

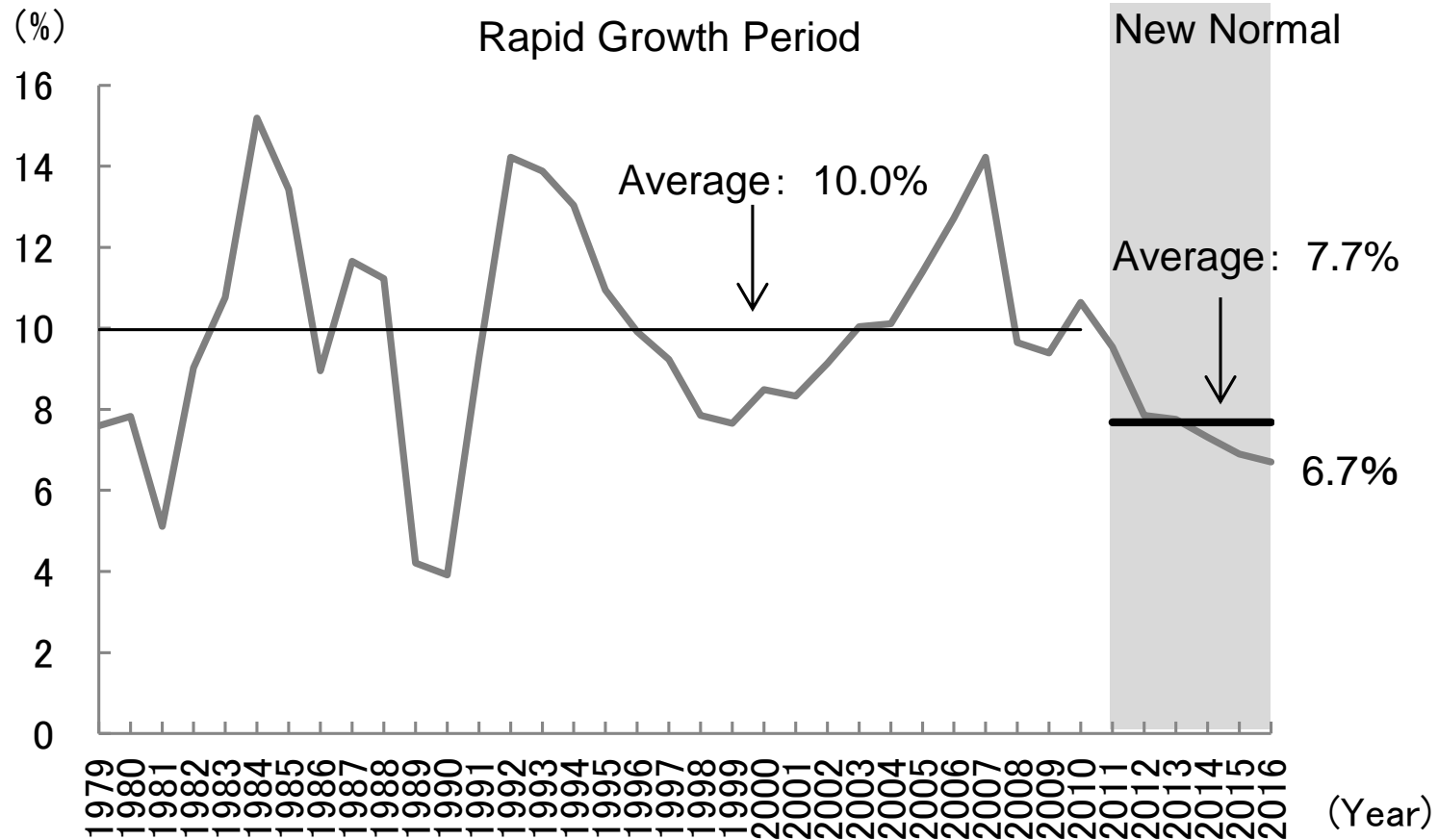
# **Labor Shortage as a Constraint on China's Economic Growth**

