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China's population decline does not spell doom

Demography is not destiny. Broader economic reforms that allocate capital better and make labour more productive can blunt the impact of a shrinking population.

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Ageing is set to drive down the traditionally high household savings rate in China by some 6 to 10 percentage points of GDP in the next decade, as more people retire and start digging into their savings. But reallocating declining savings more towards business investment can keep growth going. PHOTO: EPA-EFE

It is no surprise that China's National Bureau of Statistics' (NBS) quarterly press releases on its gross domestic product (GDP) statistics are closely followed. After all, it is the second-largest economy in the world – the largest on some count – so much is at stake.

On Tuesday, though, it was not the reported 3 per cent growth rate for 2022 that stole the show, but a number from a normally obscure part of statistical work, demographics.

For the first time since the Great Leap Forward, Mao Zedong's disastrous development experiment that resulted in a famine that killed tens of millions in China, the NBS reported a decline in the country's population. It was a small decline, at 850,000, or less than 0.06 per cent of the population, but a decline nevertheless signifying the end of an era. It is likely that India, not China, will soon be the most populous country in the world.

News agencies and newspapers jumped on the number. "China's first population drop in six decades sounds alarm on demographic crisis" headlined Reuters; "China's population falls, heralding a demographic crisis", wrote The New York Times. The fear (or hope) among many observers is that China's demographic decline spells doom for its economic growth, its real estate sector, pension and health systems, and even, as Chinese business magazine Yicai pointed out, for the sales of baby formula. Comparisons with Japan after the collapse of its asset bubble in the 1990s, which coincided with a demographic turning point, have also been made.

Current population trends indeed seem daunting for China. Its total population could fall below 700 million by the end of the century, which would be less than half the 1.4 billion now.

The median age of China's population is 39, up from 20 in 1978; it will be 50 by 2050 and almost 60 by the end of this century. By then, every retiree will be supported by only one worker, against four workers today. China's labour force will shrink by half.

With these trends in mind, some fear that China will become "wei-fu-xian-lao", (old before rich), the predicament that Chinese demographer Wu Cangping pointed out four decades ago, after the country had embarked on the one-child policy.

SO IS CHINA FACING A DEMOGRAPHIC CRISIS?

Not so fast. Before 2022's decline in population, China's labour force, the relevant statistics for economic growth, had already been dropping for more than a decade.

Whereas in the heydays of a demographic dividend, an increase in employment explained as much as one-third of economic growth, China's demographic dividend in the past decade turned into a tax.

On current policies, China would miss out on about 1 percentage point growth per year until 2035 because of lower employment rates. This is in part due to fewer people of employable age, which can also be attributed to the fact that people are now spending more time in school. The labour force participation of 15- to 24-year-olds is already down from 78 per cent in 1990 to 47 per cent now.

WORKING LONGER AND SMARTER

But China can blunt the impact of a shrinking population, in part by increasing the pension age. Its pension age is low by international standards (60 for men, 55 for women), and has not changed in decades, even though life expectancy has risen sharply.

If China's elderly were to have the same labour force participation as in Japan, about 40 million more people would be at work by 2035, about the size of the German labour market. Such a move would cut the demographic tax in half.

China's past investment in education will also pay off in the coming decades. China was late to the game, and had sufficient resources to invest in education only by the end of the 1990s. But then it did so with a vengeance.

The current cohort of graduates entering the labour force has on average 12 years of education, compared with only seven for those about to retire. This increase in human capital can add around 1 percentage point to growth in the coming 15 years, more if China managed to close the urban-rural gap in education, especially quality education.

Further opportunities exist in permanent education that can upgrade the skills of those already in the labour force.

China can also use the existing labour force better. The country still has a quarter of its labour force in agriculture, whereas, for the average high-income country, this is less than 3 per cent.

Thus, shifting labour from low productivity agriculture to higher productivity manufacturing and services would support growth.

