# Building an open economic powerhouse driven by domestic demand

Xu Congcai[*]

This paper, starting from an accounting of internal and external demand, first examines the relationship between the two under strict conditions and then points out the preferences of different countries for internal demand and external demand by relaxing the hypothesis gradually. On the basis of general theories, the evolution of the relationship between internal and external demand in China's economic growth is studied to explain that expanding internal demand and establishing an open economic powerhouse driven by internal demand is a realistic choice. Specific suggestions on such aspects as investment, urbanization, income, consumption, and distribution are also proposed in the hope of being conducive to related future research.

**Keywords:** relationship between internal and external demand, internal-demand-led economy, investment, urbanization, consumption.

## 1. Introduction

Since 1990, two major market-oriented reforms have twice bred distinct, high-speed economic growth in China: once in the 1990-1995 period resulting from the third major industrial structural adjustment towards marketization in 1989, and the other in 1992 when Chinese state-owned enterprises underwent reforms toward privatization. The latest period of rapid economic growth appeared between 2001 and 2007, resulting from China's accession into the World Trade Organization (WTO), after which China based its active participation in the international division of labor on its comparative advantages and developed an economy led by external demand. However, since 2007, China's economic potential growth rate has started to fall, as shown in Figure 1 and 2.

China's economic growth rate has been on the down side for over ten consecutive quarters, especially in 2014. The latest data from January and February of 2014 show that there is overall downward pressure on the Chinese economy. The analysis of the composition of GDP, as shown in Figure 3, reveals three reasons for the decline in China's economic growth rate.

(1) The exports have been shrinking. Since the international financial crisis in 2008, the rate of contribution by China's exports of goods and services to economic growth has fallen sharply. Especially after 2011, it has become normal for the contribution rate of China's net exports of goods

[*] Xu Congcai(email: xccnj@163.com), Professor, Nanjing University of Finance and Economics, Nanjing, China.

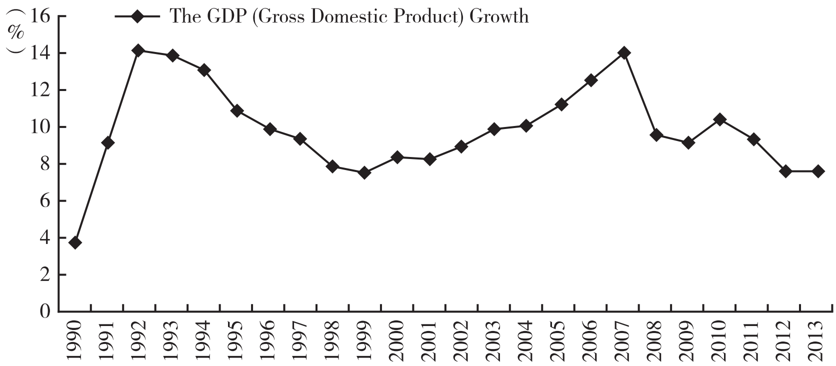


*Figure 1.* Real annual GDP growth rate for China from 1990 to 2013

Source: National Bureau of Statistics of China.

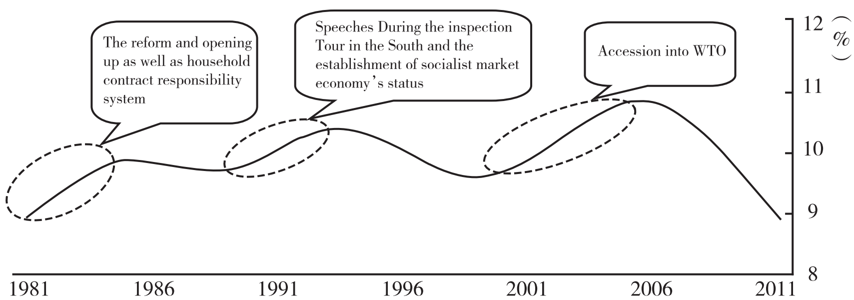


*Figure 2.* Annual growth rate of China's potential output through HP filters by China International Capital Corporation Limited (CICC)

Source: Research Department of CICC.

and services to economic growth to be negative. Some scholars believe that the economies of the United States, European Union, and Japan have begun a slow recovery since the second half of 2013, and China's exports in 2014 and even over the next several years may be better. Viewed from various data, China's exports in 2014 have indeed been on the ascent. However, we think that China's export-oriented enterprises still face challenges in seven aspects.

