual promotion of domestic and international dual circulation” for the first time, and emphasized the starting point of building dual circulation from both sides of supply and demand, that is, on the one hand, “deepening the structural reform on the supply side”, and on the other hand, “giving full play to China's super large-scale market advantages and domestic demand potential” [1].

In July 21, 2020, when general secretary Xi Jinping discussed with entrepreneurs, he stressed: “the new development pattern of domestic circulation as the main body and international dual circulation promotes each other”, “take the domestic big cycle as the main body, and never close the door to cooperate with other countries”. He also pointed that “make better use of two markets and two resources in the international market, and achieve more sustainable and sustainable development” [2].

As we can see from Xi's words, the dual circulation is a new international trade policy imposed by Chinese government [1]. The dual circulation prioritizes internal consumption and lower the weight of externation trade with other countries. As a country with 1.3 billion people, China seems to already have the enough market for domestic producers without any exports.

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Besides, given much criticism from economics that China has a much higher inflation rate than the official data, the central government of China hopes to lower the inflation rate by lowering the export volume [1].

The complaints about high inflation rate among Chinese residents are strong for years after the reform and opening-up policy, which was imposed in 1978 [3].

In this way, the new dual circulation policy may be seen not only as an economic policy but also a livelihood policy.

However, as we learned from the lecture, a lower export volume could decrease domestic producers' surplus and lower the rest of the world's utility. A policy decrease in international trade volume could also have negative impacts on countries' relationships.

## 2 Why China Imposes Dual Circulation

### 2.1 A Brief Introduction of China's Recent International Trade Policy

China's central government focused on stimulating internal demand by providing liquidity after 2008. However, after imposing years of accommodating monetary policy, China's central government found out that there are too many companies speculation by government subsidies. The central economic work conference at the end of 2015 proposed the supply side structural reform, focusing on audit government subsidies and liquidating some national companies.

Since the end of 2017 and the beginning of 2018, the focus of supply side structural reform has gradually shifted to deleveraging and risk prevention.

By the end of 2019, the above work has also made important progress. In this process, there are many different views on the balance between the supply side structural reform and the policy of expanding aggregate demand. Some people think that we should maintain the policy strength, focus on promoting structural reform, and avoid flooding at the same time; however, there are also views that there is no contradiction between the supply side structural reform and the moderate expansion of aggregate demand, and the two should not be opposed.

With the continuous improvement of external demand in 2016 and 2017, the urgency of expanding aggregate demand has declined, and the impact of the former view on economic policy seems to have the upper hand [4].

By the end of 2018, there will be two changes in the economic environment: first, the supply side structural reform has made or is making important progress in the field of de capacity and de leverage, and the short board and obstruction in the economic and financial fields have become more prominent problems.

Second, the growth rate of investment continued to fall, the growth rate of external demand slowed down significantly, the trade friction between China and the United States increased uncertainty, and the necessity of moderately expanding aggregate demand increased.

Corresponding to the above two changes, economic policy ideas also began to adjust. The central economic work conference in December 2018 has been reflected accordingly, which clearly put forward "smooth national economic cycle" and "promote the formation of a strong domestic market". On the one hand, we should "smooth the circulation of national economy".

From the perspective of supply to make up for weaknesses and supply-demand convergence, the meeting stressed that efforts should be made to “consolidate and enhance, enhance”.

At the same time, it also points out that the supply side reform still needs to continue efforts in reducing costs and making up for weaknesses. In addition, from the perspective of “smooth flow”, the conference specially emphasized the opening up of the economic cycle. The draft of the conference pointed out that “we should smooth the national economic cycle and speed up the construction of a unified, open and competitive economy.

We should strive for an orderly modern market system, improve the ability of the financial system to serve the real economy, and form a virtuous circle of the domestic market and the main body of production, economic growth and employment expansion, and finance and the real economy.” Although it only mentions “national economic cycle”, it focuses on domestic economic cycles.

## 2.2 The Internal Economic Problems

As discussed above, China’s central government has finished its deleverage action since 2019. The central government believes that the supply end has been fully reformed and the potential problems are in the demand end. So the internal economic problems could be listed as follows [5].

