

# An Analysis on Causes of Decline of China's Final Consumption Rate since 1978

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**[Abstract]** Along with the rapid economic growth and reform since 1978, there has been a remarkable trend in China, i.e. the steady decline of the share of final consumption expenditure in GDP that has made China be one of economies with lower ratio of consumption in the world for a long period. This phenomenon has become one of hot issues among the economists in China in recent years. It is also very important for policy implication given the key role of consumption in the growth.

This paper is mainly used to analyze the reasons why China's final consumption rate was declined. We found that there are four reasons to explain why China's final consumption rate was declined: decrease of propensity of consumption; adjustment of distribution structure of national income; the reform of housing system in urban area and slower growth of income of rural residence.

**[Keywords]** China's consumption rate, propensity of consumption, distribution structure of national income, reform of housing system

Final consumption rate, which is the proportion of final consumption to gross domestic product (GDP), is one of the important macroeconomic indices. The final consumption rate of China

(Mainland China, the same below) has declined from 62.1% in 1978 to 48.6% in 2008. This level is not only significantly lower than global average, but also lower than that of low- and middle-income countries. There are numerous discussions in economic policy-making and academic circles about the reasons and policy options for increasing the consumption in China in recent years. Economists in China have different judgments and analysis regarding the fluctuation of the final consumption rate. Some economists believed low consumption rate is harm to the economic development, also several scholars considered a lower consumption rate to be a normal phenomenon.

## I. The Changing Trend of China's Consumption Rate Since 1978 And International Comparison

China's economy has been growing rapidly since the reform and opening-up in 1978, with an average annual growth rate of 9.7%. By contrast, the consumption rate has shown a downward trend on the whole. Specifically speaking, the consumption rate has declined from 62.1% in 1978 to 48.6% in 2008.<sup>1)</sup> From an international comparative point of view, the level of China's

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1) This can be seen in Table 1 in the appendix.

consumption rate is also significantly lower than that of other countries or economies.

### 1. The Changing Trend of China's Consumption Rate

From Figure 1, we can find that China's consumption rate has showed a course of "rising—gradually decreasing—slightly increasing—decreasing again."

The first stage occurred from 1978 to 1981. The final consumption rate increased from 62.1% to 67.1%, a difference of 5 percentage points and the highest level within 30 years from 1978.

The second stage occurred from 1982 to 1995. Consumption rate had been declining gradually in this stage. Final consumption rate was changed from 66.5% to 58.1%, a difference of 8.4 percentage points. Comparing with the highest of 30 years in 1981, decreasing range reached 9 percentage points.

The third stage spanned 1996 to 2000. The

final consumption rate experienced a slight rise (4.2 percentage points) during this stage, changing from 58.1% to 62.3%.

The fourth stage: from 2001 until now. The final consumption rate has sustained to decline and the range of decline has been expanded significantly. Final consumption rate was changed from 61.4% in 2001 to 48.6% in 2008, a decrease of 12.8 percentage points. We can see from Table 2 and Figure 1 that China's consumption rate is decreasing at a greatly accelerated pace. The final consumption rate decreased from 67.1% in 1981 to 58.1% in 1995, a difference of 9 percentage points. But in only 9 years since 2000, final consumption rate decreased from 62.3% in 2000 to 48.6% in 2008, a decrease of 13.7 percentage points, with an average annual decline of 1.5 percentage points. Especially in 2003, consumption rate was decreased 2.8 percentage points over the previous year, and in the next two years it