First, at present, China's monthly exports have exceeded more than $200 billion, constituting tremendous export volume. Given such a large base of exports, the rapid growth of the past is simply not easy to maintain. The second challenge is that Chinese companies have been facing increasingly high labor costs in recent years, close to or even more than the average labor cost in the eastern European countries and Russia. The manufacturing of many commodities originally made by China has begun to shift to the developing countries such as those in Southeast Asia, central and eastern European countries, and even Germany. The third challenge is the heavy tax burden on Chinese business, with the corporate income tax, in particular, ranking almost highest in the world. The fourth challenge is that the huge appreciation of the yuan in recent years has constrained export enterprises. Fifth, Chinese enterprises have been suffering rather high financing costs, posing difficulties for continuing operations. For example, Wei (2014) pointed out that currently a great number of China's enterprises, especially small and medium-sized enterprises (SMEs) are unable to obtain loans with annual interest rates below 10% from banks. The sixth is that the restart of industrialization in developed countries has affected China's export-oriented enterprises. Finally, international trade rules in favour of developed countries' dominance are being reconstructed and international trade protectionism is rearing its head again. This is causing China's implementation of export-oriented strategy to face increasing resistance at home and abroad, which in turn leads to increasingly high political, economic, social, and ecological costs and mounting risks to China's economic and social development. These factors have contributed to the falling competitiveness of Chinese enterprises and the products made in China on a global scale and increased external constraints on economic growth in China.

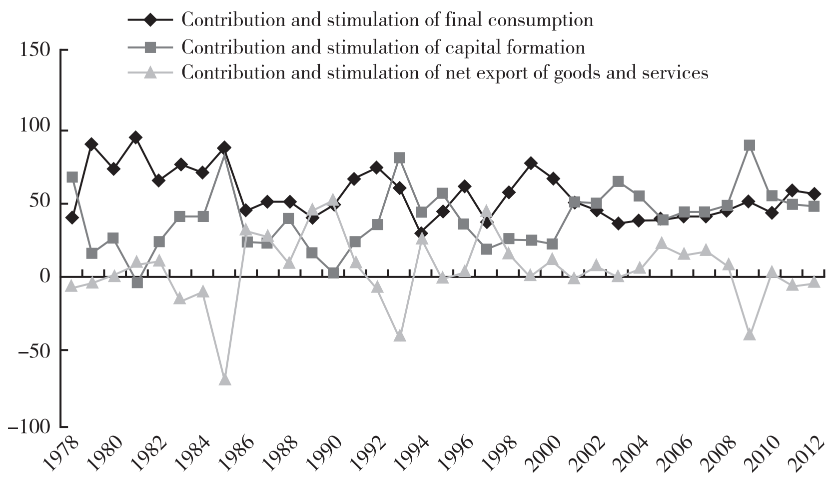


*Figure 3.* Historical contributions of final consumption, capital formation, and exports to China's GDP growth
Source: CICC Research Department.

(2) The rate of domestic investment has been falling. Overall, the contribution of capital formation to China's economic growth has dropped since 2010. In terms of the specific composition, domestic investment is divided into three parts: business fixed assets investment, real estate investment, and infrastructure investment promoted by the government. Since the second half of 2012, only real estate investment and infrastructure investment have risen. But since 2014, domestic investment, regardless of infrastructure investment or real estate investment, has been falling, especially business fixed assets investment. The ultra high-speed growth of Chinese investment ceased with the global economic crisis between 2008 and 2009. Predictably, if there are not significant increases to foreign trade export orders, China's investment environment will not improve substantially. With excess production capacity in many sectors within China's manufacturing industry, Chinese business fixed assets investment will maintain a

declining trend.

