



China-CEE Institute
中国—中东欧研究院

ISSN 2786-2860

Vol. 4 No. 5

March 2024

CHINA WATCH

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Digital Economy: Structural Opportunities for Continuous Growth of the Chinese Economy

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How should we understand the role of the digital economy in the post-pandemic era's economic recovery?

The relationship between digital technology and economic recovery is not so direct. The direct impact of digital technology was more evident during the pandemic period, when it facilitated contactless transactions and guided economic activities from offline to online, in activities such as e-commerce, food delivery, remote scientific research, and teaching. Digital technology played a significant role in maintaining normal economic activities during the pandemic period.

During the post-pandemic economic recovery period, the digital economy's role has been even more direct, as it is helping people to continue the digital habits formed during the pandemic, such as participating in various online seminars, using food delivery, and shopping online.

However, the more important role played by the digital economy in the Chinese economy lies in "structural opportunities," which essentially involve long-term growth issues instead of cyclical factors. For example:

First, can China's current economic structure, industrial transformation, and upgrading keep up? How does the digital economy come into play?

Second, with an aging population leading to a decrease in the future labor supply and a corresponding increase in social and medical care demands, can digital technology applications, such as AI and robots, address or alleviate the pressure on labor supply?

China, with its per capita GDP at around US\$13,000, is currently on the threshold of transitioning from the middle-income to high-income stage. Research by Barry Eichengreen, an economics professor at the University of California, Berkeley, indicates that typically, after a country's economy experiences rapid development to a certain stage, there tends to be a pause, usually occurring at a level of around US\$15,000 to US\$16,000. China is already very close to this level.

There used to be a concept called the “middle-income trap.” In reality, when our per capita income increases by another \$2,000 to \$3,000, we will face this question: Will the economy continue to develop, or will it possibly stagnate at that level?

As a response to this question, the digital economy offers a “structural opportunity,” in which the structural significance of its contribution to the economy outweighs its cyclical significance.

Why does China so frequently issue strategic plans in the digital economy area? How can we seize the strategic opportunities of the digital economy?

We can all perceive the outstanding performance of the digital economy and the special attention it receives from the nation. We can look at this from different angles:

From the macro perspective, China ranks among the top in the world in terms of its digital economy. For example, in terms of digital economic scale, market penetration rate, number of unicorn companies, and innovation in some key areas, China consistently ranks second globally, which is terrific.

From the decision-making perspective, the digital economy has brought all-round changes to people’s lifestyles, production methods, and governance methods; it has invigorated the economy in many areas.

From the government’s perspective, the current challenge lies more in how to achieve long-term growth, namely, how to embark on a new journey towards the “second centenary goal” after achieving the “first centenary goal.”

What are the main differences between the two centenary goals? The differences lie in, first, the great importance of innovation, considering the current increases in income levels and costs. In the past, growth seemed boundless, but now it relies on innovation. Second, in the past, we had a demographic dividend, but now it has turned into an aging population, requiring proper management of its impact on the economy. Third, in the past, the global environment was very open to globalization, but now the international environment has changed.

Based on these changes, China’s sustained economic development needs new impetus. If in the past it relied on exports, investment, and real estate, what will China’s economy rely on next? This is the problem we are facing now.

The digital economy provides a possibility for the next step in sustained economic development. Take, for example, the pioneering concept of “data as a new factor of production.” If data as a factor is utilized effectively, the efficiency of the entire

production process will increase. With the same inputs of capital, labor, land, and technology, proper utilization of data can further enhance resource utilization efficiency and increase output. This is the fundamental role of data as the fifth factor.

Although we currently face issues such as large amounts of data but low utilization rates, the digital economy indeed provides China with opportunities for continuous advancement. In the past, we relied on market-oriented reforms, learning, and imitating innovations. Now, data elements and the digital economy itself may offer a new accelerator, becoming an efficiency booster, enabling China to position itself from the outset at the forefront of global digital economic development.

What roles can the digital economy play in short-term and current economic recovery?

In the short term, we will see two main issues:

First, looking at recent trends, the short-term economic recovery appears to be relatively weak, with market participants, entrepreneurs, and others generally not particularly optimistic.

Second, looking at the causes, after three years of the pandemic, the balance sheets of enterprises and local governments have been somewhat affected. Therefore, even though some restrictive factors during the pandemic are no longer present, the recovery process is likely to be relatively slow.

In this situation, what roles can the digital economy play? We can view the question from two sides:

First, an important reason why the economy is still awaiting recovery is the “special rectification” of the digital economy, including platform enterprises, over the past few years, which has significantly undermined industry confidence. Although the government now proposes to support platform enterprises and is very confident about their development shift, the biggest issue is still “confidence.” This cannot be changed overnight; it requires enterprises to see more policy sustainability, as well as changes in economic fundamentals, before they increase investment.

Secondly, to accelerate economic recovery in the short term, the simplest means is through macroeconomic policy, including monetary policy or fiscal policy. Taking increasing investment as an example, although there are various discussions on the amount of investment, during economic downturns, increasing government expenditure can stabilize demand in the short term. Stabilizing demand allows businesses to secure

orders, enabling them to hire people or invest, which in turn provides jobs and income for ordinary people. With increased consumption following suit, production and investment will pick up, gradually forming a virtuous circle.

