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China's Dual Circulation Strategy: An Overview of the Key Drivers

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Abstract

Introduction. This article provides an overview of the main driving forces behind China's dual circulation strategy. The dual circulation strategy was introduced by China in 2020, with the aim of reducing its dependence on foreign economies and boosting its domestic economic growth. The strategy seeks to strengthen the domestic market, particularly in high-tech industries, and create a self-sufficient economy. The objective of this study is to provide an overview of the main driving forces behind China's dual circulation strategy. The methodology used in this study consists of a comprehensive literature review of academic journals, government reports, and news articles. The data were analyzed using a qualitative approach to identify the key driving forces behind the dual circulation strategy. The results indicate that the dual circulation strategy is driven by a combination of domestic and international factors, including China's efforts to reduce its dependence on foreign markets, its desire to stimulate domestic consumption, and its need to support the growth of domestic industries. The findings of this study can provide valuable insights for policymakers, business leaders, and researchers who are interested in understanding the motivations behind China's dual circulation strategy and its potential impacts on the global economy.

Keywords: China, Development Strategy, New Development Paradigm, Dual Circulation, Domestic Economic Growth, Domestic Market, High-Tech Industries, Self-Sufficient Economy, Stimulate Domestic Consumption.

Introduction

Since adopting its policy of reform and opening-up in 1978, China has implemented a development strategy that has transformed it from a poor, centrally planned economy into a global economic powerhouse. A key component of China's development strategy has been its focus on economic growth and modernization. The government enacted a series of market reforms that helped stimulate economic growth and enhance productivity. These reforms included price liberalization, the establishment of a market-based financial system, and opening the economy to foreign trade and investment. Another important element of China's development strategy was an emphasis on education and the development of human capital. The government invested heavily in education and vocational training, which helped improve the skills and knowledge of the workforce and enhance the country's competitiveness. As a result, China has become a major player in the global economy and now ranks among the world's largest exporters and manufacturers. From 1978 to 2021, China's GDP increased from 367.8 billion yuan to 114.367 trillion yuan, growing 310-fold, firmly positioning it as the world's second-largest economy; its GDP per capita rose from 385 yuan to 84,700 yuan, a 220-fold increase, enabling it to join the ranks of upper-middle-income countries (World Bank); its total volume

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of foreign trade expanded from 20.6 billion USD to 6.5 trillion USD, reaching a record high, which has made China the world's largest exporter(1); its foreign exchange reserves increased from 167 million USD to 3.71 trillion USD, placing China at the forefront of the world's currency reserve holders(2).

However, various factors have necessitated certain adjustments to China's economic course. Among these factors are:

1. The impact of the COVID-19 pandemic, which disrupted global supply chains and highlighted the need for greater self-sufficiency and internal economic resilience.
2. Increased tensions and uncertainties in China's relations with other countries, including the USA, leading to trade disputes and the potential for further economic downturns.
3. The ambition to shift the country's economic model from being export-dependent to a more balanced growth model focused on domestic demand.
4. The need to address structural problems in the Chinese economy, including overcapacity in certain sectors, high levels of debt, and the necessity to upgrade and modernize the country's economic infrastructure.

Chinese leaders, including the General Secretary of the Communist Party of China (CPC), Xi Jinping, often emphasize that the world is undergoing "profound changes unseen in a century" (3) amidst fluctuations in the existing international order and balance of power. China's 13th Five-Year Plan came to an end in 2019, and the country faced its greatest challenge to date in the form of the COVID-19 pandemic. As the world's second-largest economy, with a GDP growth rate of over 6% in 2019, China was severely impacted by the virus outbreak, which had a significant negative effect on the country's economic growth. In fact, China's GDP contracted by 6.8% in the first quarter of 2020, marking the first recorded decline since 1992. This is illustrated in Figure 1, which shows the significant drop in China's GDP due to the impact of the COVID-19 pandemic.