Firstly, the uncontrolled inflation rate in China. Even though the central bureau of statistics has pointed out that there is only about 2% annual inflation over the last 20 years in China. The actual inflation rate is believed much higher than that. Some researches pointed out that the actual inflation rate could be calculated by comparing the annual total debt of the financial industry [6]. They believe that the financial industry’s debt is mostly built up by residents’ savings. However, as the basic principle of macroeconomics points out, the saving is equal to investment.

In other words, savings equal to the total cash and equivalent in China. They point out that all of M0, M1 and M2 are manipulated by China’s government, resulting in an untrustful conclusion. If the inflation rate is calculated by their method, the annual inflation rate in China is over 10% [7]. What’s more, as China’s central government forbade most of CNY to USD exchange, most CNY are using only in China since 2015, the currency reform.

The second internal economic problem in China is the great negative externality rising recently. As a developing country, China’s leading industries are mostly heavy polluting, such as construction, chemical engineering and iron-making. All of those industries has a great negative externalities to people in China. However, China hasn’t built any carbon-dioxide trading markets or any punishment policies toward these forms. As a result, China’s environmental problems are serious nowadays.

## 2.3 The External Economic Problems

Before 2020, the policy ideas of “smooth national economic cycle” and “strong domestic market” mainly correspond to the “cyclical, structural and institutional problems” existing in China’s economic operation. Since the beginning of 2020, the outbreak of the

epidemic and the escalation of Sino US relations have further brought double impacts on external demand and international supply chain “The time and space dimensions of “smooth economic and social cycle” have also undergone important adjustments.

The epidemic broke out in early 2020, and the meeting of the Political Bureau of the CPC Central Committee in late February 2020, while deploying epidemic prevention and control, promoted the resumption of work and production as a whole. At that time, the flow of people, logistics and capital were all impacted to a certain extent. The “smooth economic and social circulation” proposed at this meeting has gone beyond the scope of supply side reform and become an urgent task of outstanding importance.

After that, the epidemic spread on a larger scale and for a longer time in the world, and began to spread in the United States in the middle and late March. Due to various reasons, the tension between China and the United States has increased significantly in the same period, and has brought new and greater impact on the stability of China’s industrial chain. After April, the US Department of Commerce announced new export control regulations (EAR) against China, and upgraded the sanctions against Huawei to restrict Huawei from using US technology and software to design and manufacture semiconductors outside the US.

The industrial safety administration of the United States further expanded its “entity list” of export controls against China. In May, the US government issued the strategic report on China, announcing that it would adopt the policy of competition with China under the guidance of “principled realism”. In June, with the advancement of Hong Kong’s national security legislation, the United States further tightened export controls on China. At the same time, the international environment is also changing on a larger scale.

On this basis, the extension of the short board in the supply side reform is further extended from the people’s livelihood short board, infrastructure short board and industrial upgrading short board to the short board in the perspective of industrial chain security.

Overall, the novel corona-virus pneumonia and Sino US tensions have promoted the “smooth circulation of the national economy” in the following three aspects: the first is the impact of the new crown pneumonia, which has caused the global economy to fall into deep recession, and the international trade and investment have been shrunk, the international financial market is turbulent and the international exchanges are limited. Moreover, since the epidemic will continue for quite a long time, the impact will also be sustained to a certain extent.

Second, in the adverse situation of economic globalization, the prevalence of protectionism and unilateralism in some countries, and rising geopolitical risks, China must seek development in a more uncertain world.

### **3 The Impact on China of the Dual Circulation**

As we learned from the lectures, China’s international trade could be simplified as the following model. The chart represents China’s trade with the rest of the world, for my topic it is explictig towards the manufacturing industry.