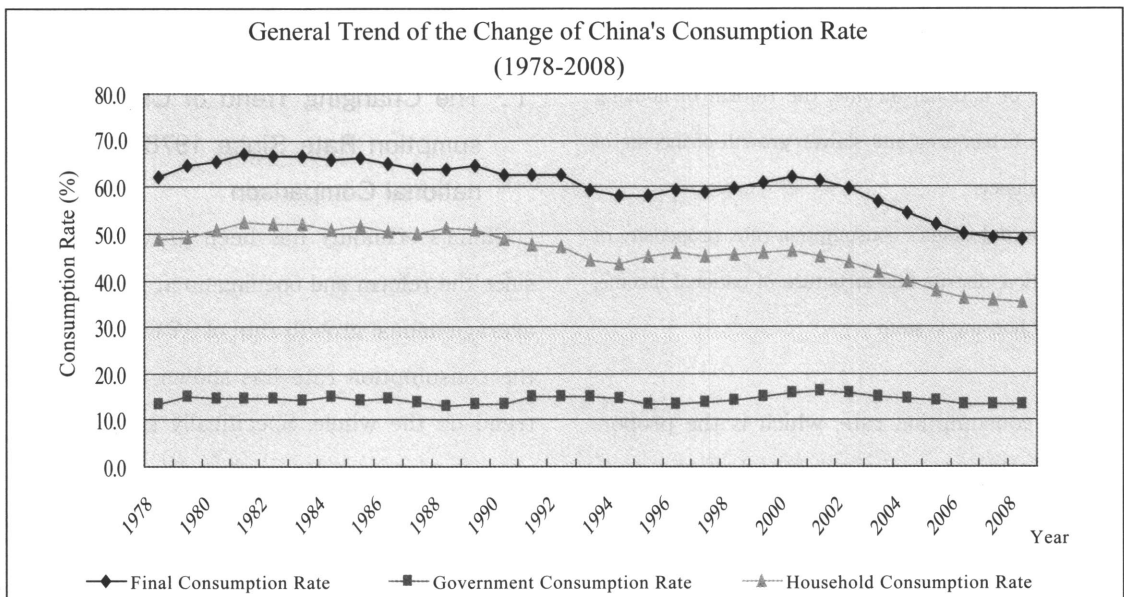


Figure 1: General Trend of the Change of China's Consumption Rate  
Source: China Statistical Yearbook (2008), China Statistical Abstract (2009)

dropped 2.5 percentage points per year. It was the maximum range of decline in the past 30 years and consumption rate in 2008 was the lowest in recent 30 years. It is obvious that consumption rate has decreased conspicuously since 2003.

Now consider the structure of the household consumption rate. It is made up of the rural household consumption rate and the urban household consumption rate. We can determine their relationship from Figure 2.

As can be seen from Figure 2, the urban household consumption rate in China had gradually risen over the past 30 years as a whole but has decreased since 2000. In contrast, rural household consumption rate has decreased constantly since 1985. In general, the rural household consumption is declining at a faster rate than the growth rate of urban household consumption rate, which results in a decline in the

total household consumption rate.

## 2. A Brief International Comparison on Consumption Rate

Now we make a brief comparison of the final consumption rate between China and other countries (Table 2).

From Table 2, it is evident that compared with other countries, China's final consumption rate is very low. As indicated in the table, the final consumption rate of the United States is the highest of these countries and has exhibited a continuing rise in recent years. Some developed countries, such as the United Kingdom, France, Italy, and Japan, continue to show an upward tendency in the final consumption rate. Other countries, however, demonstrate a downtrend. China's final consumption rate is less than developed countries by about 20 percentage points and less than developing countries such as India and Brazil by about 15 percentage points. The

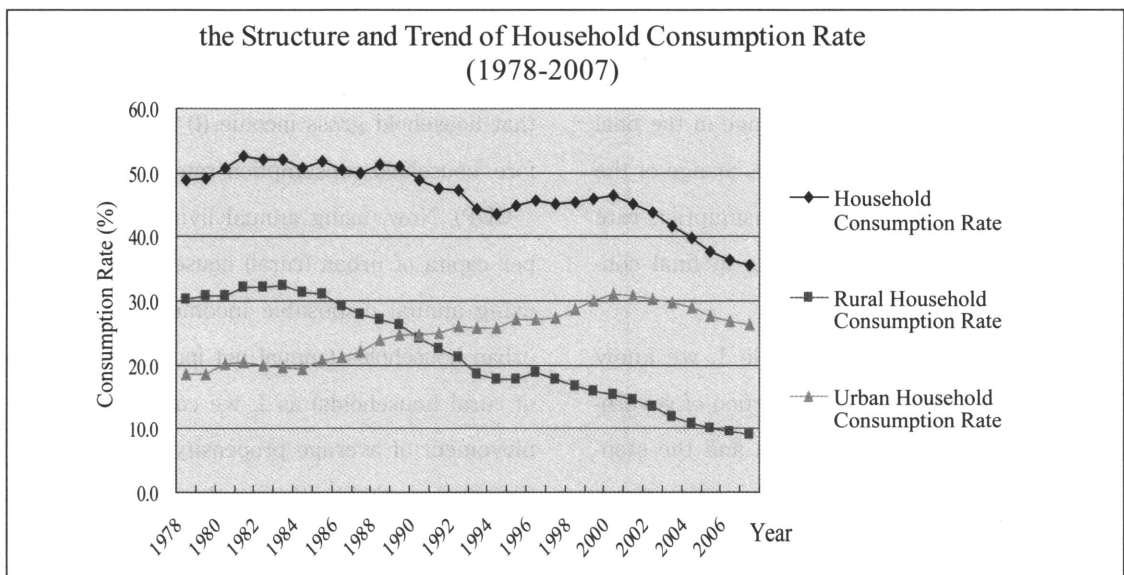


Figure 2: The Structure and Trend of Household Consumption Rate  
 Source: China Statistical Yearbook (2008), China Statistical Abstract (2009)