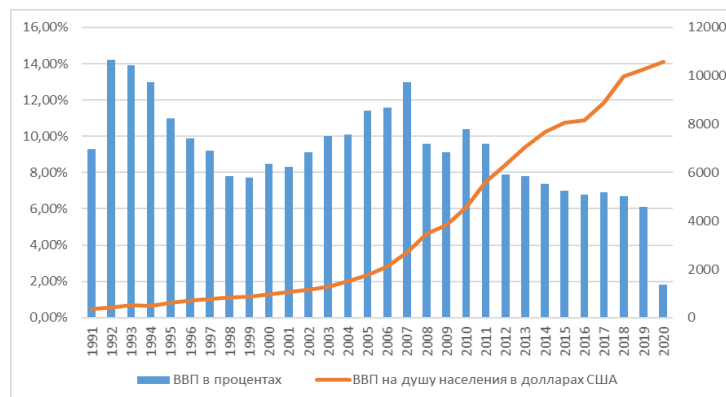


Figure 1. China's GDP Indicators For 1991-2020 (Compiled by the Authors Based on Data from the International Monetary Fund, 2022).

The COVID-19 pandemic has had a widespread impact on China's economy, with sectors such as manufacturing, tourism, and retail suffering significant damage. The country's economic growth slowed considerably as a result of the pandemic, with the International Monetary Fund (IMF) projecting China's growth rate at only 1.9% for 2020. This represented a substantial

decrease compared to China's previous growth rate of 6% in 2019 and highlighted the serious economic challenges the country faced due to the COVID-19 pandemic.

Materials and Methods

This study aimed to analyze the development of China's economy and its new paradigm of dual circulation. To achieve this goal, the following materials and methods were utilized:

Secondary Data Collection: Relevant literature, including official reports and scholarly articles, was reviewed to gather information on the dual circulation strategy. The National Plan for Economic and Social Development and the Long-Term Vision up to 2035 were also analyzed.

Content Analysis: Content analysis was conducted to examine the key goals and elements of the dual circulation strategy as described in official reports and documents. The impact of various factors, such as the COVID-19 pandemic, trade tensions, and the need for structural reforms on the implementation of the strategy, was also analyzed.

GDP Analysis: GDP data from 1978 to 2021 were analyzed to assess China's economic growth and the impact of the COVID-19 pandemic on the country's economy. Data sources for this analysis included the World Bank and China's National Bureau of Statistics.

Statistical Analysis: Statistical analysis was performed to determine the correlation between domestic consumption and investment and overall economic growth using relevant data from official sources and scholarly articles.

Case Studies: To provide practical examples of the implementation of the dual circulation strategy, case studies of successful domestic industries and initiatives that promote internal demand and supply were conducted.

The combined results of these methods were used to draw conclusions and provide insights into the development of China's economy and its new development paradigm, dual circulation.

Rationale for Adopting the Dual Circulation Strategy

Despite the challenges posed by the COVID-19 pandemic, China managed to revitalize its economy in 2020 through a comprehensive approach that included both public health measures to combat the spread of the virus and economic policies to support affected businesses and households (4). The Chinese government implemented a range of fiscal measures, such as tax reductions and subsidies for small and medium-sized enterprises, as well as monetary measures including lowering interest rates and increasing lending to support businesses (5). Additionally, the government announced plans to increase spending on infrastructure, particularly in areas such as transportation, communication, and social housing, to boost domestic demand and support economic growth. Collectively, these measures proved effective, helping China to overcome the economic challenges posed by the pandemic.

As 2021 approached, global economic prospects remained uncertain, yet China maintained stability, partly due to its long-term planning and focus on domestic economic growth. In May 2020, Chairman Xi Jinping introduced the concept of the "dual circulation" development model, aimed at fostering domestic economic growth and strengthening the interdependence between domestic and international economic activities. This strategy was officially incorporated into the 14th Five-Year Plan for Socio-Economic Development for 2021-2025 and reflected in China's long-term development goals up to 2035, emphasizing the importance and high status of such an approach to economic development.

