

AI Will Deepen Divide Between the PRC's Two Economies

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Executive Summary: The economic consequences of artificial intelligence (AI) may be especially marked in the People's Republic of China (PRC) because they will feature a major positive supply shock and negative demand shock in an economy that already presents too much of both.

- The 15th Five-Year Plan places AI in pole position of the “modern industrial eco-system,” comprising all manner of manufacturing, technology, infrastructure, and control over global supply chains.
- The very policies that are powering the industrial side of the PRC economy are exacerbating structural weaknesses and flaws in the much larger part of the economy where excessive debt, low productivity, high unemployment, and fiscal and financial failing are becoming more deeply entrenched.

General Secretary Xi Jinping and President Donald Trump discussed artificial intelligence (AI) at their September summit in Washington, D.C. Divergence on views between the People's Republic of China (PRC) and the United States make it hard to see precisely how the two superpowers might collaborate successfully on an AI security and regulatory agenda. Xi in particular needs to pay more attention to both governance and economic issues surrounding AI, which threaten to exacerbate structural issues within the PRC's domestic economy.

The government is already vocal about the risks AI could pose to political and social security. PRC Minister of State Security Chen Yixin (陈逸欣) recently sent out a warning for the first time on the topic, and Xi Jinping himself addressed AI governance in another “major changes unseen in a century” (百年未有之大变局) speech, when he delivered the opening address to the World AI Conference in Shanghai in July (Xinhua, July 18; South China Morning Post, September 14; China Brief, September 18).

The economic consequences of AI, meanwhile, loom ever larger. Notably, a number of Chinese economists took the theme up at the 2026 Inclusion Conference on the Bund (2026 Inclusion·金融) on frontier and financial technology in Shanghai (Caixin Global, September 11). For instance, Jiang Changjun (蒋昌俊), an academician of the Chinese Academy of Engineering, discussed AI risk as being threefold—hallucination, algorithmic black boxes, and data poisoning—while Zhang Jianhua (张建华), an academic at the Tsinghua University PBC School of Finance argued that AI will amplify “the existing weaknesses of third-party reliance, Internet risks, and model governance” (人工智能的第三方依赖、互联网风险和模型治理的现有弱点) (Shangguan News, September 10).

Much of the AI debate revolves around whether the PRC or the United States is going to “win the race” that is better described as a continuous struggle of leapfrog and catch up. Yet the far more relevant question for the PRC is not about its technology capacity but about whether its economic model is robust and sustainable enough to deliver the Chinese Communist Party's (CCP) ambitious industrial and geopolitical agenda.

Policy Puts AI in Pole Position

The 15th Five-Year Plan (2026–2030), unveiled earlier this year, gives pride of place to AI. It is mentioned 52 times, compared with just 11 in the previous plan (National Development and Reform Commission [NDRC], March 2026; South China Morning Post, March 5). It has moved from the grid into pole position, and is expected to lead the charge in overcoming bottlenecks in the economy, and realizing strategic initiatives, self-reliance, and national resilience.

AI has shifted from a priority sector among designated “strategic emerging industries” (战略性新兴产业) to the engine behind the CCP’s desire to create a “modern socialist nation” (现代化社会主义国家) by 2035 (NDRC, March 2026). While the PRC has been the world’s factory and principal assembly platform in the past, the plan seeks to transform it into a designer of new industrial structures and supply chains that integrate industry with the help of AI. This new ecosystem will allow the PRC to become a world leader in modern and traditional manufacturing, smart and green technologies, infrastructure, and industrial services, and it will give the country unprecedented control over global supply chains.

The AI transition is occurring at a highly sensitive time for the PRC, which the plan puts firmly in a geopolitical and industrial policy perspective, and underscores the importance it is expected to have as the country looks to dominate manufacturing and scientific research, military capability, and cybersecurity, and geopolitical power. As it states in its first chapter discussing the country’s development environment, “great changes unseen in a century are accelerating, international power dynamics are being restructured, and a new generation of technological revolution and industrial innovation is accelerating breakthroughs” (百年未有之大变局加速演进，国际力量格局深刻调整，新一轮科技革命和产业变革加速突破), demarcating the current moment as full of uncertainty but also opportunity for the PRC (NDRC, March 2026).