data indicates that China's consumption rate is lower than other countries in the statistical comparison except Singapore. This is not only reflected in the comparison with high-income countries, but also with East Asian and South Asian countries with economies similar to China's. Take India for example: Its stage of economic development is similar to that of China, but in 2007 its final consumption rate exceeded China's by 19 percentage points. At the global level, the average final consumption rate stabilizes at 78%, which means the difference between China and the world average has gradually widened.

## II. Main Causes of China's Low Consumption Rate

### 1. The Decline of Households' Consumption Propensity

The final consumption rate consists of the household consumption rate and government consumption rate; the household consumption rate comprises the rural and urban household consumption rates. So, any change in these three factors could lead to a direct change in the final consumption rate. We can see the change of the proportion that government consumption rate and household consumption rate in final consumption rate.

Calculated by data from Table 1, we know that the mean value of the proportion of government consumption rate is 23.9%, and the standard deviation is 0.02. That is to say, this proportion is nearly stable and the range of change is within 2 percentage points. The household consumption rate constitutes more than 70% of the

final consumption rate. Thus, the household consumption expenditure is the main force driving the increase of consumption. Moreover, Table 6 indicates that in recent years, the proportion of household consumption has been declining and that of government consumption has gradually been increasing. Considered with the data in Tables 1 and 2, it appears that the changing proportion is caused by the decline in the household consumption rate. Among the three constituents of the final consumption rate, the government consumption rate generally remains around 15% and its proportion is small, so household consumption rate is the most important influence on the change of final consumption rate.

The household consumption rate is the proportion of the household final consumption expenditure (C) to GDP by expenditure approach. Accordingly, we can divide the household consumption rate into two parts via decomposition analysis: multiplying the proportion that household final consumption expenditure (C) to household gross income (I) by the proportion that household gross income (I) to GDP. Therefore, household consumption rate =  $(C / I) \times (I / GDP)$ . Now, using annual living expenditure per capita of urban (rural) households as C and using annual disposable income per capita of urban households (annual net income per capita of rural households) as I, we can calculate the movement of average propensity to consume of Chinese households. The results of this computation are shown in Table 3. To observe the trend of change more readily, see Figure 3, which is based on Table 3.

From Figure 3, it appears that average propensity to consume of urban household experienced much volatility from 1978 to 1988, reaching the highest value of the past 30 years in 1988. Since then it has declined, dropping in 2008 to the minimum value of the three decades presented. Furthermore, average propensity to consume of rural household declined slightly from 1978 to 1984, and then it rose to its maximum value in 1989. In the following years, the rural household rate had a downtrend until 2004. We can determine that the coefficient of variation of average propensity to consume of urban and rural households is 0.2 and 0.06, respectively<sup>2)</sup>. Moreover, the average propensity to consume of urban households has generally been higher than that of rural households. The average propensity to consume of urban and rural households has experience a downtrend as a whole. The reasons

for the change of households' consumption propensity are related strongly to a series of changes that arose from the reform of economic institutions in China.

First of all, the social security system in China has not been fully realized. This is why households are more motivated to achieve precautionary savings. An increase in precautionary savings would lead to a decrease in consumption propensity.

Second, a growing gap in income distribution, not only between urban and rural households, but also among urban households and rural households, respectively, has led to the decline of average propensity to consume. We use the index of "the ratio of per capita income of urban household and rural household" to represent the gap of domestic income distribution. The calculation formula is that the ratio of per capita

