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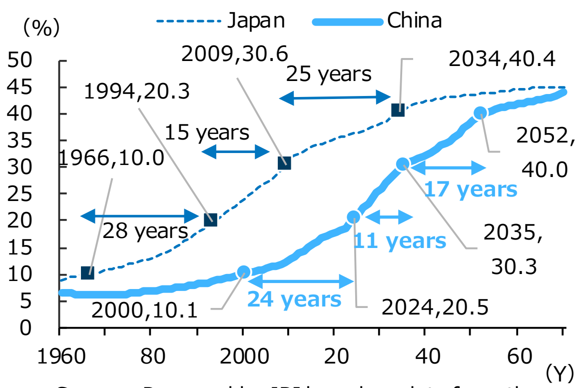
Topics *Pension issues shake China's national finances*

In China, the population is aging faster than expected. The Urban Staff and Workers' Basic Pension Insurance Fund, one of the public pension insurance funds, is expected to see its balance turn negative before 2035, a problem that will shake the nation's finances.

■ Population is aging at a rapid pace

In August 2022, the National Health Commission published a paper entitled "Writing a New Chapter on Population for the New Era" in the Party journal Quishi, in which it projected that the population would begin to decline during the period of the 14th Five-Year Plan (2021-25). The paper also noted that the aging of the population will result in more than 30% of the population being aged 60 or over by 2035, while the nuclearization of families will weaken the ability of households to care for and raise children.

<Proportion of Population Aged 60 or Over in Japan and China>



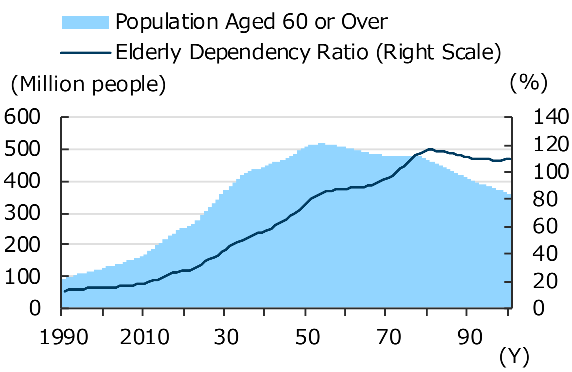
Source: Prepared by JRI based on data from the UN
Note: Median estimates

One of the characteristics of China's population aging is the rapid speed at which it is occurring. Based on the mid-range estimates contained in the UN's World Population Prospects 2022, after the proportion of Japan's population aged 60 or over reached 10% in 1966, it took another 28 years for it to surpass 20%, and then another 15 years for it to top 30%. And it is expected to take 25 years for it to exceed 40%. China reached 10% in 2000, and it took 24 years for it to exceed 20%, which is not so different from Japan, but it is expected to take 11 years to exceed 30%, and 17 years to exceed 40%, both much shorter timeframes than Japan's. Needless to say, the one-child policy is behind this.

■ Elderly dependency ratio continues to rise

Although the percentage of the population aged 60 or over will rise, the elderly population itself will peak in around 2055, after which it will begin to decline. While this may appear to be good news in terms of the sustainability of pension finances, it is certain that pension finances will become increasingly strained in the years to come as the working-age population that supports the elderly will fall by even more. The elderly dependency ratio, the ratio of the population aged 60 or over to the working-age population aged 15-59, is expected to continue rising until around 2080.

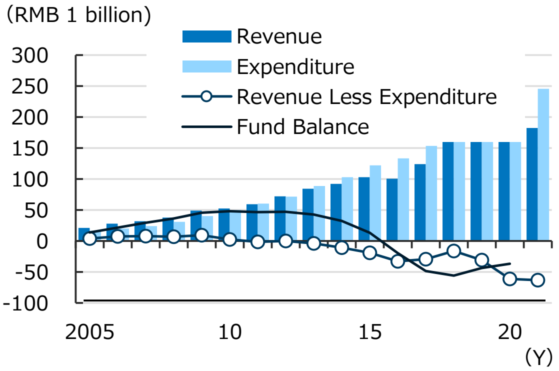
<China's Population Aged 60 or Over and Elderly Dependency Ratio>