## **— The Need for Supply-side Reform —**

Senior Fellow  
C. H. Kwan

February 3, 2017

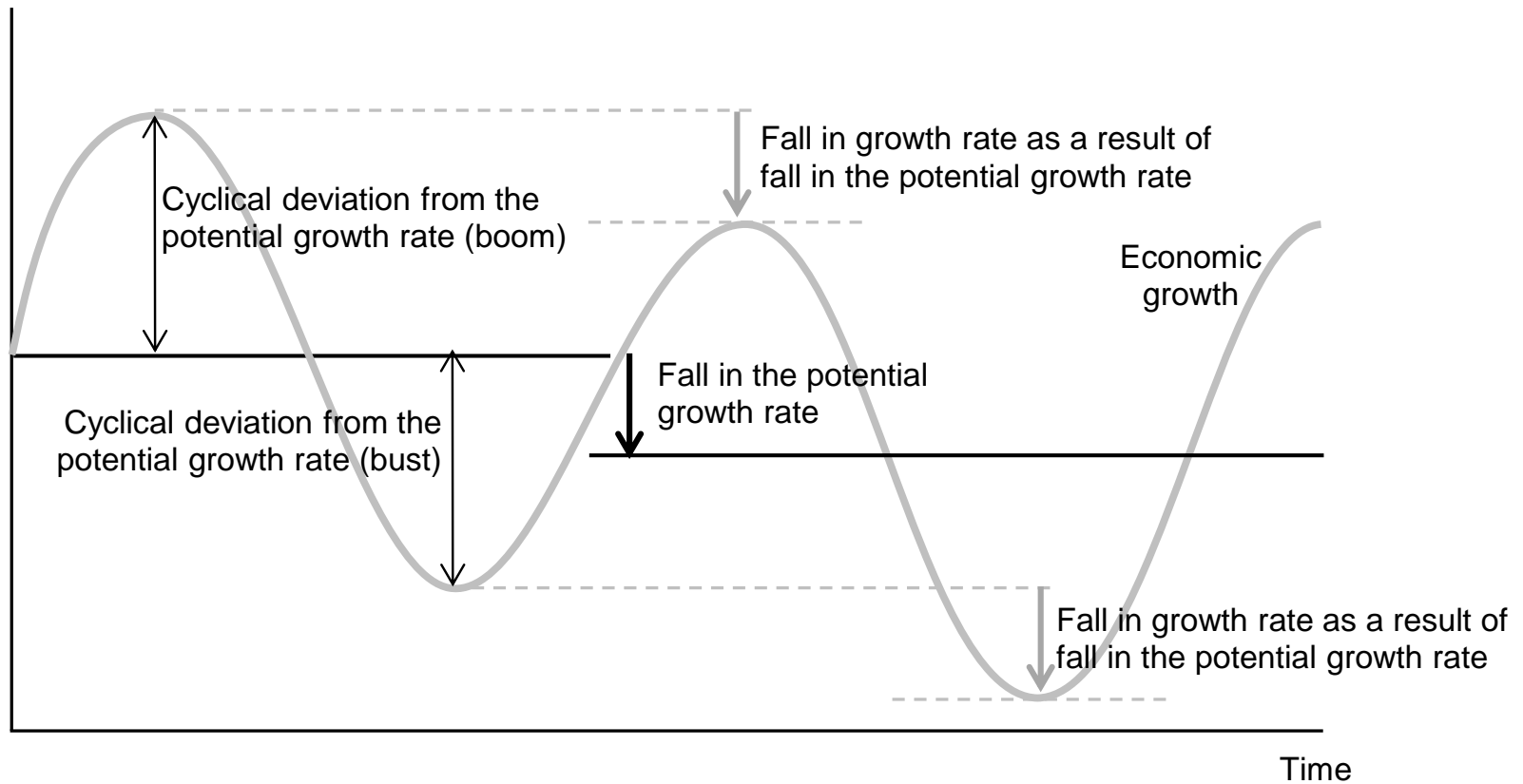
# Changes in China's Real GDP Growth



Source: Compiled by Nomura Institute of Capital Markets Research based on the CEIC Database (Original data from the National Bureau of Statistics of China)