The dual circulation strategy, aimed at balancing domestic and international economic development through the promotion of both internal and external markets, is influenced by a range of economic and political factors that determine its implementation and outcomes. These factors include domestic economic conditions, international trade policies, and political relations between countries, and they play a crucial role in determining the success or failure of the dual circulation strategy. This article is aimed at studying and analyzing these economic and political factors to understand the impact of the dual circulation strategy on the country's economic growth and stability. The dual circulation strategy is a key aspect of China's economic development, and understanding its principles and objectives can provide insight into the country's approach to economic growth and stability. By examining the goals and potential challenges of the dual circulation strategy, one can better understand how China is managing its current economy and positioning itself for the future. According to an article by Vice Premier Liu He, in which the new paradigm is outlined, the key to building a new development model lies in the seamless economic circulation and industrial links (6). This economic strategy is based on two components: "internal circulation," which pertains to economic activities within China, and "international circulation," which relates to China's economic links abroad. In the dual circulation scheme, internal and external markets complement and strengthen each other, with the internal market serving as the core and foundation. Strengthening internal circulation can enhance the resilience of economic development and facilitate international economic exchange, enabling the realization of the dual circulation model (7).

The description of the New Development Paradigm – Dual Circulation is provided in the fourth part of the National Plan for Economic and Social Development and the Long-Term Vision up to 2035, titled "Forming a Strong Domestic Market and Building a New Development Model." In the introductory section dedicated to dual circulation, it states: "We will persistently expand domestic demand as a strategic foundation, accelerate the creation of a complete system of internal demand, and organically combine the implementation of the strategy to expand internal demand with structural reform from the supply side, using innovation-oriented high-quality supply to create new demand (8)." The introduction explains that demand and supply in the domestic market are at the center of the reforms. According to the text, both require changes that will start with better resource utilization, leading to improved supply and, ultimately, a higher level of demand. The government plans to achieve this through innovation and high-quality supply, which, in turn, will create a high level of demand.

Through content analysis of the plan, it can be noted that the key tasks of the "Dual Circulation" strategy are:

Increasing Domestic Consumption and Stimulating Internal Demand: The dual circulation strategy aims to boost domestic consumption and investments in order to reduce dependency on exports and foster more balanced economic growth oriented towards internal demand. This includes measures such as tax reductions, increased social spending, and efforts to stimulate private sector investments.

Promoting the Development of Domestic Industries, Particularly High-tech and Advanced Manufacturing Sectors: This involves investments in research and development, infrastructure, and human capital to support the growth and competitiveness of these sectors.

Strengthening Internal Supply Chains: The dual circulation strategy also aims to enhance the resilience and competitiveness of Chinese industries and supply chains, reducing dependence on imports and increasing the country's self-sufficiency. This includes initiatives to upgrade and

modernize domestic production capacities, as well as efforts to promote innovation and the development of high-tech industries.

Facilitating International Cooperation: While prioritizing domestic demand and supply, the dual circulation strategy also seeks to continue participation in international economic exchanges and cooperation. This includes initiatives such as the Belt and Road Initiative (BRI), which aims to promote economic development and interaction in countries along China's trade routes, as well as efforts to promote the international use of the Chinese currency, the yuan.

In recent years, China has undergone changes in its development model, which traditionally relied on external markets and resources. Internal circulation signifies China's transition from an export-oriented economy to one focused on consumption. This shift is evidenced by the decline in the trade-to-GDP ratio, which fell from 67% in 2006 to less than 32% in 2019, and the reduction in the current account surplus-to-GDP ratio, which decreased from 9.9% in 2007 to less than 1% today. These trends indicate that domestic demand has become a more important driver of China's economic growth, accounting for more than 100% of GDP growth for seven years following the global financial crisis of 2008.

To facilitate this internal and international trade circulation and further orient the economy towards domestic markets, China has implemented supply-side structural reforms and expanded domestic demand. This has resulted in production, distribution, goods and services flow, and consumption in China increasingly being based on the domestic market, with the supply chain better adapted to internal demand. This led to a higher stage of well-regulated balance where demand determines supply, and supply, in turn, creates demand, allowing China to better regulate its economic structure and achieve quality development. Overall, these efforts to promote a new development paradigm will help China continue deepening supply-side structural reforms and expand internal demand, leading to a more domestically-oriented economy and improved development indicators.

Several measures have been implemented or proposed by China to stimulate internal demand within its dual circulation strategy:

Tax Reduction: The tax system can play a key role in supporting national development goals by providing the necessary resources to fund government programs and initiatives that contribute to these goals (9). To stimulate domestic consumption, China has implemented tax cuts for businesses and individuals, such as reducing the value-added tax (VAT) rate and increasing personal income tax deductions.