(3) Consumer demand has been low. As the consumption consciousness of ordinary Chinese consumers is deficient at a relatively low level due to long-term constraints, the hierarchy of needs of Chinese residents' consumption is also at a relatively low level (Zhang & Liu, 2012). China's consumption demand has been rather slack. In addition, although the contribution rate of final consumption to economic growth in China is increasing, its growth rate in recent years has been declining.

One can see that in the past decade, China has realized its economic boom through reliance on an export-led development model. But now, China's traditional engines for rapid growth, including exports, real estate, and investment, have been lagging in strength. Moreover, the traditional economic growth pattern has also brought China a series of negative effects and emerging problems, among which the sustained low final consumption rate and relatively lagging domestic trade have formed a bottleneck seriously restricting the further development of China's economy. In today's stagnant international economic environment, it has become a top priority to re-examine the selection of dominant demand in our country.

## 2. A general analysis of the relationship between internal and external demand

### *2.1. The accounting of internal demand, external demand, and the national economy*

Internal demand refers to the portion of national economic output used to meet domestic demand, while external demand refers to the output caused by foreign demand. As the total revenue of the national economy is comprised of internal demand and external demand, the relative scale can be calculated by dismantling the national economic accounting equation. When GDP is measured with an expenditure approach, the final products consist of five parts: household consumption, business investment, government spending, imports, and exports. Among them, export can be used to measure the scale of external demand, while the rest of consumption, investment, and government spending after the deduction of imports, wholly belong to internal demand. These two parts are used to reflect the proportion of domestic products meeting domestic and foreign demand respectively, termed as internal demand and external demand in this paper. It is important to note that the calculation of internal and external demand in general is much more complicated. For instance, investment includes investment made by businesses for export and thus must be included in the calculation of external demand as such investment is made for export expansion.

### *2.2. An analysis of the relationship between internal and external demand under the strict hypothesis*

In reality, according to the difference in relative importance of internal and external demand, economic growth models can be divided into internal-demand-led and external-demand-led.

For the former, domestic investment and consumer spending play a crucial role, while in the latter, national income mainly depends on demand from foreign markets. Such concepts as domestic demand and foreign demand are separated according to their source. We can make a bold hypothesis: under extremely strict assumptions, domestic demand and foreign demand possess equal importance and exert almost the same pulling effect on the growth of the national economy.

To ensure the above conclusion is established, there are several necessary assumptions. First, the objects of study must be market-economy countries that have experienced natural growth. This means that domestic resources have been fully and effectively allocated, and the allocation of international resources has obtained the effective support of the allocation of domestic resources. Second, the objects of study can only be countries in an abstract sense regardless of their large or small sizes. When these two conditions are satisfied at the same time, the transaction costs of the relevant economic activities of internal and external demand tend to be entirely equal and would never differ due to disturbing factors such as dynamic changes occurring in economic development or domestic market capacity.

Yet, such strict conditions are difficult accepted in reality. In order to enhance the practicability and guiding significance of the theory, the assumptions must be relaxed.

### *2.3. An analysis of the relationship between internal and external demand under the condition of being a great power*

Now, let us relax the second condition and pay attention to whether the sizes of countries will affect their preference for internal demand or external demand. Compared with countries of a small size, great powers boast unique advantages in natural resources, geographical space, and domestic market capacity. If they can fully integrate domestic resources, cater to the domestic market, and develop domestic trade, two positive effects conducive to economic growth will be stimulated.

First of all, in large nations, the interregional division of labour can be deepened through interregional trade, strengthening the comparative advantages among different regions, optimizing the allocation of interregional resources, and improving the productivity of each region. The economic benefit of carrying out interregional trade lies not only in consumption advantages and growth in material benefits for both sides, but also indirect and long-term positive impact on the economic and social development of each region. Second, through domestic trade, great powers can catalyse industrial division of labour and promote industrial integration in order to maximize economies of scale. As a result, we believe that for great powers, the importance of the internal demand is higher than that of external demand, making it an inevitable choice to prioritize the development of domestic trade and give play to the pulling effect of internal demand on national economic growth.

