Spotlighting China’s new two-child policy

Abandoning China’s one-child policy announcement

- We discuss the one-child policy abandonment and its likely impact. In a previous report we highlighted that it was likely to be much lower than the popular consensus in overall impact. China's officially announced and implemented one-child policy has not really had the intended impact of reducing the country's fertility rate. The current fertility rate of 1.55 children/woman does not reflect the success of the decades-long policy.

- China’s fertility rate exceeds many ageing countries in both Asia and Europe that face more adverse ageing and shrinking population effects. The social and political rhetoric surrounding the imposition and effect of this policy is in our view far stronger than the actual outcomes related to this policy. Example: Hong Kong, Singapore and Korea all have lower fertility rates.

- While this policy move was well anticipated, the immediate economic impact is not going to ameliorate the situation of supply-side labour shortages. Babies born as a consequence of abolishing the one-child policy are at best likely to join the labour force in another 16-17 years.

- The important lesson is that fertility rate declines of huge magnitude have occurred and are occurring in countries that never had a one-child policy. The single biggest common reason in emerging market countries as well as many developed countries for having fewer babies (one, two or three) have centred squarely on the realization of the economic reality that child-rearing is a costly and long commitment for parents.

- Relaxations on having a second child are unlikely to get couples to change their mindsets enthusiastically and have a second child. Also, this policy needs to be approved by the National People's Congress in March 2016 and may take a few years to be fully implemented by local governments. Previous relaxations to the one-child policy started around 2010 but were only actually implemented in 2014.

- In terms of behaviour, in most countries women are having children later and are having fewer of them. Indeed, women are generally better informed and want both a better life for their children as well as a better work life balance for themselves. The changes under hukou (system of household registration) reform, innovation, education and land reforms are likely to have a more positive impact on China's productivity and growth than this policy announcement. Nevertheless the end of a draconian policy impinging on women’s rights to choose is likely to be welcomed both in China and outside.
China’s current one-child policy

China is getting old before it gets rich.

This places it in a relatively unique position that not many countries have faced before. Exhibits 1 and 2 show China’s old-age dependency ratio relative to that of other countries and over time. In 2015, China is already older than most other large emerging market countries. According to the UN’s latest population projections, in 35 years China will be as old as Japan is today.

According to the UN, China’s working-age population has already started turning negative in 2015 (Exhibit 3). As mentioned in our 2009 demographics report, *A Demographic Perspective of Economic Growth*, negative working-age population growth adversely affects a country’s real GDP growth.

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China’s current policy easing is unlikely to affect the short-term labour supply significantly. In our 2013 report, *China: Abolishing the one child policy*, we stated that we expect China to face a net labour shortage in 2020, given the changing population dynamics. As a consequence of the one-child policy and the country’s falling fertility rate, we expect the labour shortage to increase significantly in the 2020s (Exhibit 4).

**Easing of the one-child policy has been long expected**

Given the growth imperatives as well as the mounting demographic pressures faced by China, the easing of its one-child policy is not unexpected. Over the years, we have already seen a gradual loosening of the one-child policy as policymakers have been constantly adjusting to changing economic circumstances.

In *China: Abolishing the one child policy*, we assessed the impact of abolishing the one-child policy based on the assumption that by about 2016 all families would be allowed to have two children. Exhibit 5 shows an updated timeline for China’s one-child policy.

**Exhibit 5: The evolution of China’s one-child policy**

<table>
<thead>
<tr>
<th>Time</th>
<th>Phrase</th>
<th>Initiatives and Policies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-1979</td>
<td>Voluntary</td>
<td>Promotion of &quot;prefer one, at most two children&quot; was initiated in 1978.</td>
</tr>
<tr>
<td>1980-1984</td>
<td>Mandatory with strong reinforcement</td>
<td>One-child policy and strict enforcement became the state policy.</td>
</tr>
<tr>
<td>1984 - Present</td>
<td>Mandatory with steady adjustment</td>
<td>Second child was allowed for some provinces if criteria were met, e.g., rural family</td>
</tr>
<tr>
<td></td>
<td></td>
<td>with first child as a girl. It was later extended to some other areas.</td>
</tr>
<tr>
<td>Around 2000 - 2014</td>
<td>Mandatory with some ease</td>
<td>The &quot;second child for two-singleton couple&quot; rule allows couples to have two children if</td>
</tr>
<tr>
<td></td>
<td></td>
<td>both parents are only child.</td>
</tr>
<tr>
<td>2010-Present</td>
<td>Mandatory with greater ease</td>
<td>Selective two-child policy allows couples to have two children if either parent is an</td>
</tr>
<tr>
<td></td>
<td></td>
<td>only child. This rule was implemented nationwide in 2014.</td>
</tr>
<tr>
<td>Oct 2015</td>
<td>Two-child policy</td>
<td>Formal announcement that China will allow all couples to have two children with no</td>
</tr>
<tr>
<td></td>
<td></td>
<td>detailed timeline mentioned.</td>
</tr>
</tbody>
</table>

Source: Credit Suisse

**Impact of the two-child policy is uncertain but is likely to be limited**

We agree with Tao & Deng’s view (*EM Economics Daily*) that the response in the actual birth rate increase is going to be muted.

This is because, first, **the last two rounds of policy easing in this area have shown limited impact.** Not all couples who meet the second child criteria apply and not all the applications approved lead to an actual birth. Exhibit 6 shows the impact of past policy easing in some regions.
Exhibit 6: Additional births post policy easing may not be as high as expected

Impacts of "second child for two singleton couple":
The policy that allows parents, who both are single children in their family, to have the second child was started in China in 2000.

