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People, Growth, and Reform: China's Uncertain Future

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This December will mark the 30th anniversary of the Chinese Communist Party's decision to initiate market-oriented economic reform. At the time, China was an insignificant part of the world economy. Now, scarcely a week goes by without a new projection of its greatness.

China bulls start with the growth of the past three decades, pat it down somewhat, then extend the lines forward on a graph to reach wondrous conclusions. But will the expansion be sustained for another 30 years?

The answer lies ultimately in the future of market reform, which does not look promising of late. But the choice to reform further will not occur in a vacuum. There are core variables that frame it. Case in point: population demographics. For the last 30 years, demographics in the People's Republic of China (PRC) have been a very strong ally of economic growth. That support, however, will soon weaken, starting a transition period toward weaker growth.

With the wrong policies, the much-heralded era of Chinese economic leadership could stop almost before it starts.

People and Growth. It seems unnecessary to chronicle the contribution of labor to growth. For the first 20 years of reform, the PRC was capital-poor, and labor did the heavy lifting. Even now, the attractiveness to foreign investors, for instance, stems primarily from features of the labor market.

This component of China's success is built upon a well-known population boom. As the worst of the

Cultural Revolution began to ebb around 1970, net births accelerated sharply, eventually fueling reform-era expansion. The party responded to population pressure in 1979 with the infamous one-child policy. This policy has had a dramatic impact on urban families, and the demographic changes it begat may eventually have a dramatic impact on the entire economy.

End of an Era. For nearly two decades, new workers have poured into the labor force in such numbers that the party has been compelled to keep growth high to accommodate them. Annual entrants to the urban labor force are typically put at 10 million.¹ In a startling change, the central government's Chinese Academy of Social Sciences (CASS) sees labor surpluses beginning to dissipate as soon as next year.² The first effect of the demographic transition is therefore beneficial: fewer annual entrants to the labor force and a less pressing need to grow for the sake of jobs.

There is a catch. As the demographic transition takes hold during the next decade, pressure will rise to find greater efficiency in the use of labor. Market reform is the obvious option; without it, China will find it more difficult to sustain its high rates of growth.

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Rural Pension Peril. A failure to genuinely reform in this environment could also be a major fiscal problem. There were more than 150 million people over the age of 60 at the end of 2006,³ compared to fewer than 50 million in the U.S. The proportion in the PRC is still much smaller, of course, but it is absolute numbers that matter with regard to pension payments.

In an 800-million-strong rural population, there were only 55 million contributing to the national pension scheme at the end of 2006, and the number was shrinking.⁴

Fewer than 5 million people are receiving payments averaging less than 40 percent of the unpleasantly low per capita rural cash income. Yet, between 1991 and 2006, the central government did not contribute a dime to rural pensions.⁵

Affluence is spreading in urban areas in no small part due to the surplus of rural labor. Rural areas are still poor and will soon begin to see labor balance. Without a historically unprecedented effort to channel resources back from urban to rural areas, changing demography means affluence will not spread to the majority of the population. If the rural pension

program remains effectively non-existent, there could be outright stagnation in rural household income as a smaller number of workers earn more but are forced to support a larger number of retirees. The China miracle might stop at the city limits.

Japan Redux? The CASS transition is only the beginning. Official data imply that no fewer than 135 million people were between the ages of 30 and 35 in 2005.⁶ As these citizens age, the reserve labor pool will become inadequate. Among other things, export competitiveness will erode, weakening a cornerstone of expansion and testing the party's capacity for innovative policy.

Unless the retirement age shifts, the group of 135 million will begin to leave the labor force soon after 2020—the beginning of the end for the brief period of labor balance—and start to push China into an actual labor deficit. The State Committee on Aging then sees the growth contribution of the pure quantity of labor actually turning negative after 2030.⁷

At that point, China can be confidently projected to be middle income and, in urban areas, perhaps even tending toward rich.⁸ The impact of labor deficit in wealthy economies is clearly seen in a some-

1. "Supply of China's labor force still exceeds demand," *People's Daily*, July 3, 2007, at http://english.people.com.cn/200707/03/eng20070703_389639.html (August 19, 2008).
2. Chinese Media Watch, "Labor shortage to emerge 2009," May 11, 2007, at <http://www.biz.cn/news/showarticle.asp?id=2468> (August 19, 2008). While an important marker, this will not have an immediate impact. Rural unemployment is not officially measured but estimates go as high as 25 percent, for a huge pool of reserve labor. Charles Wolf, Jr., et al., *Fault Lines in China's Economic Terrain* (Santa Monica, Calif.: RAND, 2003), chapter 2, at http://www.rand.org/pubs/monograph_reports/MR1686/MR1686.ch2.pdf (August 19, 2008). When rural workers cannot fill urban jobs, there is another labor pool, as the average urban retirement age is barely 51. "China won't change retirement age," *People's Daily*, December 16, 2005, at http://english.people.com.cn/200512/16/eng20051216_228469.html (August 19, 2008). With health and life expectancy improving, early urban retirees are much more capable.
3. Xinhua, "China's Aging Population a Strategic Challenge," GOV.cn, February 29, 2008, at http://english.gov.cn/2008-02/29/content_906265.htm (August 19, 2008).
4. Xinhua, "240 Mln Chinese Covered by Social Pension System," Chinagate.com.cn, December 6, 2007, at http://en.chinagate.com.cn/socialsecurity/2007-12/06/content_9352897.htm (August 19, 2008).
5. "Twelve percent Chinese rural laborers participate in old-age pension," *People's Daily*, November 27, 2006, at http://english.peopledaily.com.cn/200611/27/eng20061127_325683.html (August 19, 2008).
6. Author's calculations based on data from National Population and Family Planning Commission of China, "Total population, Crude Birth Rate, Crude Death Rate, Natural Increase Rate and Total Fertility Rate (1949–2002)," at http://www.npffc.gov.cn/en/endata_1.htm (August 20, 2008).
7. China Daily, "Nation faces challenges of graying population" China.org.cn, December 18, 2007, at <http://en.invest.china.cn/english/China/235987.htm> (August 19, 2008).
8. Robert Lawrence Kuhn, "What Will China Look Like in 2035?," *Business Week*, October 16, 2007, at http://www.businessweek.com/globalbiz/content/oct2007/gb20071016_143714.htm (August 19, 2008).

time model for China: Japan. After four decades of a young population and rapid growth founded on exports, Japan was also projected by many to challenge the U.S. for global economic preeminence. Instead, Japan is now approaching 20 years of starkly inferior performance, coincident with an aging population and much lower birth rates than those seen at the outset of that earlier “miracle.” There are similar stories to be told ranging from Korea to the Russian Federation to original members of the EU.

Not So Fast. Population is at the heart of long-term economic expansion. China is soon to leave what has been an extended demographic pattern supporting economic growth and enter a very different pattern entailing difficult policy choices. It remains likely that at some point China will pass the United States in broad economic measures, such as total GDP, but 2009–2039 will not necessarily just extend the trends from 1979–2009.

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