## 3. The historical evolution of the relationship between China's internal and external demand and China's realistic choice in the context of economic transformation

### *3.1. The historical evolution of the relationship between China's internal and external demand in the context of economic transformation*

As a developing country, China faces more complex considerations in handling the relationship between internal and external demand. Differing from other market economy countries that have undergone natural growth, China has experienced a transformation from a planned economic system to a market economic system. While seizing the opportunity to participate in the international division of labour, China has not fully grasped the opportunities for domestic trade. Therefore, the relationship between internal and external demand is by no means as simple as "equally important." In contrast to other powers in a general sense, in making the strategic choice of guiding demand, China must not only consider endowments and other natural conditions, but also internal conditions in a certain period and historical opportunities in the external environment.

In the first 30 years of reform and opening up, China began to transform from a lack of market economy foundation. The lack of trading agents and motivating factors led to the faltering development of domestic trade. On the other hand, China has rich labour resources, large resource capacity, and large environmental capacity. Meanwhile, over the past 30 years the world economy has experienced relatively stable development and the international division of labour has been in a period of integration, both of which have provided a historic opportunity for China to be actively involved in the international division of labour. During this period, the policy orientation that gave priority to export development and promoting economic growth by boosting external demand was not only an objective requirement of domestic conditions and the foreign environment, but also a practical measure to enhance the sustained and rapid growth of the national economy and to assist the expansion and competitiveness of China's export industry, which in turn increased the allocation efficiency of domestic resources and promoted the upgrading of the industrial structure.

However, as economic development enters a new stage now, fundamental changes have taken place in the domestic and international environment, and great negative effects are increasingly shown due to an economic growth model excessively dependent on external demand. On one hand, excessive dependence on foreign trade leads to negative effects such as distorted factor prices, excessive consumption of material resources, as well as deteriorating environment pollution. On the other hand, excessive dependence on external demand causes the volatility in economic development, while shrinking international demand leads to a large number of business failures in domestic processing trade, slowing down sustained and rapid economic growth.

Sluggish external demand has coincided with a downturn domestic demand growth.

(1) In the past twenty years, the huge amount of investment amassed rapidly by relying on government spending has largely focused on the construction and improvement of "quality

assets" such as large-scale infrastructure construction, urban living environment, and traffic improvement and communication network construction. Such "quality assets" to offset local government debt cannot bring about qualified cash flow. Infrastructure construction investment is regarded as good assets from the angle of serving society, but from the perspective of rate of return on investment, these assets are public services provided by the government that can neither bring cash flow to repay capital and interest in normal circumstances to cover debt service, nor can they be sold to private buyers during the crisis at a price higher than the cost of construction. This means that the public service provided by government through loans is beyond the level that current economic development is able to undertake, and therefore the government does not have a self-liquidating capability. The inability to pay off debt is more dreadful than debt itself. If a project does not have a qualified rate of return on investment, exists due to institutional factors, and is difficult to withdraw from, a steady stream of financing support is the only way to ensure its existence. On the entity level there are so-called zombie companies and excess capacity, and on the financial level there are ever-climbing debt ratios. New highs are being set on both levels. At present, the debt of both China's local governments and businesses is in a serious situation in which new bank loans are used to pay former debt and build infrastructure, making investment in infrastructure and fixed assets in the future more and more difficult.

(2) China's final consumption rate of below 60% implies a huge gap compared with the world average of 80%. Internal demand has not been given full play in stimulating economic growth. Instead, it has become a shortcoming in furthering our China's economic growth. Thus, China will have a difficult time continuing the past model of economic growth led by external demand. To realize sustained economic development over the next 30 years or longer, China must change its economic growth model of excessive dependence on external demand and speed up the shift toward internal demand with coordinated development of both internal and external demand. Building an economy led by internal demand is an essential option for a great power.