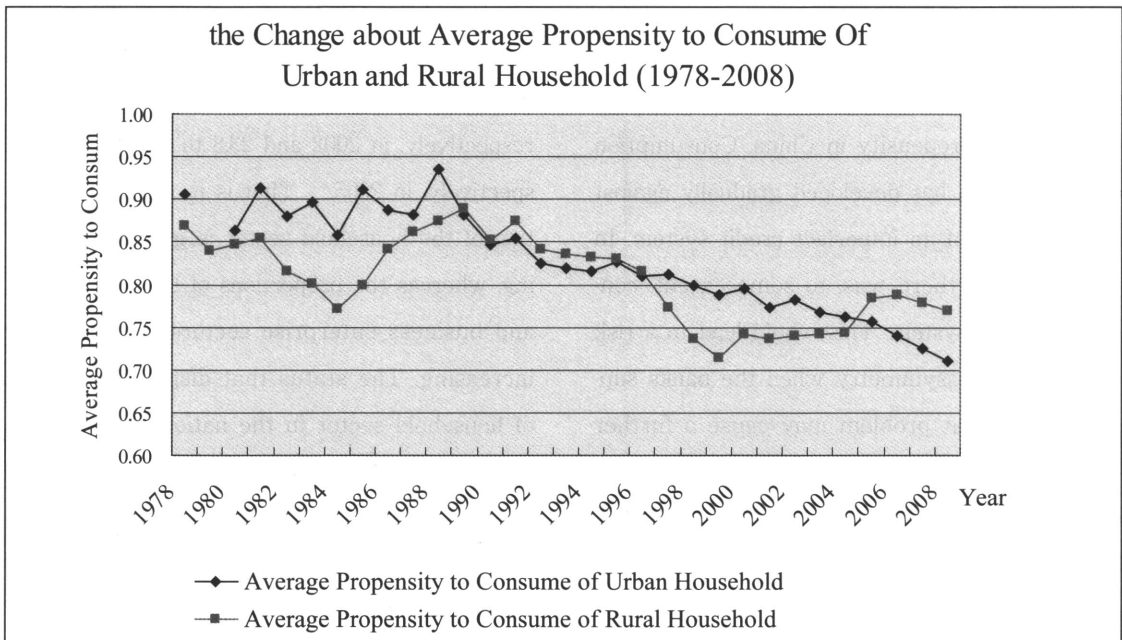


Figure 3: The Change in Average Propensity to Consume of Urban and Rural Household (1978-2008)

Source: Calculated by related data from *China Statistical Yearbook* (2008) and *China Statistical Abstract* (2009)

2) These are calculated by the data from Table 3 in the appendix.

income of urban household and rural household equals per capita annual disposable income of urban households divided by per capita annual net income of rural households. And we use the Gini Coefficient directly to represent the income-distribution gap among urban households and rural households (see the detailed data in Table 4).

From Table 4, one can see that the income gap had been widening gradually. According to the data, the ratio of per capita income of urban households to that of rural households reached 3.2% in 2003. According to Keynesian theory, the marginal propensity to consume is diminishing. In this way, low-income consumers have the intent to consume but do not have enough money. Conversely, high-income households have enough to consume, but they prefer to save and invest. As a result, the household consumption propensity has declined gradually.

Last, the liquidity constraint is another important reason for the decline of household consumption propensity in China. Consumption credit in China has developed gradually against the backdrop of an imperfect credit system. In the beginning there was, to some extent, constraint of the system. This would lead to a risk of information asymmetry when the banks supply credit. That problem may cause a further lack in the credit supply or difficulty in getting credit. Low incomes would weaken the economy's ability to bear consumption credit. Then it constrains credit from playing a role in stimulating consumption. Furthermore, laws and regulations on consumption credit are unsound. Banks

therefore face a higher risk, which constrains the development of consumption credit. These conditions hamper the development of consumption credit in China and induce an increase in households' liquidity constraint.

## 2. The Disequilibrium of the Structure of National Income Distribution

The structure of national income distribution refers to the proportion of the national income distributed among the household, business, and government sectors and the interrelation of the three. Before the 1990s, China's national income distribution was inclined toward the household sector. Since the 1990s, especially after the tax system reform in 1994, this situation has changed a lot. According to the data from the Funds Flow Statement in *China Statistical Yearbook*, the distribution ratio among the government, business enterprise, and household sectors was 18.3 to 14.3 to 67.4, respectively, in 1994. This proportion changed to 20.5 to 14.9 to 64.6, respectively, in 2002 and 23.8 to 16.2 to 60.0, respectively, in 2005.<sup>3)</sup> That is to say the proportion of the household sector is gradually declining, whereas the proportions of the government and business enterprise sectors are gradually increasing. The status that disposable income of household sector in the national income has declined gradually comparing with government sector and business enterprise sector is an important reason, which induces the decline of household consumption rate.

The proportion of employees' wages to gross national income in 1980, 1990, and 2000

3) These are calculated by the data from the Funds Flow Statement in *China Statistical Yearbook*.

was 17.0%, 15.8%, and 10.9%, respectively. In 2006, it declined to 9.8%<sup>4)</sup> and has continued a downtrend.

Furthermore, with the distribution of national income inclined to government sector, the saving rate of government is rising constantly. A research report in 2007 issued by the Institute of Finance and Banking of the Chinese Academy of Social Sciences shows that 75% of the newly added national savings came from the government sector since 2000,<sup>5)</sup> and business savings were stable whereas household savings declined.