From an economic standpoint, the Party hopes that AI can be harnessed to produce a “revolutionary productivity leap” (生产力革命性跃升) (NDRC, March 2026). This is increasingly urgent, as productivity growth has ground to a halt under Xi, and has not risen in lockstep with commensurate advances in industry and technology. Approved commentary, such as that in the *People’s Tribune*, views AI as a possible compensation for likely labor and skill shortages and other demographic headwinds, acknowledging that it could have disruptive effects on jobs that will require government attention (People’s Tribune, July 8, 2024). And the 15th Five-Year Plan rightly makes the point that, to be successful, diffusion of AI throughout the economy is everything, and must be rolled out successfully and widely—something it seeks to achieve under the rubric of the “AI+” initiative (China Brief, March 28, 2025, September 21, 2025)

From the crow’s nest, the plan’s focus on AI amounts to a massive technological bet to steer the PRC toward global economic superiority and domination of the so-called fourth industrial revolution. In other words, it is a doubling down on the Party’s long-standing and huge mobilization of resources that underlines existing industrial strategy. The pursuit of AI-led technological transformation, as currently envisaged, will very likely deliver further gains in industry and manufacturing. In so doing, however, it will also exacerbate the dichotomous nature of the PRC economy, or what might be better referred to as its two economies. **[1]**

One economy is the PRC’s “strategic emerging industries,” guided by Xi’s “new quality productive forces” (新质生产力). This accounts for about 13 per cent of GDP, featuring the dynamism of several world class brands (NDRC, December 29, 2025). The other is the rest of the economy, which features problems that have become more evident since the bust in real estate started in 2021, but which have in fact been building steadily for many years. These include a rising burden of predominantly state debt, weak consumption and productivity, population decline and rising unemployment, misallocated capital, and monetary and fiscal policy tools that have lost traction.

Any accomplishments that follow from the PRC's pursuit of AI, therefore, will not constitute a macroeconomic cure for the phenomena that are chipping away at its economic resilience and adaptive capacity. AI will create winners and losers unevenly distributed across the economy, likely exacerbating the "problem of unbalanced and inadequate development" (不平衡不充分的发展) identified in the 15th Five-Year Plan (NDRC, March 2026). The PRC's already lagging economic development model may be especially vulnerable to AI because it represents a major positive supply shock and negative demand shock in an economy that already features structural oversupply and inadequate demand as parts of a model which the government seems unwilling and unable to reform.

Seeking Economic Truth from Reality

Like other nations, the PRC cannot know the ubiquitous repercussions of AI on the economy, or how the shorter-term economic and labor market costs and longer-term, hoped-for productivity benefits will fall. Unlike other countries, though, there are few effective forums in which open and unrestrained discussion can occur about how to manage the transition, or institutions of constraint and consensus that can help to frame the agenda. This is especially significant given the dualistic nature of the PRC's economy, itself largely the result of years of large-scale industrial policy.

It is arguable that AI is already bringing some economic benefits. It is leading to higher capital spending at home and demand from overseas—reflected in buoyant exports—for AI supply chain-related goods. With residential and manufacturing investment weak, and infrastructure investment trending lower, AI has stimulated demand for semiconductors, servers, data centers, power equipment, industrial automation, electronics, and advanced machinery. The PRC is also uniquely positioned to harness AI economies of scale due to its massive domestic AI user-base of 700 million users. As a recent article from the *Economic Daily* notes, "user population is the foundational strategic resource in the AI industrial ecosystem" (用户人口是AI工业生态系统的战略资源) (*Economic Daily*, October 5).

The AI boom has been bullish for stock market valuations, at least for the moment, which is helpful given that the privately funded part of the PRC's AI sector is heavily dependent on the equity market (as opposed to the bond market). In the April-June quarter, for example, electronics and IT, which capture most AI activities, contributed over half of the 3.6 percent annualized economic growth compared to the first quarter, and a third of the reported 4.3 percent rise in growth, compared with a year ago (Capital Economics, July 16). Commentary on Sina Finance summed up the effect of the AI boom as twofold: directly creating productivity increases due to automation, and speeding up the pace of innovation to "expand the industrial boundaries of what is possible" (拓展工业边界) (Sina, October 7).

By substituting capital for labor and helping firms move up the value chain, the government hopes AI will boost productivity growth. There is no evidence to date, though, that this is happening, as the International Monetary Fund has explained (IMF, August 2025). While some firms have almost certainly enjoyed an uptick in productivity, it has stalled at the macro level and has been sluggish for much of the last decade. This is largely a result of liberal economic and market reforms grinding to a halt.

