

China: From Population Dividend to Reform Dividend

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Citing the forecast by the United Nations' Population Division, recently published Green Book of Population and Labor (2019) edited by Institute of Population and Labor Economics, the Chinese Academy of Social Sciences announced that China's population will reach its peak in 2029 with 1.44 billion people. This means that China's population will then enter an era of negative growth, as a result of long-term slow growth of population. Such a prediction however should not surprise us too much.

Based on international experience of population development, the demographic transition theory asserts that a country's fertility rate tends to follow a reverse U-shaped curve. In the early stages, population development is characterized by a low birth rate, a high death rate, and as a result, low growth rate. But as per capita income increases, the death rate first declines while the birth rate remains unchanged, so the growth rate rises. But eventually, the birth rate declines as economic and social developments move forward, and population development enters its highest stage characterized by a low birth rate, a low death rate, and low growth rate.

China is no exception.

China's total fertility rate (read as the number of children given birth to by a woman in her entire life) dropped from 2.5-3.0 in the late 1970s and early 1980s to 2.0 in the first half of the 1990s. As the result of the fertility below replacement level of 2.1 – namely, minimum level for number of children to replace their parents — it is inevitable for the Chinese population to shift from a rise to a fall at a certain point of time.

Long prior to the total population peak, in 2010, the working age population aged between 15 and 59 had already reached a turning point, from an increase to a decrease. Such a dramatic change in the population age structure has significant implications to China's economic growth.

For most of the reform period, the rapid growth of the working age population relative to the non-working age population, which is also represented by the decline of the population dependence ratio, has helped the high-speed growth of the Chinese economy through a sufficient supply of labor; improvement of human capital; high savings rate; high return on investment, and efficient reallocation of resources. Therefore, the economic growth in the period benefited from the population dividend.

The shrinkage of the working age population and increase of the dependence ratio, which began in 2010, therefore indicate the disappearance of the population dividend, resulting in a slowdown in economic growth.

The experience of the past 40 years of reform have taught us that following the laws of economic development matters for a country to reach its goal of getting rich. And the same can be said of laws of demographic transition. So, it is natural that low fertility and moderate economic growth become a new normal as China transitions from middle-income to high-income.

In most cases, the population dividend is only a transient driver of economic growth when an economy is in transition from low-income to middle-income. The fact that the Chinese economy will grow at a slower rate, therefore, doesn't mean the economy loses its driving forces of growth. Instead, this is a tipping point for the transformation of the Chinese economy from high-speed growth to high-quality development.

In general, economic growth is driven by accumulation and allocation of factors of production, which include inputs of labor, human capital (embodied in workers' education attainment and skills) and physical capital, and improvement of productivity. In particular, at different stages of development, countries tend to more rely on certain factors of growth than others.

As far as the Chinese economy is concerned, whereas the absolute amount of labor force becomes limited because of its dependence on the magnitude of the working age population, labor reallocation – namely, from agriculture to non-agricultural sectors – can still transfer surplus laborers from agricultural engagement to non-agricultural employment, and other factors can be better mobilized, and productivity can be enhanced.

Since all these new drivers of growth require further reform, the expected effects of the reform to strengthen potential growth rate of the Chinese economy can be attributed to reform dividend.

The first reform is to exploit the potential of the population dividend. The household registration system reform is an area in which reform dividend measured by increase in potential growth rate is most apparent.

By eliminating the institutional barriers preventing agricultural laborers from mobility in the first place and then migrant workers from settling down in urban areas will expand labor supply for urban sectors and bolster productivity improvement resulting from the reallocation of resources.

As the result of more sufficient supply and more efficient allocation of labor, potential growth rate of the Chinese economy can be significantly raised.

The second reform should be to take advantage of the talent dividend. So, reforms of education system should aim to accumulate overall human capital through improving quality of education at all levels; expanding quantity of education and providing on-the-job training, which are vital of sustaining long-term growth.

When breaking down the sources of economic growth, economists find that years of schooling attained by workforce as an indicator of human capital can directly expand quantity of factors input and indirectly increase productivity, thus contributing to economic growth.

For one thing, the extension of compulsory education to pre-schooling and senior high schooling is necessary way to augment years of schooling at the stage of development

where China stands.

A third reform is to gain dividend from supply-side structural reforms such as reducing debt ratio, deleveraging, letting “zombie firms” go bankrupt, mitigating transaction costs facing enterprises and startups in obtaining resources, and creating level playing field for all market players.

By building a mechanism for destructive creation that is necessary for increasing return to capital input and enhancing productivity, these reforms will help accomplish the transformation of China’s economic growth from an inputs-driven pattern to an innovation-driven pattern, replacing population dividend with reform dividend.

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