Source: Prepared by JRI based on data from the UN
Note: Median estimates

Of concern for the deterioration of pension financing is the Urban Staff and Workers' Basic Pension Insurance scheme, which covers workers in state-owned enterprises and large private-sector enterprises, who are referred to as "zhí gōng ." As one of the public pension insurance schemes, it is operated based on a design that combines a pay-as-you-go financing system and a funded financing system, which means that pension finances will inevitably be strained as the elderly dependency ratio rises. In Heilongjiang Province, where the elderly dependency ratio has risen rapidly due to labor outflows and declining birthrates, the fund's expenditures began to exceed its revenues in 2013, and by 2016 the reserves had run out and the fund balance was negative. Although it is believed that the funding shortfall is being covered from the province’s coffers, the Urban Staff and Workers' Basic Pension Insurance scheme in the province can be said to be unsustainable as a system given further increases in the elderly dependency ratio.

<Urban Staff and Workers' Basic Pension Insurance Revenue/Expenditure and Fund Balance in Heilongjiang Province>



Source: Prepared by JRI based on data from CEIC
Note: Revenue and expenditure figures are for single years. Fund balance figures are cumulative.

■ Pension reform is unlikely

The government has been implementing several reforms in anticipation of increased pressure on pension finances. One of these is the establishment of a “central coordination system.” The system is designed to unify pension schemes managed at the provincial level and to maintain the overall soundness of pension financing by having the central government manage the risk of rapid increases in pension expenditures, which vary from region to region. Another is the extension of the retirement age. The government has designated Jiangsu Province as a pilot area and will raise the starting age for receiving Urban Staff and Workers' Basic Pension Insurance benefits there from March 2022 by increasing the retirement age.

However, it is unlikely that these reforms will improve the soundness of pension finances. The "central coordination system" was actually adopted four years ago, and is one of a set of policies that have not been effectively implemented. The system involves the bailing out of areas with deteriorating pension finances by areas where funds have been steadily accumulating. Since this could curtail the amount of benefits paid out in the latter, coordination is different in practice, and even the Xi Jinping administration is finding the road rocky.

There are also questions about how far Jiangsu's retirement age increase will extend. The increase must be at least one year, and it is not uniform, as it is based on the free will of employees and is limited to cases where the company agrees. Past public opinion polls have shown that extending the retirement age is perceived as being basically a benefit reduction, and with 60-90% of respondents opposed to the idea, implementation is not going to be smooth sailing.

■ Pensions will erode national finances

Across China as a whole, the balance of the Urban Staff and Workers' Basic Pension Insurance Fund is building steadily, and it does not appear that the pension finances will collapse any time soon. However, with China's overall population aging at a rapid pace, if no progress is made with pension reform, it is only a matter of time before the fund balance begins to decline.

In fact, the Urban Staff and Workers' Basic Pension Insurance Fund received a subsidy of RMB 1,276.3 billion in 2021, seven times more than in 2010. This represents 28.9% of the Fund's premium revenues, so it is already unsustainable without subsidies. The current state of pension financing in Heilongjiang Province must be seen as a mirror of the near future, not the distant future, of China.

The World Social Insurance Research Center of the Chinese Academy of Social Sciences, a government think tank, has stated that the Urban Staff and Workers' Basic Pension Insurance Fund will have a negative balance in 2035. This is an estimate as of 2019, and given the declining birthrate and aging population revealed by the Seventh National Population Census and the UN’s Population Prospects, there is no doubt that it will turn negative earlier than that. According to the International Monetary Fund, China's outstanding government debt stood at 93.1% of GDP in 2020, which is not outstandingly high by international standards, but the Urban Staff and Workers' Basic Pension Insurance scheme will undoubtedly cause this figure to increase and will be a source of erosion of state finances.