The main objective of China's tax reduction policy is to lower operating expenses, labor costs, and personal living expenses for businesses, thereby increasing the disposable income of individuals and legal entities and promoting sustainable growth in public consumption and production. These measures, including the recent reform to replace the profit tax with VAT and income tax, are designed for long-term and continuous, rather than temporary, impacts. By reducing the tax burden on economic entities and stimulating residents' consumption, this policy aims to increase the overall level of production and support the construction of the "new development model" (10).

Urbanization. One way to increase household incomes and consumption to promote internal circulation within China has been the continuation of urbanization programs and focusing on transforming millions of migrant workers into urban residents. This expansion would enlarge the middle class and increase the number of people with disposable income capable of making

purchases, thereby stimulating the economy. Currently, about 60% of China's population resides in urban areas, but increasing this number could further accelerate economic growth through increased consumption. Maintaining a balance between demand and supply is crucial in any economy, and this is particularly pertinent for China, which aims to enhance the potential of its internal market. To achieve this, there needs to be a focus on creating new urban agglomerations and developing existing major urban areas, such as the Guangdong-Hong Kong-Macao Greater Bay Area and the Yangtze River Delta, as they can act as "engines" of urbanization and contribute to economic growth through increased consumption. This approach has been emphasized by Fan Gang, Director of the National Institute of Economic Research and Chairman of the China Reform Foundation (11), and Su Jian, Director of the National Economic Research Center at Peking University, believes that to expand internal consumption and accelerate internal circulation within China, it is necessary to establish major consumer centers in the country. However, this cannot be achieved without compact housing for consumers, underscoring the importance of urbanization in stimulating economic growth through increased consumption. Su Jian suggests that this requires a focus on developing urban areas and creating compact housing for consumers (12). To offset the effects of the pandemic and stimulate consumption, local authorities and major cities are distributing cash vouchers to encourage residents to make purchases, thereby stimulating demand (13).

Promoting the Development of Domestic Industries, Particularly High-tech and Advanced Manufacturing Sectors. In the coming years, China will strive to ensure that consumption growth goes hand in hand with improvements in the quality of life. By refining consumer preferences, companies will pay more attention to innovation to meet their needs. In the proposals for the 14th Five-Year Plan, innovation was considered the main driver of China's development. The quality and sustainability of internal circulation depend on scientific and technological innovations. The US's encroachment on China's strategic high-tech sector has partly prompted the country to increase its self-sufficiency in science and technology. In 2019, China's investments in scientific research grew by 12.5% compared to the previous year. The state expanded support policies for areas such as big data, 5G, and artificial intelligence. Being a leading producer of goods, accounting for 28% of global production, the country aims to integrate innovations across all sectors and modernize production chains.

In 2020, China's total investment in R&D exceeded 2.4 trillion yuan, increasing by 224.95 billion yuan or 10.2% compared to the previous year, continuing a double-digit growth trend since the "13th Five-Year Plan". The growth rate decreased by 2.3 percentage points compared to the previous year. Since the growth rate of R&D expenditure was 7.2 percentage points higher than the current GDP growth rate, the intensity of R&D investment (ratio to GDP) reached 2.40%, an increase of 0.16 percentage points compared to the previous year, marking the highest level of growth in the last 11 years. Compared to other countries, the total volume of R&D investments in China has been steadily increasing, leading the world in growth rate. In 2020, China's total R&D expenditure accounted for about 54% of the United States', which is 2.1 times more than that of Japan, the second-largest in the world. From 2016 to 2019, the annual net increase in R&D spending exceeded 200 billion yuan, roughly equal to that of the G7 countries (USA, UK, Germany, France, Japan, Canada, and Italy) and constituted 60% of the total annual increase, becoming the main driving force of global R&D financing growth. From 2016 to 2019, China's R&D expenditures grew by an average of 11.8% per year, significantly higher than in the USA (7.3%), Japan (0.7%), and other technological giants. (14)

According to preliminary calculations by the National Bureau of Statistics, in 2021, the total volume of investments in research and experimental development in China reached 2.7 trillion yuan, increasing by 14.2% compared to the previous year, and the growth rate was 4.0 percentage points higher than the previous year, continuing the double-digit growth trend since the "13th Five-Year Plan". In constant prices, R&D investments increased by 9.4%, exceeding the expected average annual growth rate of at least 7%, as proposed in the "14th Five-Year Plan", achieving a good start. (15)