<table>
<thead>
<tr>
<th>Region</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangzhou city</td>
<td>14,000 couples eligible, but only 360 additional babies in 2009</td>
</tr>
<tr>
<td>Nanjing city</td>
<td>More than 10,000 couples eligible, but additional babies were only slightly above 100 in 2009</td>
</tr>
<tr>
<td>Henan province</td>
<td>The last province implemented this scheme in late 2011, but only around 600 additional babies were born in the two-year period until 2013</td>
</tr>
</tbody>
</table>

Impacts of "selective two-children policy"
The policy allows couples to have two children if either parent is an only child starting 2014.

<table>
<thead>
<tr>
<th>Region</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>Approximately 1 million couples applied by Jan 2015, much lower than the original estimate of 2 million</td>
</tr>
<tr>
<td>Liaoning province</td>
<td>Started implementing in March 2014. By end-2014, 17,424 couples had applied. This leads to no more than 20k babies born in 2015, far lower than the 100-150k originally estimated</td>
</tr>
<tr>
<td>Beijing</td>
<td>There were around 30k applications made in 2014; 27k of them were approved. The original official estimate was 54k annually</td>
</tr>
</tbody>
</table>

Source: Xinhua News, Yicai, Credit Suisse

High child-rearing costs, increasingly aspirational women and changing family values are all cited as reasons by the public for not having another child even when policy allows.

Indeed it takes some time for attitude and behaviour to change and the change is unlikely to be linear. Once more families start to have second child, it is possible that change will happen in a faster pace due to peer, parental and societal pressure.

Declining fertility rate is a general trend even without one-child policy. Exhibit 7 shows that China’s fertility rate started declining long before the one-child policy was introduced. Even with the one-child policy still in place, China’s fertility rate stayed higher than one and in 2015 its fertility rate is higher than that of other Asian economies (Exhibit 8).

Exhibit 7: China’s fertility rate since 1950

Exhibit 8: Total fertility rates, 2010-15

Additionally, in a cross-country comparison, China does not belong to the group of countries with the highest fertility decline.
Almost all the countries have experienced lower fertility rates in the past 50 years. Indeed as countries develop, excessive child-bearing to ensure one or two survivals is no longer necessary and child-rearing becomes more expensive. This commonly leads women and families to have fewer babies irrespective of the regions they come from.

Assessing impact

Exhibit 10 shows our projected additional births as a result of policy change in 2013. We made this projection based on the assumption that around 2016 all families will be allowed to have two children. We projected that an additional 438k babies would be born in 2014 and 733k babies in 2015. Over 2014-20, we estimate a total of 8.3 million additional children will be born due to the relaxation of the policy.
Exhibit 10: Projected additional births as a result of policy change

Incremental number of births in millions

![Graph showing projected additional births](image)

Source: NBS, Credit Suisse

Note that the impact of the policy will likely differ across regions. Indeed regions such as Shanghai and Beijing, where the cost of living is high and where there are abundant opportunities for men and women, the policy response will probably be more muted based on the experiences of Singapore, Hong Kong and South Korea. In smaller cities, where there is less life pressure and the cost of living and child-rearing is lower; young couples tend to stay near their extended family for childcare support. These characteristics will likely translate into a higher response towards this policy. It is important to note that in smaller cities, the one-child policy has also been implemented less strictly than in the big cities. The overall impact, therefore, is harder to assess.

**Structural reforms**

To address the problem of an ageing population, we think relaxing the one-child policy alone will be far from sufficient. Comprehensive structural reforms are crucial to ensuring sustainable growth.

**Incentives for women**

Past policy experience has shown that relaxing the one-child policy is only the first step towards increasing China’s fertility. As shown above, a significant part of the decline is due to structural shift. As women become more educated, they are finding more opportunities in the work place and are finding themselves having to choose between family and work. In order to boost fertility further, China may need to put in place measures and incentives such as better childcare facilities, longer maternity leave and education/housing subsidies as did Singapore, Hong Kong and other European countries.

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2 The details of China’s structural reform progress were covered in our previous report: China’s structural priorities: A progress report in the context of its 12th Five-Year plan (March 2015).
Pension

Despite efforts to boost fertility, the number of women of child-bearing age is set to decrease; ageing is inescapable. The state has to deal with the ageing population problem head on. There are still 200 million Chinese not covered by old-age insurance, according to China’s Ministry of Human Resources and Social Security. The government announced just yesterday (29 October) its commitment to extend old-age insurance to all.

China clearly has to continue its pension reforms such as setting out a clearer timeline for increasing retirement age, ensuring fairness and adequacy of state basic pensions and improving the management of state pension assets.

Productivity is the key to drive future growth

There are still a lot of structural inefficiencies present in China’s economy. In order to boost productivity, China needs to implement or facilitate:

- **Urbanization and hukou reform**: to allow labour moves to the most productive regions.
- **SOE and market reforms**: so that labour can be allocated to the most productive companies and industries.
- **Education reform**: so that additional children's potential can be maximised.
- **Innovation and technological development**: to allow each worker to be more productive.

We discuss Chinese labour markets in more detail in *China: The turning point of the labour market* (2011), *Chinese Demographics – Labour mobility, migration, urbanization and reforms* (2013) and *Demographic insights into policy: Asia’s Big 3 (China, India & Japan)* (2013).

Conclusion

While the one-child policy will officially end, its legacy looks set to last. It has created a fiscally strained generation of couples with four parents, potentially eight grandparents and one or two children to support. Their needs cannot be ignored in our view. The government will likely be under pressure to build crucial support infrastructure for childcare and old-care quickly. After all, the government has previously promised: “Having one child is good; the government will support your old age”. Now it's time to fulfil that promise.
Disclosure Appendix

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