(Yuji Miura)

Topics Indonesia expands ore export ban

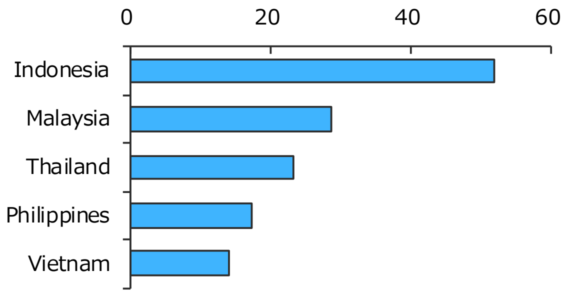
Following the success of its prohibition of nickel exports in attracting foreign investment, Indonesia is now moving forward with export bans for various other resources. However, the country has experience of prohibiting the export of other ores in the past, a policy that ended in failure, and it is unclear whether the expanded export bans will be successful.

■ Following nickel, exports of bauxite and copper are to be banned

The Indonesian government is stepping up its prohibition of ore exports. Following the ban on nickel ore exports that was imposed in January 2020, bauxite ore exports will also be prohibited from June 2023. The government has also announced its intention to ban the export of unprocessed copper ore by the middle of the year.

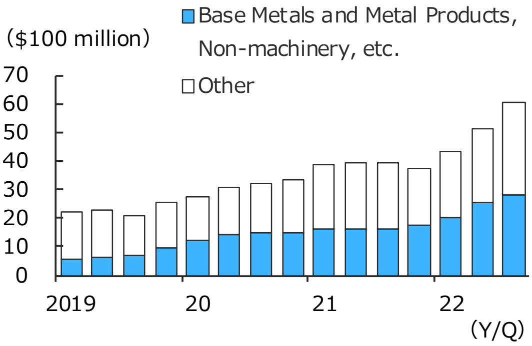
The bans are aimed at upgrading the country's industrial structure. Indonesia is rich in natural resources, and primary products have long accounted for a high percentage of its exports. It is the only one of the ASEAN5 (Indonesia, Thailand, Malaysia, the Philippines, and Vietnam) for which such products exceed 50% of exports. The Indonesian government aims to shift away from the current resource-dependent economic structure, which is easily affected by trends in global commodity demand, to a structure that earns money in high-value-added sectors. To this end, the government has banned the export of ore and mandated that processes such as refining and smelting be carried out domestically, with a view to developing the high-value-added metal processing business.

<Primary Products' Share of Exports>



Source: Prepared by JRI based on data from UN Comtrade
Note: Averages for 2017-21. Primary products refer to SITC categories 0-4 and 68.

<Inward FDI>
(Manufacturing, Actual Amounts)



Source: Prepared by JRI based on data from the Indonesian Ministry of Investment
Note: Three-month trailing moving averages

The nickel export ban has so far led to industry adding greater value, which is exactly what the Indonesian government is aiming for. The number of nickel smelters has increased from only two in 2014 to 16 by the end of 2021. The fact that inward FDI into Indonesia is increasing in various sectors including base metals, mainly as a result of Chinese investment in the construction of new smelters, also suggests that the export ban is paying off. In addition, Indonesia is aiming to establish a grand ecosystem that will take advantage of nickel, an important raw material for electric vehicle (EV) batteries, to handle everything from nickel production to smelting, EV battery manufacturing, EV production, and battery recycling. To that end, the country is actively trying to attract foreign capital, and a number of foreign companies, including ones from China and South Korea, are investing in plants for producing EV batteries and finished vehicles. President Joko has said that the successful experience of increased investment in nickel-related downstream sectors by foreign enterprises has taught him how to quickly develop processing industries through the prohibition of ore exports, and that he intends to extend the bans to all mineral resources in the future.