As the chart shows, China is currently trading with other countries. By doing international trade, consumers in China lose the utility of area a but producers in China gain

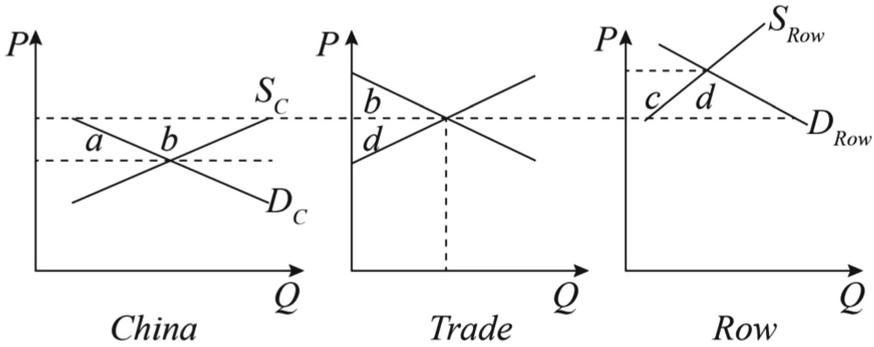


Fig. 1. Trade between China and the rest of world

area  $a + b$ . China as a total gains a utility of area  $b$ . By imposing the new policy, area  $b$  will be lost by China for all foreign trade will be forbidden in the worst situation.

More specifically, producers in China will suffer from a major loss due to the dual circulation policy. Since the manufacturing industry in China is mostly export-oriented, the manufacturing industry may experience a recession if the policy validated. As a result, more people are unemployed and a higher unemployment rate is expected.

However, for consumers in China, if they are not unemployed, they can live with a much lower price level. The price will move along with the supply-demand curve to the new balance. The balance price will be significantly lower than before (Fig. 1).

#### 4 The Impact on the Rest of World of China’s Dual Circulation

The analysis for the rest of the world is totally different with the above analysis on China. Since the rest of the world is importing from China, they benefit from the low price brought with China’s products. However, if the dual circulation policy validated, China will no longer be able to import to other countries in the world. The price level of the rest of the world will increase since the supply from China is eliminated. A total loss of area  $d$  will be imposed to the rest of the world. The consumers in the rest of the world will suffer from a price increase and lose the utility of area  $c + d$ . However, producers in the rest of the world could earn an economic profit of area  $c$ .

#### 5 Case Study: How Gree Offset the Impact of Dual Circulation

Gree Electric was founded in 1991, is a listed electrical manufacturing company in China. Gree’s main business is manufacturing and selling white household appliances, including air conditioners, refrigerators, washing machines, etc. Gree Electric is famous for its high quality products. Gree Electric has a number of self-developed technology patents. Due to its successful operation for many years, Gree Electric was selected as one of the top 500 manufacturing enterprises in China in 2000 and the top 500 enterprises in the world in 2019.

Gree Electric is an export-oriented company. In the past five years, Gree's export business accounted for more than 50% of its total business. Its business scope covers North America, South America, Europe, Asia and Africa. Gree not only exports home appliances to the world, but also continues to acquire home appliance enterprises in various countries. In the past five years, Gree Electric has successfully acquired a number of companies located in the United States, Canada, Germany, Japan, France, etc., realizing leapfrog development.

However, with the implementation of the dual cycle policy, Gree's export business is bound to receive a great impact. As previously analyzed, China's manufacturing enterprises will face the problem of falling demand and prices. Gree will also face the challenge of export business. As an export-oriented manufacturing enterprise, Gree Electric must solve this problem. Gree electric appliances have the following methods to solve the above problems.

- (1) Set up oversea facilities. As discussed in the textbook, an embargo could block all trades with the target country. However, companies in the target country usually set up new facilities in other countries to avoid the impact of the new policy. The United States imposed voluntary import policy toward Japan in the 1980s and Japan enterprises set up new facilities overseas to avoid such a policy. Gree now is taking the same strategy as those Japanese firms to avoid the impact of the dual circulation policy.
- (2) Set up a high end brand to increase the export condition. Gree has set up several high end brands to increase the profit per unit produced. It is also a usual method for firms to avoid embargo.

## 6 Conclusion

China has two special advantages in building a new development pattern of double circulation: one is a very large domestic market, the other is a very rich human capital. The core of realizing high-quality development in "building a new pattern of dual cycle development" by making use of dual advantages is to grasp the key move of deepening reform, so as to create a new channel and provide powerful power for dredging the dual cycle of economy. However, if we only rely on the domestic market, we can not make up for the damage caused by the lack of export market. For export-oriented enterprises, especially manufacturing enterprises, the damage is more serious. China's manufacturing industry is bound to be hit by the dual cycle policy. However, Chinese consumers will be able to enjoy lower prices and get more utility.

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