### 3. Housing System Reform and Housing Investment

Before 1998, China had a welfare-oriented public housing distribution system and urban households' working unit, such as state-owned enterprises or public institutions, was in the position of providing houses for their workers or employers. So housing for urban dwellers depended primarily on their working units. The households did not own their residences but could only live in the house by renting a public-owned dwelling. In 2000, the old, welfare-oriented housing allocation system ceased in all urban areas, and housing reform was carried out formally nationwide. At the macroeconomic level, before housing system reform, urban households could use more income for consumption and did not need to buy a house due to low rents and dependent on the working units. After reform, buying a house is the largest expense for most families in urban

areas. In order to save enough money, urban households must reduce current consumption and increase savings. Table 5 shows the related statistics in the real estate industry after housing reform (1998–2008).

According to the accounting method of GDP by expenditure approach, the expenditure for purchasing or building housing is not included in consumption but is included as a fixed assets investment. In this way it has a double influence on consumption. On the one hand, households have to deposit their income into banks instead of consuming in order to accumulate enough money to buy a house, and this leads to a decline in the consumption rate. On the other hand, the expenditure would be counted as an investment once households bought house, and this would lead to an increase in the investment and saving rates and a decline in the consumption rate.

Figure 4 derives from Table 5. From this figure, it is clear that not only investment in but also consumption of real estate increased after housing reform. In addition, loans for individual housing have increased rapidly. With the development of past 10 years, loan for individual housing in 2008 was 41.97 times that in 1998, and the average annual growth rate was 140.5%. In 2007, when it increased most rapidly, loans exceeded 714.7 billion yuan over the previous year.<sup>6)</sup>

4) These are calculated by the data from *China Statistical Yearbook 2008*.

5) Institute of Finance and Banking of the Chinese Academy of Social Sciences (2007). The growth of China's macroeconomics: stable and slightly fast. *Chinese Academy of Social Sciences Review*, 11(in Chinese).

6) These data are taken from Table 5 in the appendix.

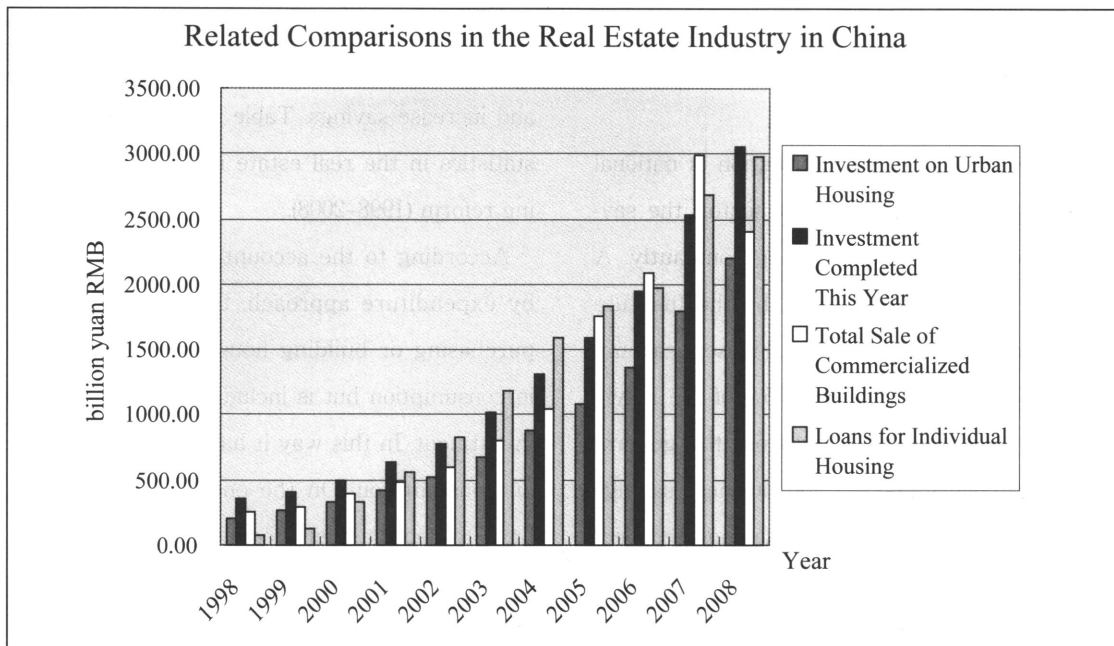


Figure 4: Comparisons for the Related Statistics in the Real Estate Industry in China (1998-2008)