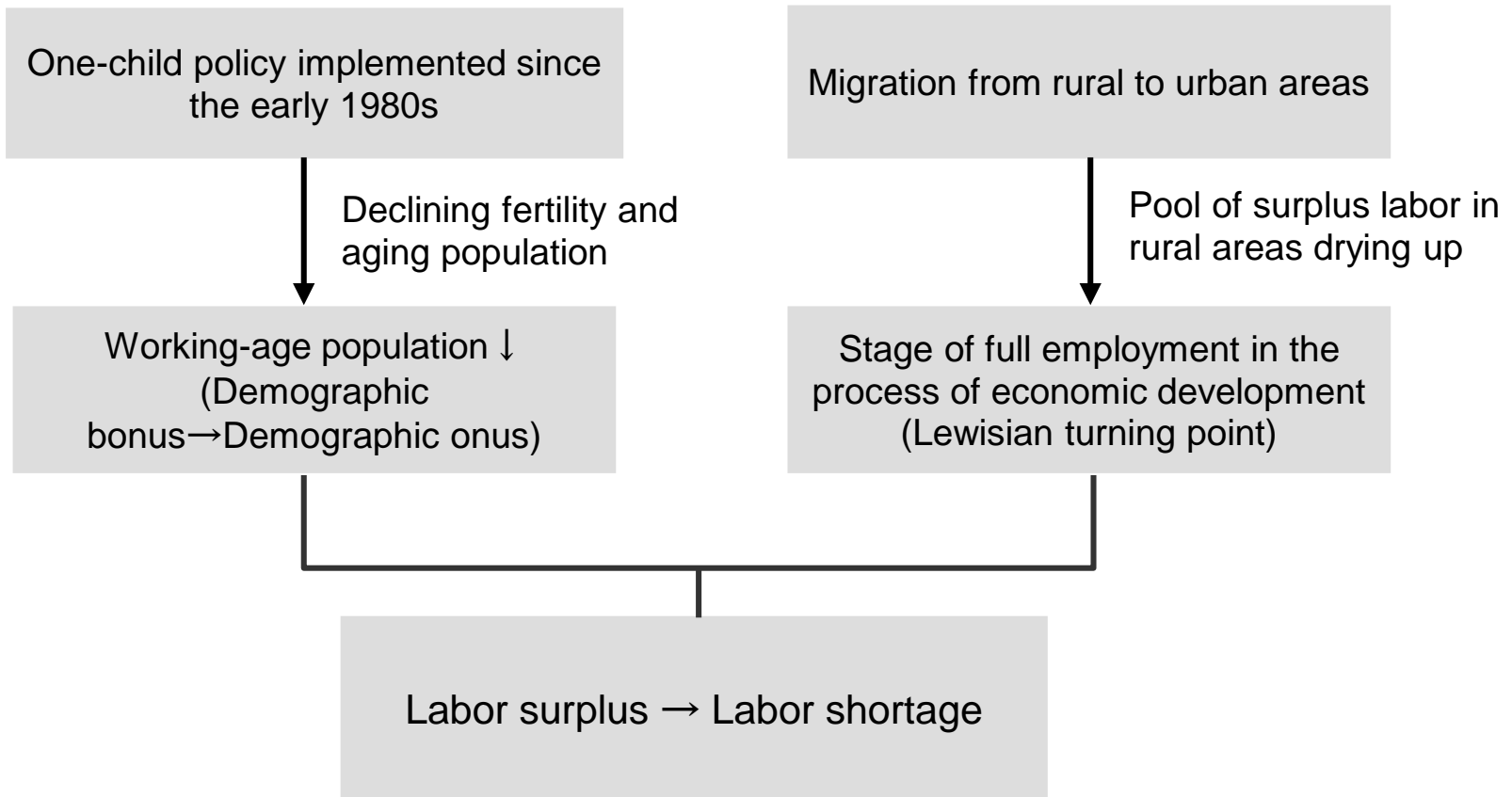
# Cyclical Movement vs. Fall in Potential Growth Rate