### *3.2. The meaning and characteristics of an economy led by internal demand*

The internal-demand-led economy, the opposite of an export-led economy, refers to an economic development model in a modern market economy in which economic growth is mainly dependent on domestic demand, especially the continued expansion of investment demand and consumption demand. The most remarkable feature of the internal-demand-led economy is the leading role played by business investment and consumer spending, which are not only reflected in the pulling effect of the investment market and the consumer market in promoting economic growth as the primary power source, but also in the conclusive function of the selection of business investment and consumer spending in resource allocation.

Establishing an open economy led by internal demand implies not merely expanding domestic demand, but also bringing the fundamental pulling effect of domestic demand in enhancing economic growth into full play on the basis of balancing the relationship between internal and external demand. Establishing an open, internal-demand-led economy implies three layers of meaning. In the short term, domestic demand expansion, foreign demand stabilization, and commodity price control are three focal points. In the medium term, the proportions of moderate investment and final consumption in GDP need to be maintained and improved, respectively. In the long run, it is essential to establish an effective mechanism for the virtuous interaction and coordinated development of internal and external demand.

## 4. Approaches to establishing an open economy led by internal demand for a great power

Establishing an open economy led by internal demand entails efforts in the following five areas: maintaining moderate investment, accelerating the urbanization process, enhancing consumption capability, stimulating desire for consumption, and addressing distribution problems. Maintaining moderate investment lies in carrying out fiscal and taxation reform, establishing a central-local relationship with reasonable division of authority in financial administration and power, and addressing corporate financing difficulties through the reform and construction of the capital market. The connotation of accelerating the urbanization process requires coordinated economic development between urban and rural areas and among different regions. Promoting consumption ability requires the establishment of a consumption system genuinely dominated by market forces. Stimulating consumption desire requires an innovative consumption model and consumption management methods, the expansion of consumption of services, the release of rural consumer potential, and the construction of a consumption pattern and consumption policy system with Chinese characteristics. To resolve the distribution problem, reform of distribution system must be deepened in order to provide a guaranteed distribution network in establishing an open economy led by internal demand.

### *4.1. Maintaining moderate investment*

Modern economic growth theory shows that the growth of capital input per capita and total factor productivity is the cause of economic growth. The establishment of an open economy led by internal demand, therefore, should be based on the expansion of consumer spending instead of requiring the exclusion of investment. On the contrary, stable investment is the key, and China's top priority in maintaining sustainable economic development is to solve the problem of the declining investment rate. Important approaches include keeping the focus of moderate investment on the field of welfare, releasing the potential of private investment, reforming the fiscal and taxation systems, and constructing a multi-level capital market.

First of all, to maintain moderate investment, China must grasp the principle of allowing the market to play the decisive role in regulating resources and better managing the role of government. Through simplified government and decentralization of power, reduction of examination and approval, breakup of monopolies, and active encouragement of private investment in infrastructure, a situation in which governmental and private investment cooperate on public projects and release private investment potential may be formed. The major focus in maintaining investment should be investment in welfare. A large amount of welfare investment is needed in today's China, such as improvement of the ecological environment, improvement of air quality, and management of water resources, all of which constitute welfare and public consumption by nature and are concrete measures to ensure people's well-being (Li, 2014).

Second, the decisions of the Third Plenary Session of 18th CPC Central Committee in the form of documents concerning comprehensive reform should be carried out to accelerate tax reform and establish a central-local relationship with a reasonable division of authority in financial administration and power. China's outstanding performance in infrastructure investment and upgrading can be explained by China's fiscal decentralization model and successful governmental transformation (Zhang, 2013). In the current fiscal decentralization system, as the authorities of the central government and local governments in financial administration and power do not match each other, the large-scale investment made by the local government in the previous decade is mainly dependent on bank loans and a variety of debt financing platforms. Now, local governments are facing an increasingly serious situation of debt, with another repayment peak between the years of 2013 and 2014 (Liu, Zhang, & Liu, 2013). In this situation, if China's current fiscal system reform is not carried out, local government debt will become increasingly burdensome, making future infrastructure investment more difficult. Accordingly, infrastructure investment will make less of a contribution to promoting China's economic growth in the future, a natural determinant for China's macro-economy to enter a period of intermediate growth or even intermediate-low growth.