Source: *China Statistical Yearbook (1999-2008)*, *Statistical Communiqué of the People's Republic of China on National Economic and Social Development (1999-2008)*, *China Statistical Abstract (2009)*

From Table 5, it is apparent that the loans for housing comprise the major proportion of the total sale of commercialized buildings in China. That is to say, the majority of housing purchases depend on the mortgage loans. So the mortgage payment is the most important expenditure for most urban households. Moreover, the price of commercialized buildings has increased continuously in recent years. The majority of household incomes were used to repay loans, with the rest meeting the needs of daily life. This leads to a constraint in the increase of household consumption. After 2000, rapid growth within the real estate market stands in stark contrast to the rapid decline of the urban household consumption rate in the same period. This is an indication that housing system reform is an important reason for the decline in the consumption rate.

#### 4. Slow Increase of Income in the Rural Household

As showing in Figure 2, first part of this paper, the downtrend in the consumption rate of rural households over the past 30 years is unvaried and persistent. We believe that this is affected by many factors. However, the relatively slow growth of income of rural households may be the most important factor in this trend.

In order to clarify this point, we used 1978 as the base period, adjusted by the factor of price change, and then recalculated the data of average income in rural and urban households from 1978 to 2008 to create Figure 5.



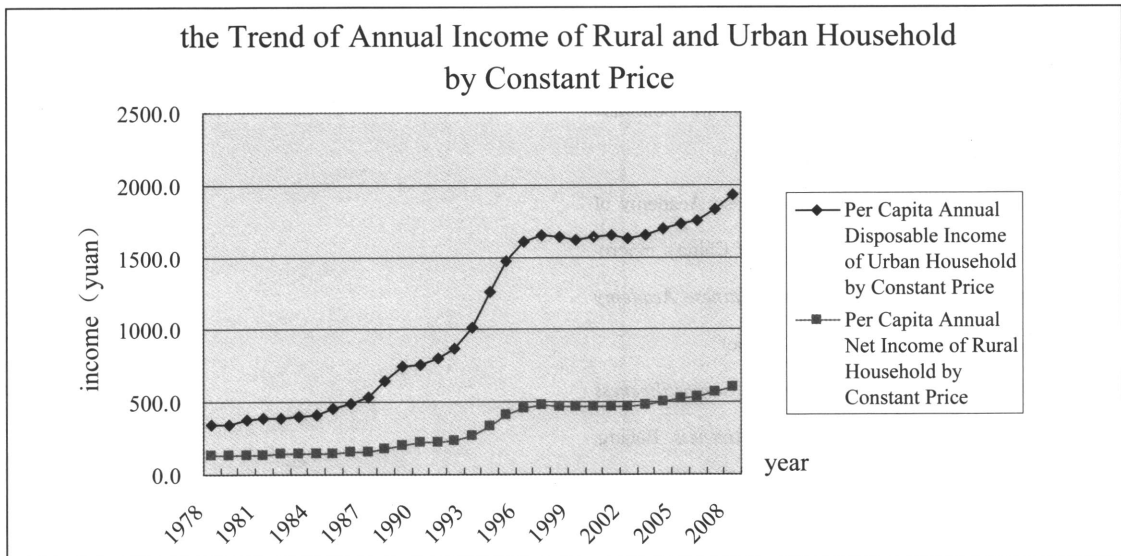


Figure 5: The Change Trend of Annual Income of Rural and Urban Household per Capita Calculated by Constant Price (1978 as the Base Period)

Source: *China Statistical Yearbook* (1999-2008), *China Statistical Abstract* (2009)

From this figure, it is clear that the growth of urban households' income has accelerated since the mid-1980s. From 1997 to 2002 the growth rate slowed. The pace picked up again in 2003. It was a rapid growth period of rural households' income from 1978 to 1985. Chinese government increased the price of agricultural products by a large margin in this period. And the relative income of rural households grew rapidly than that of urban households. Because of financial crisis in Asia from 1997 to 2002, many coastal industries in China were closed, and further affected township enterprises and other industry. The majority of rural households' income in China is depended on the development of township enterprises and urban industry, and urban income is depended on the urban industry basically. This led to the slow increase of peasants' incomes from 1997 to 2002 and the same with urban households. Rural incomes have continued

to increase since 2003 because of a series of policies to increase the peasants' income.

Note that the rural households' annual income per capita mentioned in this paper is not income to be used for consumption but is the households' net income, which, according to the China State Bureau of Statistics, includes not only money but also income in kind. Furthermore, a part of the monetary income must be used for agricultural production, such as the purchase of fertilizer and seeds. Thus the monetary income that can be used for consumption may be very limited. In effect, this widens the gap between rural and urban households and constrains the development of the consumption in rural areas. It follows, then, that overall consumption expenditure would further decline, causing a concurrent decline in the consumption rate.