Economic growth



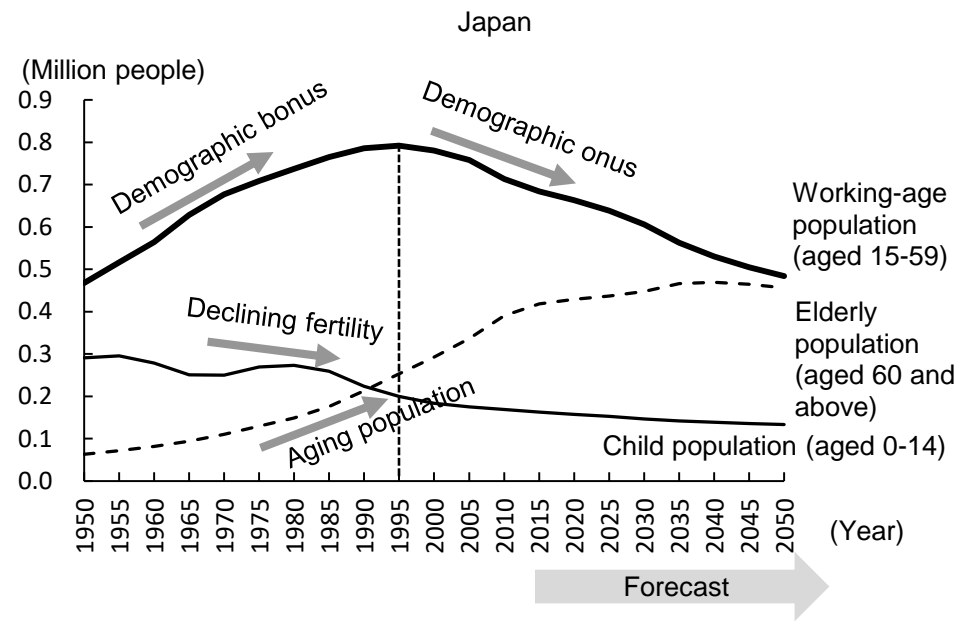
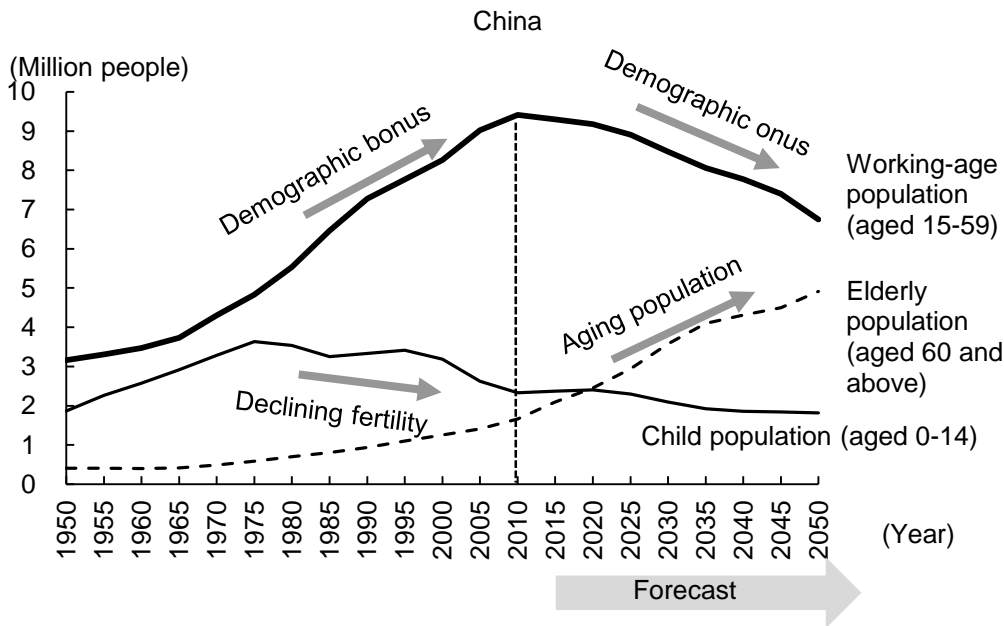
Source: Compiled by Nomura Institute of Capital Markets Research