More urbanisation would also help. China's urbanisation rate is currently 65 per cent, but 20 percentage points of this is migrant labour without permanent status. Encouraging more migration by unifying urban and rural hukou, the household registration system, would further increase urbanisation, structural change and labour productivity.

LESS INVESTMENT, BUT BETTER

Ageing will cause headwinds for an important plank in China's rapid growth: capital investments.

China's investment rate, at more than 40 per cent of GDP, has been a big driver in growth, more so in the past decade, and all financed with high domestic savings. Ageing is set to drive down the traditionally high household savings rate in China by some 6 to 10 percentage points of GDP in the next decade, as more people retire and start digging into their savings.

The question, though, is did China need all the investment it made?

The government has for more than a decade now tried to increase the share of consumption in GDP, with little success. Demography can help achieve this goal. For growth to keep going, the use of remaining investment needs to improve. Since the global financial crisis, not just the level but also the composition of investment has shifted dramatically towards infrastructure and real estate.

Among Group of 20 countries, China now has the highest infrastructure stock as a share of GDP, and investment in housing tops 18 per cent of GDP. Both are probably too much of a good thing.

In contrast, business investment – both state-owned and private – has dwindled, and now barely constitutes a quarter of all investment done in China. So reallocating declining savings more towards business investment can keep growth going. However, for it to happen, major reforms in the financial sector and the fiscal system are needed.

CONTROLLING THE COST OF PUBLIC SERVICES

A declining and ageing population will put growing pressures on China's pension system. But it faces challenges of financial sustainability and equity.

While an urban worker can expect to receive a pension of on average 2,700 yuan (S$535) per month, a rural pensioner receives only 90 yuan on average, according to a World Bank study. With the proportion of pensioners in the population rising rapidly, such disparities are increasingly becoming a source of income inequality.

If China were to aim for pensions for all similar to those received in Organisation for Economic Cooperation and Development countries, spending would increase from about 5 per cent of GDP today to more than 13 per cent by mid-century, according to the same World Bank study. Even without those changes, the China Academy of Social Sciences projects that the pension reserves at central and local government would be exhausted by 2035.

Fixing this requires major reforms in the system. China has started experimenting with private pension accounts and, if well regulated, this can be part of the solution as the higher returns on pension balances could keep social security taxes in check.

The government could also use state assets to fill the gap in pension coffers – and it has started to do so in moderation. Government assets, such as state-owned enterprises and part of infrastructure, yield healthy returns, which can be used to fill the gap in the pension coffers.

Ageing also threatens to push up costs in the health system. Health spending as a share of GDP has already risen in the past decades, and is now almost 6 per cent of GDP, exceeding Singapore's 4.1 per cent for 2019.

The growing numbers of the aged in China will add to this, and some project health spending in the country as a share of GDP will increase by half to more than 9 per cent of GDP. Some of this increase is unavoidable, but lifestyle improvements, a better organisation of the health sector – notably better primary care – and better incentives for cost control through the health insurance system can at least slow the increase.

MAKING MORE BABIES?

Rather than doing all these hard reforms, can China simply turn the tide by having more babies?

The main cause for the population decline is that China has fewer babies than before. Abolishing the one-child policy has not put a dent in this trend. The government is keen to turn this around, and has announced a slate of policies to increase the birth rate – something few countries in the world have thus far achieved.

Even if fertility rates were to rebound in response to government policy, the increase is likely to be modest. Moreover, the population cohort in their fertile years is now smaller than in the past; thus, the impact of increased fertility on population size will be muted.

Furthermore, increased fertility is likely at first to reduce the labour force participation of parents, whereas additions to the labour force resulting from such a policy will be some 20 years away.

Broader economic reforms that allocate capital better and make labour more productive are more important than attempts to turn the demographic tide. And public sector reforms can ensure financial sustainability (and equity) in pensions and health services.

What the new population numbers say is that all of these reforms are becoming more urgent. The Year of the Rabbit is a good time to make a start on those reforms.

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