As noted by Shu Qiueting, an official representative of China's Ministry of Commerce, innovation is a key part of China's new development concept and an important driver for the quality development of the economy. She also stated that thanks to the strategy of stimulating development through innovation, China has risen in the Global Innovation Index from the 34th position in 2012 to the 12th in 2021, and that foreign companies, including those from Europe, have contributed to this progress and benefited from China's openness and innovative development. (16)

The Chinese Academy of Macroeconomics has proposed nine main directions to accelerate the construction of the new "dual circulation" development model. One important aspect highlighted was the improvement of capabilities in scientific and technological innovations: "Firstly, there is a need to focus on breakthroughs in a number of key basic technologies. Core technologies, fundamental R&D tools, key components, and technological equipment in critical industries such as electronic information, biomedicine, and aerospace are controlled by others, and there is a clear risk of supply chain disruptions leading to poor circulation in the industry. There is an urgent need to focus on the 'bottleneck' link, strengthen collaborative research, and achieve substantial breakthroughs as soon as possible. This is a crucial issue for the country's overall development and also key to forming a domestic cycle. For key fundamental technologies that need to be industrialized in the near future, it is necessary to fully leverage the advantages of the new national system and actively explore the organizational model 'enterprise-led + research institutes and universities as main forces + state support + open collaboration'. For key fundamental technologies that require long-term continuous investment, a number of national-level industrial technology research institutes will be established with new mechanisms and models for conducting long-term research. Actively develop new advantages for the country to participate in international cooperation and competition and strive to seize the initiative in the new scheme of dual circulation development.

Secondly, vigorously enhance the technologically innovative capabilities of enterprises. Enterprises are the drivers of innovation. Only through enterprises can the elements of innovative resources such as talent, capital, and technology be effectively combined and transformed into real productive forces, thus promoting the economic cycle. However, the innovative capacity of enterprises is insufficiently prominent, becoming a noticeable deficiency that limits the current dual circulation. In 2019, industrial enterprise investments in R&D above a designated size accounted for only 1.3% of the main business income, which is much lower than the 2.5–4% level in developed countries. The proportion of enterprises engaged in R&D is less than one-third, and the level of R&D investment in fields such as electronic information and biomedicine significantly lags behind developed countries. There is an urgent need to adapt to the requirements of economic transformation and development and increasingly strict international competition, further strengthen economic policy support for corporate innovations, accelerate the creation of an inclusive and prudent regulatory system, and adopt practical

measures to accelerate the improvement of corporate technological processes and innovative capabilities.

Thirdly, strengthen fundamental research. Fundamental research is the source of innovations, but the proportion of China's R&D funds used for fundamental research is only about 6%, which is several times lower than in developed countries. China's technological level has made significant breakthroughs in some areas, and the gap with developed countries is narrowing, while competition among major powers for the commanding heights of the scientific and technological revolution is becoming increasingly fierce. This requires us to increase investment in fundamental research, raise the level of fundamental research, improve the systems and mechanisms of fundamental research, actively explore next-generation technologies that can lead to future leadership and define the direction of progress, aim to bring the country's fundamental research to a world-leading level, and effectively expand the initial innovative capabilities.

Fourthly, accelerate the improvement of scientific and technological innovation systems and mechanisms. The current scientific and technological innovation system of the country was mainly formed during the transition from a planned economy to a socialist market economy and is not suitable for accelerating the construction of a scientific and technological powerhouse and realizing the innovative development necessary for the current new model of dual circulation development. Issues such as decentralization and unclear functional positioning of the main part of innovations are more noticeable. There is an urgent need to adapt to the new situation and new requirements, accelerate the reform of the scientific and technological innovation system, put innovation actors in appropriate positions, and unleash the enormous potential of the country for innovation, entrepreneurship, and creativity." (17)

Strengthening Internal Supply Chains.

The COVID-19 pandemic exposed the vulnerability of global supply chains and the necessity for countries to strengthen their internal supply chains. One of the key aspects of the dual circulation strategy is the diversification of imports of essential goods such as energy, food, and raw materials. By reducing its dependency on external markets, China aims to minimize the impact of external risks and capitalize on opportunities provided by global markets. Furthermore, this strategy seeks to promote the localization of supply chains where possible (18). This not only helps ensure the availability of vital goods during a crisis but also boosts the country's economy by creating jobs and supporting local businesses.