# China Shifts from Labor Surplus to Labor Shortage



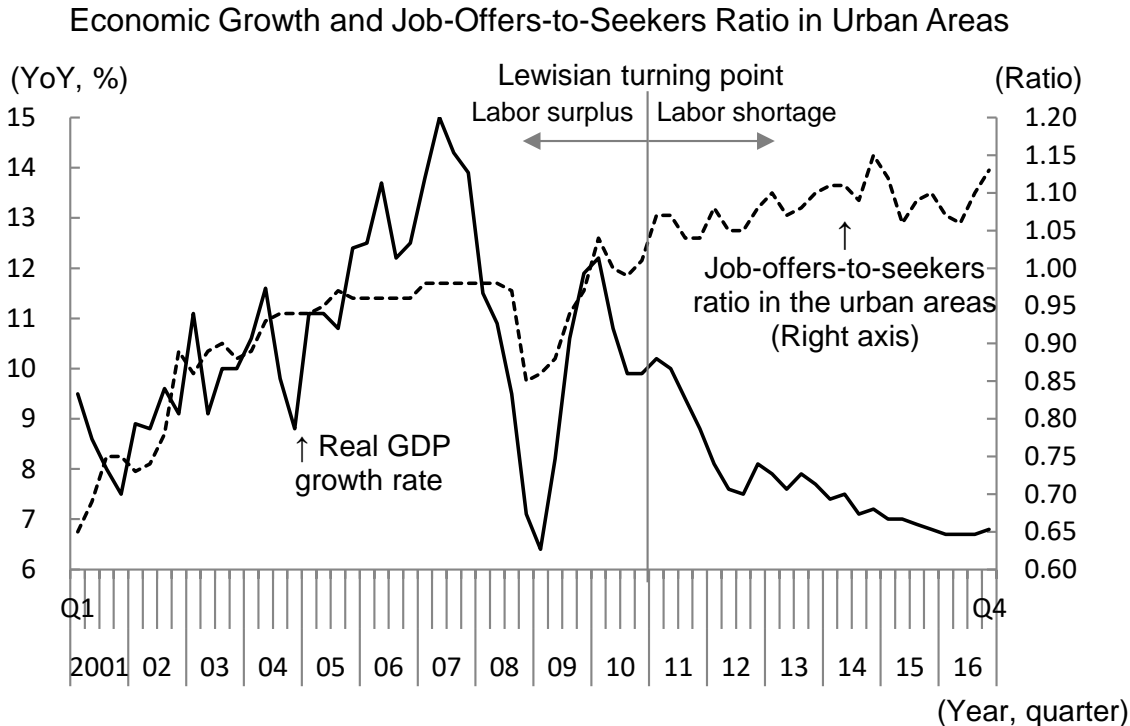
Source: Compiled by Nomura Institute of Capital Markets Research.

# Changing Age Composition of China's Population -- Comparison with Japan



Source: Compiled by Nomura Institute of Capital Markets Research based on United Nations, *World Population prospects: The 2015 Revision*.