There might well be measurement issues, as often happens with new and significant technologies and, importantly, the pace of AI diffusion might still be slow or unaccounted for. It is also probable, however, that AI's benefits at the firm level are being checked or choked in the wider economy by a number of economic drags. These include the effects of high debt and limited debt capacity, weak consumer demand, misdirected resources and capital allocation, the deadweight of overcapacity and over-indebtedness, the real estate bust, too many zombie firms even in modern industries such as electric vehicles and solar manufacturing, a monetary and financial sector that is too beholden to

state enterprises and uncommercial lending, along with inadequate credit for small firms, and the broad prioritization of politics over regulation and efficiency (Huxiu, August 12).

A Mixed Picture for the Labor Market

The Party envisions AI taking on many tasks normally performed by people. They hope mass AI adoption will offset the economic impact of contraction in the labor force and in skill availability brought about by rapid population aging. This is a credible position but it might not be straightforward. Workers with high and low levels of skill may well be less vulnerable to AI-induced job destruction—and the PRC is well endowed with both. Yet the crucial factors that might determine the rate and nature of job losses are likely to be the speed with which jobs are lost before new ones are created and the degree of routine. In this regard, the PRC remains vulnerable because of the preponderance of low skill and routine work in manufacturing, for example, but also higher skill levels in technical and technology services.

In other ways, the PRC labor market may be particularly vulnerable to the AI shock. Professor Zhang Dandan (张丹丹) of Peking University has drawn attention to the predominance of gig or on-demand working (Caixin, February 14, 2025). Li Daokui (李达科), Dean of Tsinghua University's Academic Centre for Chinese Economic Practice and Thinking, has argued that the country's unemployment is more than double the official rate (Caixin, July 13). Youth unemployment alone is officially almost 19 percent, although possibly higher (Caixin, September 18). Even the Vice Minister of Human Resource and Social Security, Wu Xiuzhang (吴晓章), has acknowledged that about 200 million people were engaged in "flexible employment"—essentially freelance, platform-based, gig economy jobs without social or employment benefits—equivalent to 27 percent of the employed, and 43 percent of the urban working population (Caixin, March 2).

These caveats matter because for all the economic benefits that AI might bring, it is not going to magically make the macro-economy healthy or address some of the important problems that even the National Development and Reform Commission unusually cited in its annual report to the National People's Congress earlier this year. The normally self-congratulatory and well scripted celebration of the CCP's accomplishments and objectives did not mince its words about the state of the Chinese economy in a brief section, stating:

"The imbalance between strong supply and weak demand is acute; real-estate development investment continues to decline; infrastructure investment growth has turned from positive to negative; manufacturing investment growth has slowed further; overall investment faces mounting downward pressure; consumption growth lacks momentum; and the price level continues to run low" (NDRC March 5).

Nothing of substance has changed since then. Car sales are down 20 percent from a year ago, household consumption is sluggish, and the beleaguered real estate sector, now in its fifth year of decline, still reveals declining sales and transactions volumes (China Brief, April 2; Caixin, July 8; Sina, October 7). Given the basic orientation of economic and industrial policies, the clouds over economic flexibility and adaptive capacity are liable to remain. The PRC could theoretically derive significant benefits from AI-adjacent sectors, including advanced chips. Fully harnessing such benefits, however, requires entrepreneurial incentives; successful diffusion; high-quality, shared, and transferable data and information; and a relatively well-balanced economy in which small firms get adequate and stable funding. These conditions, however, do not currently exist in the PRC.

Conclusion

The essential contradiction is really about the consequences of AI for an economy that possesses a

highly sophisticated modern industrial sector but is struggling to adapt to the AI age. There is risk of a turbo-charged, AI-powered version of its wider growth imbalance in which remarkable technological and industrial capability, financed heavily by the government, sitting alongside an economy with too little market demand, inadequate private risk capital, low employment creation, and too much dependence on investment and potentially fragile foreign demand.

To alleviate the basic supply and demand imbalances in the economy, the government needs to embrace extensive fiscal, monetary, and financial reforms designed to transfer resources from the state to the private sector and write down or write off losses in the state sector. To sustain open and mutually beneficial foreign trade, the government would have to reform the PRC's economic model so the country's massive trade surplus shrinks to a more acceptable size. This would allow imports from other countries to rise steadily, and Chinese exports would no longer threaten their industrialization plans and programs of not just richer nations but many in the Global South.

AI, even in pole industrial position, is not the answer or solution to these trenchant challenges in the wider economy. And it might make them worse.

Notes

[1] A growing corpus of voices in the PRC have started to refer to the economy as exhibiting “K-shaped divergence” (K型分化) (Caixin, June 22). Western analysts have picked up on the same phenomenon (Substack/Yasheng Huang, July 29)

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