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## Appendix

Table 2: The Change of China's Consumption Rate (1978-2008)

(%)

Year	Final Consumption Rate	Government Consumption Rate	Household Consumption Rate		
			Total	Rural Household	Urban Household
1978	62.1	13.3	48.8	30.3	18.5
1979	64.4	15.2	49.2	30.7	18.5
1980	65.5	14.7	50.8	30.7	20.1
1981	67.1	14.6	52.5	32.0	20.5
1982	66.5	14.5	52.0	32.0	20.0
1983	66.4	14.4	52.0	32.3	19.7
1984	65.8	15.0	50.8	31.4	19.4
1985	66.0	14.3	51.6	31.0	20.7
1986	64.9	14.5	50.5	29.1	21.3
1987	63.6	13.7	49.9	27.9	22.0
1988	63.9	12.8	51.1	27.1	24.0
1989	64.5	13.6	50.9	26.3	24.6
1990	62.5	13.6	48.8	24.2	24.6
1991	62.4	14.9	47.5	22.5	25.0
1992	62.4	15.2	47.2	21.2	26.0
1993	59.3	14.9	44.4	18.6	25.9
1994	58.2	14.7	43.5	17.7	25.8
1995	58.1	13.3	44.9	17.8	27.0
1996	59.2	13.4	45.8	18.8	27.0
1997	59.0	13.7	45.2	17.8	27.4
1998	59.6	14.3	45.3	16.7	28.6
1999	61.1	15.1	46.0	16.0	30.0
2000	62.3	15.9	46.4	15.3	31.1
2001	61.4	16.2	45.2	14.5	30.7
2002	59.6	15.9	43.7	13.5	30.2
2003	56.8	15.1	41.7	12.0	29.7
2004	54.3	14.5	39.8	10.9	28.9
2005	51.8	14.1	37.7	10.2	27.6
2006	49.9	13.6	36.3	9.5	26.8
2007	49.0	13.4	35.6	9.1	26.4
2008	48.6	13.3	35.3	—	—

Source: *China Statistical Yearbook* (2008), *China Statistical Abstract* (2009)

Table 2: International Comparison on Final Consumption Rate (%)

Country/Year	1980	1990	2000	2001	2003	2004	2005	2006	2007
China	66	62	60	60	57	54	59	55	46
India	83	78	79	79	78	78	72	69	65
Japan	69	66	71	72	73	75	75	75	75
Korea, Rep.	76	63	66	71	68	68	65	69	70
Singapore	62	57	50	50	53	52	52	49	48
Canada	75	79	77	77	75	75	76	75	74
United States	81	84	81	82	86	86	87	86	87
Brazil	79	78	80	80	78	75	73	80	76
France	77	77	79	78	79	79	80	81	81
Germany	—	77	77	77	78	78	78	78	76
Italy	76	78	78	78	79	79	79	79	79
Russian Federation	—	70	67	65	69	70	66	66	67
Spain	79	77	76	76	76	76	76	76	76
United Kingdom	81	83	84	84	86	87	86	87	86
Low Income	72	79	80	81	81	81	76	74	83
Middle Income	76	74	74	74	73	71	72	72	75
High Income	76	76	78	78	81	81	80	80	80
East Asia & Pacific	69	65	65	64	64	59	62	61	54
South Asia	85	81	81	80	80	79	74	73	69
World	76	76	77	78	79	79	79	78	78

Source: World Bank, *World Development Reports* (2002-2009), *World Development Indicators* (2000, 2004)