# Changes in the Labor Market Suggest a Fall in the Potential Growth Rate

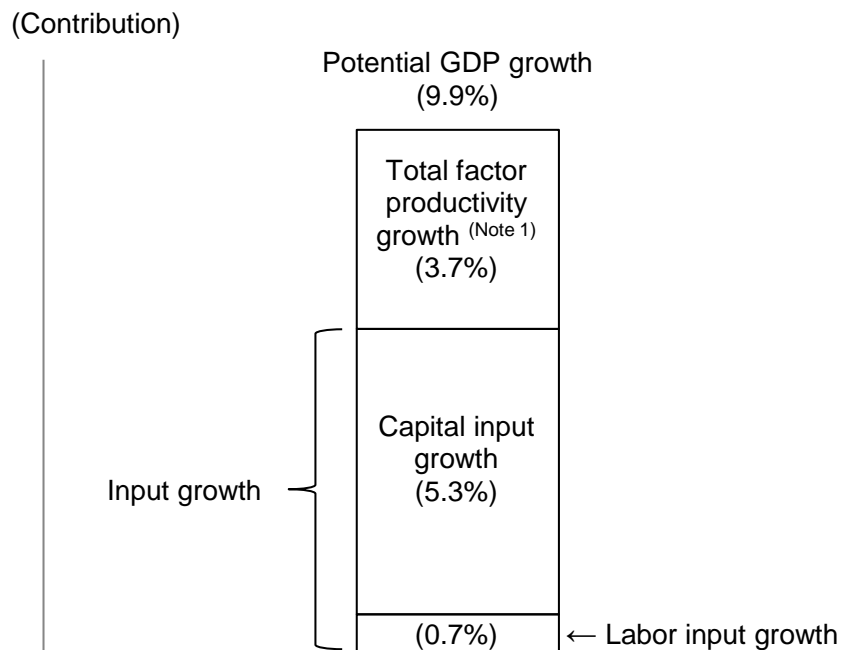


Note: The job offers-to-seekers ratio shown above is calculated by dividing the number of job offers by that of job seekers registered in public employment services organizations in approximately 100 cities in China. Source: Compiled by Nomura Institute of Capital Markets Research based on data provided by the National Bureau of Statistics of China and the Ministry of Human Resources and Social Security.

- Despite a sharp fall in the economic growth rate, the labor market has remained tight.
- The job-offers-to-seekers ratio has followed an upward trend since 2009 and stayed at a high level.
- The job-offers-to-seekers ratio has diverged sharply from the economic growth rate since 2011, suggesting that the economy may have arrived at the Lewisian turning point where surplus labor in the rural area has dried up.
- Coupled with the decline in working-age population, the potential growth rate has fallen sharply.

# Factors Contributing to the Decline in China's Potential Growth Rate

Growth Accounting for China (1995-2011)



Notes: 1) Contribution of total factor productivity growth includes contribution from human capital growth.

2) Components do not add to 9.9% due to rounding.