As for current government investment, consideration can be given to more digital infrastructure investments, including various digital technology innovation projects, and even some digital innovation projects related to people's livelihoods. This could provide assistance for short-term economic recovery, although not directly.

How should we understand the different roles of digital industrialization and industrial digitization?

The process of transforming data into production factors involves the accumulation, collection, processing, transaction, sharing, and utilization of data. Whether data elements can function and become new drivers of economic growth depends mainly on how they can help improve efficiency, which is a very important direction.

Digital industrialization is crucial for long-term growth, but it is presented in some new forms. For example, the production of storage devices, chips, computers, or internet tools, which were absent in the past, all fall under digital industrialization. Their contribution to economic growth actually lies in providing solutions for industrial digitization and supporting systems, which are essential components of digital economic development.

A more intuitive understanding of industrial digitization lies in considering how it makes existing industries perform better. For example, e-commerce is the most evident manifestation of industrial digitization. Moving traditional offline markets and department stores online improves efficiency.

Applying digital technology to the economy will change that economy's operating characteristics. I summarize this with the phrase, "three increases and three decreases." The three increases include expanded scale, improved efficiency, and enhanced user experience; the three decreases include reduced costs, controlled risks, and minimized direct contact.

For example, in finance, a single platform now can provide payment services and credit services to hundreds of millions of users. This is difficult to imagine in traditional financial institutions, and compared to traditional finance, digital finance has greatly reduced the scale of personnel. This scale effect, also known as the long-tail effect,

means that a platform integrates previously unprofitable or difficult-to-do businesses into a single huge operation.

The most typical example in the digital finance area is the original Alipay. It aggregated funds of a few tens or hundreds of yuan from each person and turned it into the largest investment fund in the country—and it was all because digital technology made possible many things that were previously impossible. Therefore, from the “three increases and three decreases” perspective, digital technology offers many possibilities for transforming traditional industries.

In the process of developing the digital economy, what are the boundaries between the government and the market, and what tacit understanding exists between them?

A well-functioning economy certainly requires cooperation between the market and the government; relying solely on either one is unlikely. The point of contention lies in what role the government should play, and how much space the market should have within this framework.

Look at the issue directly: which enterprises in China have been most successful in developing the digital economy? All of them are private enterprises that have grown from scratch in the market. This was the result of market-oriented reforms. Fundamentally, we need to have a clear understanding that these enterprises were not planned by the government, nor were they directly supported by government policies.

Of course, one does not rule out that these enterprises might have received government support, but they still mostly relied on market mechanisms. A group of young entrepreneurs combined their ideas with market mechanisms and created a new economic form. The government’s importance has been evident in the following aspects:

First, maintaining market order cannot be a task separate from government.

Second, in the area of infrastructure investment, the government makes significant contributions. In China, for example, where internet penetration rates are high, many investments in network infrastructure are undertaken by state-owned enterprises. China had previously advocated “moderately advanced infrastructure investment,” in which the government’s role was prominent. Developing digital technology, digital industries, and the digital economy would not have been possible without networks, smartphones, and the Internet.

Third, the government, in addition to supporting large-scale investments, also needs to support original discoveries. Although over 70% of innovation in China is related to private enterprises, there are still many innovations that require the involvement of public research institutions and universities. With the development of the digital economy, China's technological innovation is increasingly approaching the forefront, and in the future, there will be a growing demand for original technological innovations.

How can entrepreneurs address the challenges of short-term economic recovery? How can they seize the structural opportunities of the digital economy?

While observing the digitalization process in the banking industry, one can see the so-called “Matthew effect”—larger-scale enterprises that have invested a lot of resources, manpower, and material resources into digital transformation tend to have relatively better development outcomes. Some smaller banks have also attempted digital transformation, but objectively speaking, the results have been mediocre, with little noticeable improvement in efficiency and minimal returns.

Digitalization is an inevitable trend; no one can escape it. However, for each individual entrepreneur, truly embracing digitalization means finding the approach that best suits their own circumstances. The degree of automation is not necessarily “the higher, the better.” Instead, it should be determined by economies of scale. Achieving scale is essential; without it, automation may yield little return.

The concept of scale, in simple terms, includes having a large market, numerous customers, and abundant data. Pursuing automated systems without having achieved scale could lead to financial losses for a company. However, this does not imply that small enterprises cannot develop digitalization strategies.

Entrepreneurs need to fundamentally clarify the most critical question: what are the biggest pain points the company currently faces? They should strive to address these pain points as much as possible.

Addressing issues does not negate strategic vision. Whether complex or simple digital technology is being used, the benefit lies in the fact as long as the application of digital technology can improve operational efficiency, it can yield returns. Long-term sustainable becomes possible only with such digitized operations.

Otherwise, pursuing overly grand systems without having accumulated a certain scale of customers is essentially meaningless. The direction of digitalization is

irreversible, and everyone must participate, but one must find what is most suitable for the enterprise itself and do it well.

This article is the text of a speech delivered at the China Finance 40 Forum (CF-40) by Huang Yiping, Dean of the National School of Development and Professor of the China Center of Economic Research, Peking University.

Translated by Thomas E. Smith