Finally, China should proceed actively but prudently with reform of the stock issuance and registration system. The construction of multi-level capital market should be accelerated, a market-oriented merger, acquisition and reorganization should be encouraged, and provisions for delisting should be improved in order to enhance the efficiency of listed companies and their ability to consistently provide returns to investors. Only in this way can the excessive capital in real estate market enter the capital market, providing businesses with low-cost financing, which is conducive to the expansion of investment and the development of an innovation economy.

### *4.2. Steadily pushing forward urbanization*

The greatest potential for expanding domestic demand lies in urbanization (Li, 2012). In 2011, China's urban population surpassed 50 per cent of the total. However, the urbanization rate in China still clearly lags far behind that of others, not only far below developed countries but also lower than the world average. Urbanization rates in the developed countries reach 80% in general, developing countries where the per capita income is similar to that of China have urbanization rates over 60 per cent. By speeding up China's urbanization process, a large amount of social needs can be released, including ample demand for services, demand for urban construction and real estate, as well as demand for services in fields like science and technology, education, health, and culture. Such demand is long-term and massive. Based on the price index of 2011, total retail sales in China may increase by about 30% once the problems of China's 180 million migrant workers are resolved, which is a major impetus for the expansion of domestic demand.

First of all, coordinated development of urban and rural areas must be promoted in order to solve the "dual structure" problem between rural and urban areas. This requires researching and formulating medium-term and long-term plans for urbanization and enacting comprehensive policy measures while fully respecting the will of farmers, maintaining their rights and interests, and strictly protecting arable land. Urban planning and management should be strengthened in accordance with the objective law of urban development, and population flow and industry transfer should be reasonably guided to promote intensive development in large and medium cities and small towns with scientific layout, reasonable divisions of labour, and complementary functions. Policy measures facilitating the integration of migrant workers into cities should be formulated quickly and enforced to gradually allow migrant workers equal coverage by basic public services. Migrant workers who have stable jobs and residence in cities and towns will also be turned into urban residents in an orderly manner. Another point of focus is whether the sound development of the real estate market can be accomplished within urbanization. The results of regulation and control must be solidified, the construction of government-subsidized housing must be actively promoted, ordinary commodity housing must be effectively increased, and the establishment of a long-term mechanism to promote the sound and stable development of the real estate market must be accelerated in order to ensure the steady progress of urbanization.

Second, coordinated development among regions should be promoted. Regional development is closely related to urbanization. One important piece of evidence of the backward development of less developed areas of China is their lagging urbanization. In areas with good development conditions and large environmental capacities, urbanization should be actively and steadily promoted for the reasonable agglomeration of factors, centralized layout of enterprises, intensive utilization of land, cultivation of new economic growth poles, and strengthening of their own development abilities. National policies including regional policy, industrial policy, and land policy should not be universally imposed with disregard to special cases. Instead, they must give different guidance to different entities with both security and control. As to the national key development areas in western areas where industries with local advantages are developed, a differentiated policy should be adopted under the precondition of energy conservation and environmental protection being strictly carried out, quality and safety being ensured, and the layout being scientific and reasonable.

### *4.3. Establishing a consumer market dominated by market forces*

A consumer market dominated by market forces means the market must play a fundamental role in the distribution of income, while the government is mainly responsible for solving the problem of market failure.

First of all, fair labour rights must be ensured and a policy of enriching people must be carried out. Currently, our country's national income has been too tilted toward government and business, as the proportion of people's income has decreased from 63.8% to 56.6% in the previous decade.

Excessive proportions taken by government and business have led to a slow growth of household income, which has restrained the consumption demand of residents. Emphasis on labour rights can greatly improve workers' incomes, making most of them wealthier and raising the purchasing power of society as a whole. Second, the healthy and rapid development of many SMEs should be promoted to cultivate a middle class. At present, the middle class takes up too small a share in China's social structure, which has severely suppressed the effective growth in market demand and led to insufficient domestic demand. The solution to this problem lies in breaking up monopolies, relaxing administrative controls, and establishing effective, competitive markets, all of which will promote the healthy and rapid development of a great number of SMEs, expand the proportion of middle-income groups with stable incomes, and strengthen the backbone of the consumer market. Finally, the government should reasonablly carry out its role as a regulator in income distribution. In reality, there is overstepping, absence, or dislocation of government to different degrees in all areas of economic life, among which overstepping caused by strong government intervention in the economy is the most common phenomenon. Therefore, the government should have the courage to decentralize, assume the responsibility of solving only the problem of market failure, and allow the market to distribute incomes.