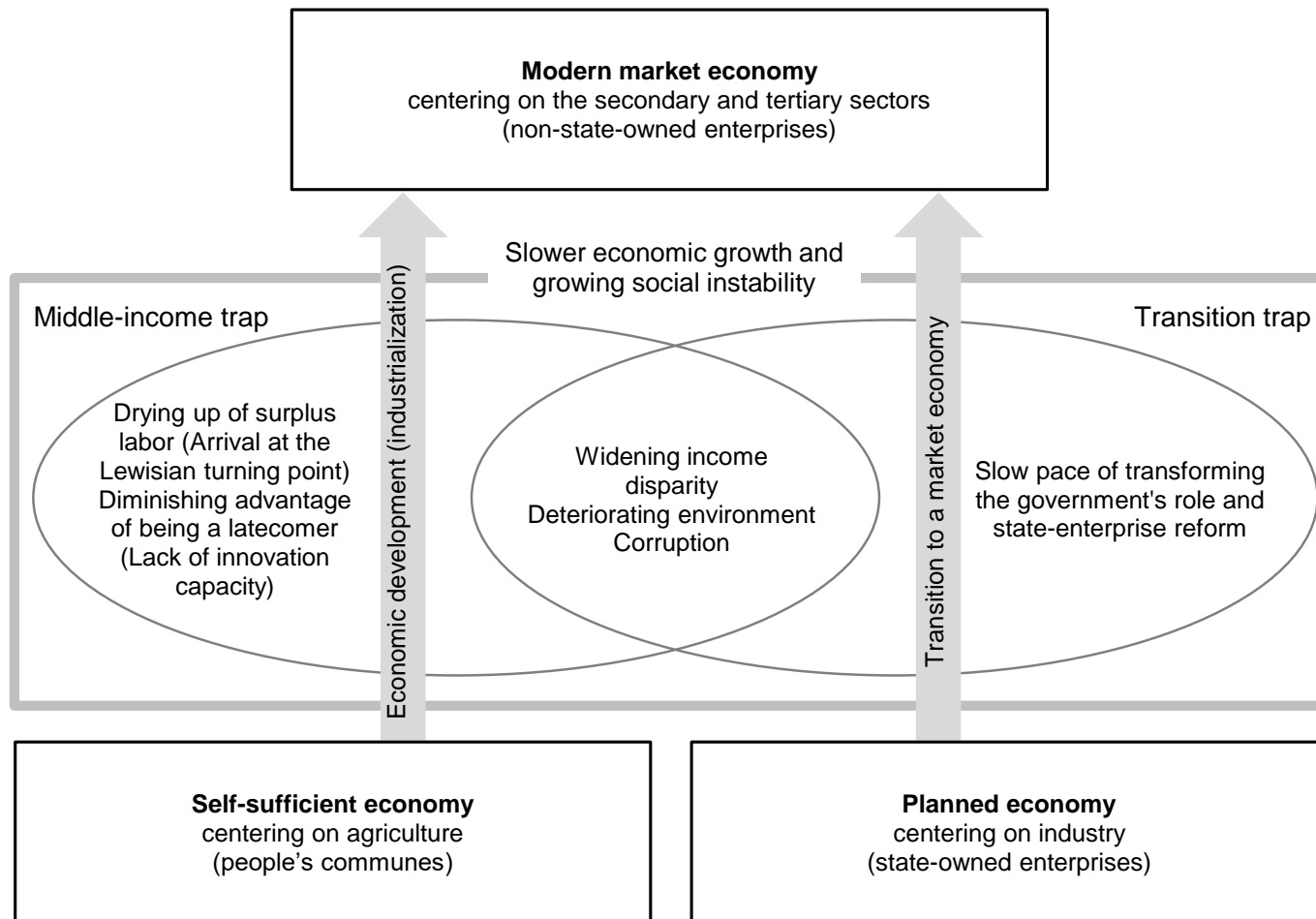
Source: Compiled by Nomura Institute of Capital Markets Research based on Kuijs, Louis, "China's Economic Growth Pattern and Strategy," Paper prepared for the Nomura Foundation Macro Research Conference on "China's Transition and the Global Economy," November 13, 2012, Tokyo.

- Contribution of labor input is turning negative as working-age population declines and the pool of surplus labor in rural areas dries up.
- Contribution of capital input should be suppressed by a lower savings rate.
- The one-child policy has been relaxed, but the effect is expected to be limited.
- Since the traditional growth pattern based on expanding inputs is no longer sustainable, China needs to shift to a new one based on productivity growth.
- Productivity growth has replaced job creation as the top priority of economic policy.

- Promoting Innovation
  - Strengthening the protection of intellectual property rights
  - Supporting venture business
  - Loosening control over information flow
- Improving the allocation of resources through industrial upgrading
  - Building new industries instead of protecting old ones
  - Removing barriers hindering the movement of factors of production
  - Promoting inward, rather than outward, direct investment
  - Guaranteeing the free flow of trade through negotiating FTAs, etc.
- Improving the allocation of resources through ownership reform
  - Reforming state-owned enterprises through privatization, etc.
  - Promoting the growth of private enterprises
  - Building a fair environment for competition



# The Two Traps Facing China



Source: Compiled by Nomura Institute of Capital Markets Research.



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Books in Japanese	<i>The New Normal of the Chinese Economy</i> , Nikkei Publishing Inc. 2015. <i>China Facing Two Traps</i> , Nikkei Publishing Inc., 2013. <i>China as Number 1</i> , Toyo-keizai Shimposha, 2009. <i>Economists Who Changed China</i> , Toyo-keizai Shimposha, 2007. <i>Japan-China Relations - A Win-win Game</i> , Toyo-keizai Shimposha, 2005. <i>China's Economic Reform - The Last Lap</i> , Nihon-keizai Shimbunsha, 2005. <i>Dilemma Facing the Chinese Economy</i> , Chikuma Shobo, 2005.
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Homepage	“China in Transition” (since January 2002) <a href="http://www.rieti.go.jp/en/china/index.html">http://www.rieti.go.jp/en/china/index.html</a>

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