China has long been known for having one of the most complete manufacturing supply chains in the world, partly thanks to the presence of foreign companies. However, tensions with the United States have highlighted China's vulnerability, as it heavily relies on high-tech US products such as semiconductors for its internal supply chains. In response, Beijing is emphasizing domestic innovations to secure its supply chains. While Chinese leaders promote innovation and localization, they also continue to advocate for broader market opening to attract more foreign investment in high-end manufacturing. This will help strengthen the security of China's supply chain and prevent firms from relocating from China to other countries.

The growing import of crude oil into China has made the country dependent on foreign states and susceptible to supply chain disruptions and price fluctuations. In 2017, China became the world's largest importer of crude oil, surpassing the USA, and the gap between China's oil consumption and domestic production continues to widen. Although China has taken steps to

diversify its sources of foreign oil, it remains heavily dependent on countries in the Middle East and Africa, where political instability poses a threat to China's energy security.

Additionally, according to the US Department of Defense, a significant portion of China's imports of oil and natural gas, 84% of oil and 61% of natural gas, pass through the South China Sea and the Strait of Malacca. These areas could become strategic choke points in the event of military conflict, further exacerbating concerns about China's energy security.

Promoting International Cooperation within the Framework of the Dual Circulation Strategy.

There are opinions suggesting that "dual circulation" signifies China's turning away from the external world. Chairman Xi Jinping has emphasized that this is not the case: the new development model features not a closed internal cycle but a more open internal and international circulation. This "dual circulation" is not only suitable for China's development but will also benefit people in all countries.

The new dual-cycle development model requires a balance between internal and international cycles, with a priority given to the internal cycle. This is necessary to reduce economic dependency and external risks while also benefiting from participation in the global economy. Globalization has deeply integrated China into the world economy, and cross-border trade, labor division, and cooperation have become commonplace. Complete self-isolation is unfeasible due to the complementarity of technologies, markets, and goods, as well as the dynamic development of international comparative advantages. Global resource distribution benefits all economies, and it is difficult for any country to extract itself from the global market.

International circulation means that China will continue to open its market economy to foreign investments and free trade. As the global economy recovers from the COVID-19-induced recession, China's dual circulation model will become an important factor in economic growth.

The analysis above underscores the importance of a balanced approach between internal and international cycles in the new dual-cycle economic development model. Relying solely on internal circulation is insufficient. The demand in the domestic market supply chain and effective supply depends on the uninterrupted flow of foreign supply chains and cross-border cooperation with them. This leads to mutual promotion and coordinates development of both internal and international economic circulations, forming a new model of dual circular economic development.

Conclusion

As the defining strategy of the 14th Five-Year Plan, "dual circulation" aims to achieve sustainable socio-economic development by expanding the internal consumer market. China's ambitious plans do not allow for complacency with the country's current status as the "world's factory," merely participating in the international cycle and remaining in the lower and middle segments of the international division of labor. China's new strategy requires a focus on the internal cycle, which will give a strong impetus to healthy and sustainable economic development.

The dual circulation strategy represents a comprehensive approach aimed at strengthening China's internal supply chains and reducing its dependency on external markets. By diversifying imports of essential goods, promoting the localization of supply chains, strengthening internal demand, and advancing innovations, China hopes to create a stable and resilient internal market that can support economic growth in the post-pandemic era.

The new development paradigm with dual circulation is a proposal by the Chinese government aimed at making the country's economy more resilient to external shocks. This is achieved by prioritizing internal circulation of goods and services as the foundation of the economy, while still relying on external circulation to facilitate expansion. The goal of the dual circulation strategy is to achieve quality growth and support the Chinese government's two centennial goals, which are to build a moderately prosperous society by 2021 and transform China into a modern socialist country by 2049. The Chinese government supports globalization and encourages cooperation to achieve common prosperity for all its citizens and promote a fair global order based on collaboration. The country's growth will significantly impact the global economy and benefit trade partners through increased income levels, market expansion, and fostering prosperity and stability.

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