### *4.4. Establishing consumption patterns and a consumption policy system with Chinese characteristics*

China's economy has come to a development stage in which economic growth relies more on expanding domestic consumption. Consumer spending is not only an important endogenous power for economic growth, but also an important connotation of economic upgrading and efficacy enhancement. Therefore, the strategic position of expanding consumption must be highlighted in the establishment of consumption patterns and a consumption policy system with Chinese characteristics. Efforts must be made to focus on the innovation and improvement of consumption-stimulating policy, the innovation of consumption patterns and commercial activities, the expansion of service consumption and information consumption, and the promotion of upgrades to household spending. Expanding rural consumption should be emphasized as the key point of releasing consumer demand. The social security system should be reformed and the adjustment function of tax should be further brought into play.

First, innovation is required in consumption patterns and commercial activities to promote additional household consumption. China is the world's second largest economy, but in size rather than power. This can be seen from its low ability to innovate, low quality of life, and low consumption level. At present, domestic demand expansion and consumption promotion are influenced and restricted to a great extent by the low quality of consumer goods and bad consumer environment. A lot of consumer goods are highly affected by product quality and cost-effectiveness. Some products of inferior quality are sold at high prices and there are even fake and shoddy products, both of which impede consumption and cause food safety and quality to be the focus of social attention. Service consumption is in a stage of rapid growth, but there is still a lack of pension and health service supply. The new situation and problems in the field of consumption urgently require us to improve the quality of economic growth starting from improvement of the quality of consumption. Service consumption should be expanded in supporting social forces to set up all kinds of service units among which services such as pensions, health, tourism, and culture should be given priority. Meanwhile, a system of paid vacation should be implemented. To promote information consumption and the implementation of "broadband China" strategy, development of fourth-generation mobile communications networks should be accelerated through the promotion of urban 100 Mbps optical fibre engineering and a rural broadband project that will raise the Internet speed. Across the nation, the "integration of three networks" should be implemented to encourage e-commerce innovation and development and to maintain network security.

Second, expanding the rural consumption demand and developing the rural market are some of the important measures for fostering a new mechanism for rapid and stable economic growth (Research Team of the Rural Survey Organization, 2003). These measures include: increasing rural employment and income by actively promoting strategic adjustment of agricultural structure, stretching and deepening the agricultural industry chain, and speeding up the development of labour-intensive industries; cultivating the consumption demand of rural residents by continuing to increase rural public investment and improving rural consumption environment; resolving the contradiction between rural fund supply and demand by fostering the rural capital market and improving rural financial services; supplying rural residents with marketable commodities suitable for different regional conditions, living standards, and consumption habits and actively exploring the rural market through hard efforts made in development and production.

Then, the social security system should be reformed. With an imperfect social security system, residents delay consumption, making it difficult to improve effective demand. The original social security system is a type of business insurance with compulsory savings. It needs to be gradually turned into a policy system incorporated into the public budget.

The income tax base also needs to be improved. Income adjustment mainly means adjusting income differences. The root cause of income disparity is now disparities in capital income, with only a small portion consisting of labour income. Changing the tax base should not only aim at differences in labour incomes, but should focus on differences in capital incomes.

### *4.5. Deepening reform of the distribution system and building a modern distribution system and efficient distribution network*

In addition to improving the consumer willingness, another important point in building an open economy led by internal demand is to solve the problem of distribution. A key reason behind the current slump in the development of the real economy is excessive administration, advanced virtualization, and artificial hollowing out. Such a situation makes deepening distribution system reform and the establishment of an open, orderly and efficient distribution system and distribution network more urgent. We should deepen reform of the distribution system, eliminate barriers in unifying the national market, reduce distribution costs, and promote the development of logistics, the express delivery industry, and the online shopping.