**Table 3: The Change about Average Propensity to Consume Of Chinese households (1978-2008)**

Year	Urban Household			Rural Household		
	Annual Living Expenditure Per Capita (yuan)	Annual Disposable Income(yuan)Per Capita	Average Propensity to Consume	Annual Living Expenditure Per Capita (yuan)	Annual Net Income Per Capita(yuan)	Average Propensity to Consume
1978	311.16	343.4	0.91	116.06	133.6	0.87
1979	—	405.0	—	134.51	160.2	0.84
1980	412.44	477.6	0.86	162.21	191.3	0.85
1981	456.84	500.4	0.91	190.81	223.4	0.85
1982	471.00	535.3	0.88	220.23	270.1	0.82
1983	505.92	564.6	0.90	248.29	309.8	0.80
1984	559.44	652.1	0.86	273.80	355.3	0.77
1985	673.20	739.1	0.91	317.42	397.6	0.80
1986	798.96	900.9	0.89	356.95	423.8	0.84
1987	884.40	1002.1	0.88	398.29	462.6	0.86
1988	1103.98	1180.2	0.94	476.66	544.9	0.87
1989	1210.95	1373.9	0.88	535.37	601.5	0.89
1990	1278.89	1510.2	0.85	584.63	686.3	0.85
1991	1453.81	1700.6	0.85	619.79	708.6	0.87
1992	1671.73	2026.6	0.82	659.21	784.0	0.84
1993	2110.81	2577.4	0.82	769.65	921.6	0.84
1994	2851.34	3496.2	0.82	1016.81	1221.0	0.83
1995	3537.57	4283.0	0.83	1310.36	1577.7	0.83
1996	3919.47	4838.9	0.81	1572.08	1926.1	0.82
1997	4185.64	5160.3	0.81	1617.15	2090.1	0.77
1998	4331.61	5425.1	0.80	1590.33	2162.0	0.74
1999	4615.91	5854.0	0.79	1577.42	2210.3	0.71
2000	4998.00	6280.0	0.80	1670.13	2253.4	0.74
2001	5309.01	6859.6	0.77	1741.09	2366.4	0.74
2002	6029.88	7702.8	0.78	1834.31	2475.6	0.74
2003	6510.94	8472.2	0.77	1943.30	2622.2	0.74
2004	7182.10	9421.6	0.76	2184.65	2936.4	0.74
2005	7942.90	10493.0	0.76	2555.40	3254.9	0.79
2006	8696.55	11759.5	0.74	2829.02	3587.0	0.79
2007	9997.47	13785.8	0.73	3223.85	4140.4	0.78
2008	11242.85	15780.8	0.71	3660.68	4760.6	0.77

Source: Calculated by related data from *China Statistical Yearbook* (2008) and *China Statistical Abstract* (2009)

**Table 4: The Change of Income Gap in Urban and Rural Household**

Year	Ratio	Urban Gini Coefficient	Rural Gini Coefficient	Year	Ratio	Urban Gini Coefficient	Rural Gini Coefficient
1978	2.571	0.16	0.21	1991	2.400	0.24	0.31
1979	—	—	0.24	1992	2.585	0.25	0.32
1980	2.496	0.16	0.24	1993	2.797	0.27	0.31
1981	2.193	0.15	0.21	1994	2.863	0.30	0.31
1982	1.944	0.15	0.24	1995	2.714	0.28	0.31
1983	1.817	0.15	0.24	1996	2.512	0.28	0.33
1984	1.829	0.16	0.24	1997	2.469	0.29	0.32
1985	1.859	0.19	0.23	1998	2.509	0.30	0.34
1986	2.123	0.19	0.25	1999	2.648	0.30	0.33
1987	2.166	0.20	0.24	2000	2.786	0.25	0.32
1988	2.168	0.23	0.23	2001	2.899	0.26	0.32
1989	2.287	0.23	0.30	2002	3.111	0.31	0.32
1990	2.200	0.23	0.29	2003	3.231	0.32	0.30

Notes: 1. Source: Luo Yunyi, *Researches on Consumption-Investment Relations*, P 264.

2. "Ratio" in the table represents "the ratio of per capita income of urban household to rural household"

**Table 5: The Related Statistics in the Real Estate Industry in China (1998-2008)**

Year	1998	1999	2000	2001	2002	2003
Investment on Urban Housing (billion yuan RMB)	208.160	263.850	331.200	421.670	522.780	677.670
Investment Completed This Year (billion yuan RMB)	361.423	410.320	498.405	634.411	779.092	1015.380
Total Sale of Commercialized Buildings (billion yuan RMB)	251.330	298.787	393.544	486.275	603.234	795.566
Loans for Individual Housing (billion yuan RMB)	71.000	131.500	331.600	559.800	825.800	1178.000
Year	2004	2005	2006	2007	2008	
Investment on Urban Housing (billion yuan RMB)	883.700	1086.090	1363.840	1800.540	2208.130	
Investment Completed This Year (billion yuan RMB)	1315.825	1590.925	1942.292	2528.884	3057.980	
Total Sale of Commercialized Buildings (billion yuan RMB)	1037.571	1757.613	2082.596	2988.912	2407.140	
Loans for Individual Housing (billion yuan RMB)	1585.300	1829.700	1973.600	2688.300	2980.000	

Source: *China Statistical Yearbook (1999-2008)*, *Statistical Communiqué of the People's Republic of China on National Economic and Social Development (1999-2008)*, *China Statistical Abstract (2009)*