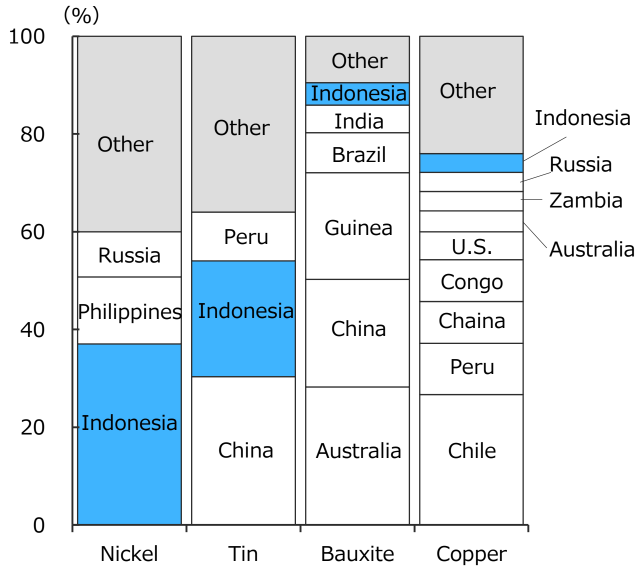
■ Background to the successful nickel export ban

One of the reasons the ban on nickel exports attracted foreign investment is that Indonesia has the world's largest nickel reserves and is the world's number-one ore producer. It seems that foreign companies have been forced to establish nickel processing facilities in Indonesia due to the scarcity of alternative, i.e., non-Indonesian, sources of nickel. In addition, nickel has been in the spotlight in recent years for its use in battery materials, and expectations of increased demand are growing, which is providing a tailwind for Indonesia. The International Energy Agency forecasts that total demand for nickel will increase by 1.5 to two times the 2020 level by 2030 due to higher demand for EVs. The U.S. Biden administration's 2021 report on "Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-Based Growth" also indicated that the supply and demand balance for nickel could come under significant pressure in the next three to seven years.

■ Expansion of the export bans could end in failure

However, in contrast to nickel, prohibiting the export of bauxite and copper might not attract foreign companies, and there is a risk that attempts to advance industry in this way will end in failure. Reasons for this include the following: 1) Indonesia does not have a sufficient market share, 2) it lacks downstream industrial infrastructure such as smelters, and 3) it faces opposition from the international community. First, Indonesia's share of bauxite and copper production is small. In fact, Indonesia banned the export of various types of unprocessed ore in 2014, but relaxed the restrictions in 2017 after China, the largest buyer of its bauxite at the time, switched to sourcing from Guinea. As a result, investment in Indonesia did not grow much, and this is believed to have led to the easing of the bauxite export ban.

<Share of Output of Main Metal Ores, 2021>



Source: Prepared by JRI based on data from the U.S. Geological Survey

Second, domestic smelting capacity and related industries are not sufficiently developed. Even at the time of the 2014 ban, there was a shortage of domestic smelting capacity, which resulted in several mines cutting production or closing, causing job losses and other problems, and this was another factor behind its relaxation. There are also concerns within Indonesia about future export bans. The Association of Indonesia Bauxite and Iron Ore Producers notes that currently there are not enough smelters in the country to smelt the current output of bauxite. Commission VII (Energy, Mineral Resources, Research and Technology, Environmental Affairs) of the Indonesian parliament has also stated that since 98% of tin produced in the country is exported, large-scale investment in downstream industries would be essential to process the entire output domestically. The Ministry of Energy and Mineral Resources is aiming to complete 32 new smelters by 2024, but has revealed that 12 of these projects, including ones for nickel and bauxite, are facing financing problems (as of the end of 2021). Furthermore, the Indonesian Chamber of Commerce and Industry has remarked that the trend toward decarbonization has deterred the financing of smelters that receive their power supply from coal-fired power plants.

Third, the international community is opposed to the Indonesian government's export ban policy. In the dispute with the EU over the prohibition of nickel exports, the WTO panel ruled in November 2022 that Indonesia was violating WTO rules. Indonesia has appealed the ruling, but if the appellate panel concludes that WTO rules are being broken, the country might have to modify the ban, otherwise its trading partners could take countermeasures.

(Mitsuhiro Matsumoto)