First of all, we should vigorously promote innovation in distribution organization, build a harmonious relationship between production and sales and promote the transformation of the distribution industry. At present, in the vertical relations between consumer goods production and sales, there has been a major shift in the relative strength of buying and selling. Retailers located in the downstream industrial chain have obtained the dominant position by using their special function in communicating with both supply and demand sides and realizing a balance of supply and demand. They have begun their vertical constraint on upstream manufacturers. Intensified contradictions between production and sales have posed a severe challenge for the construction of an internal-demand-led economy. As to this uneven distribution of interests caused by unmatched market forces and unbalanced market position, the right response is not “curbing the strong” but rather “supporting the weak.” The government should encourage agglomeration of producers in the form of business alliances and improve their overall bargaining power to achieve equal dialogue. On the other hand and on a deeper level, a large number of retail manufacturers should be trained for the active development of integrating production and sales as a whole in order to promote organizational innovation and the re-blending of the distribution industry so as to achieve the aim of establishing a harmonious relationship between production and sales.

Secondly, it is necessary to build an open and orderly modern distribution system and network. One of the biggest sticking points of the current distribution industry is the high cost and low efficiency of distribution. The huge potential of domestic demand is not fully developed because of a lack of a guarantee of a modern distribution system, showing that distribution has become the bottleneck restricting the expansion of domestic demand. To solve this problem, first of all, an information-oriented system taking business flow as the hub and logistics as the carrier should be set up in accordance with the characteristics of specific goods and consumption as well as the rules in the direction and volume of commodity flow. Then, focusing on contracting and institutional improvement, the construction of network organization should be strengthened to integrate the resources in distribution internally, to break into distribution the market externally, and to build an open and orderly distribution network. Next, the government should establish a unified and efficient distribution management system and quality assurance system for products in distribution by giving full play to its advantage of information and reasonably exercising its function. Fourth, measures to strengthen the construction of electronic business logistics distribution systems and vigorously develop e-commerce services include: encouraging distribution enterprises to realize transformation and upgrading by applying e-commerce, supporting the development of community e-commerce, mobile e-commerce and other new electronic commerce mode, exploring the building of a credit rating certification system for electronic commerce, developing third-party electronic commerce platforms, and promoting the construction of e-commerce trade regulation platforms. Finally, because it is fundamental and concerns people’s livelihood, the distribution industry should establish and improve a fiscal and taxation policy support system and create a good environment for the development of enterprises in distribution.

## References

Li, K. Q. (2012). Thoroughly applying the strategy of boosting domestic demand. *English Edition of Qiushi Journal*, 4, 3-10.

Li, D. K. (2014). Never allow the economy to stall or glide. (Available at: http://www.xcf.cn/tt2/201403/t20140331_566171.htm)

Liu, H., Zhang, Y. Y., & Liu, H. W. (2013). The analysis of debt characteristics and risks of local government financing platforms: a case study on a certain province in eastern China. *Journal of Finance and Economics(Caijing Yanjiu)*, 5, 123-133.

Research Team of the Rural Survey Organization. (2003). Suggestions about expanding demand from rural residents of China. *Statistical Research(Tongji Yanjiu)*, 8, 8-12.

Wei, S. (2014). The realistic situation and long-term growth prospects of China's economy. (Available at: http://mp.weixin.qq.com/s?__biz=MjM5OTgwODA0MA==&mid=200071516&idx=1&sn=6e014aeb5b714ee837443a06b0237fe0&scene=1#rd)

Zhang, J. (2013). *Personal Anthology of Zhang Jun*. Shanxi: Shanxi Economic Publishing House. (In Chinese)

Zhang, Y. Y., & Liu, Z. B. (2012). The preferences of consumers and the problems in the development of China's service industry—evidence under general equilibrium. *Economic Perspectives(Jingjixue Dongtai)*, 10, 57-64.