



A Weak Driver of a Strong Economy

*Challenges in China's Move Toward Consumption-Oriented Economic Growth
Gallup Chinese Consumer Study: 1994 -2006*

Gallup's studies of Chinese consumers began in 1994 and have focused on tracking attitudinal changes over the past 12 years. For each of the five surveys conducted over that time, 3,400 to 4,200 in-person interviews were conducted, with results representative of the entire Chinese population. Residents of China's 10 largest cities were oversampled to analyze those cities' different characteristics.

Among the findings of the latest study, conducted in October 2006, are three key insights:

1. The country's blistering growth has helped urban consumers far more than their rural counterparts.
2. Chinese consumers' concerns regarding the lack of a strong social safety net are a prime reason for high savings and low consumption rates.
3. "Rural rich" consumers offer an increasingly lucrative opportunity for those companies brave enough to venture into the hinterlands.

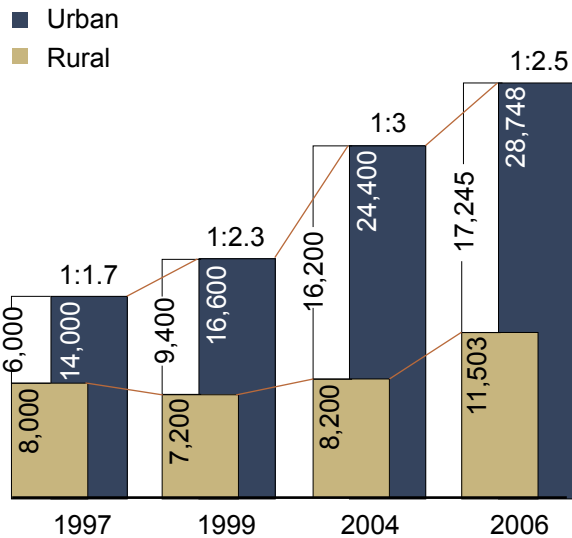
The Urban-Rural Divide Continues to Widen

Despite China's rapid economic growth and urbanization, a majority of its 1.3 billion residents still live in rural areas (the population is currently split between 560 million urbanites and 745 million rural dwellers, according to Chinese government statistics). Uneven development has, in a very real sense, split China into two economies: urban and rural. In contrast to significant income growth in urban areas, rural incomes only saw moderate growth until 2004.



Thus far, the income gap between rich and poor in urban areas shows no sign of narrowing. Urban respondents reported an average annual income of 28,748 RMB, an increase of more than 4,000 RMB since 2004. Respondents in rural households also saw their average income rise, but by a somewhat lower 3,300 RMB. However, it's important to note that rural incomes are rising at an accelerating rate; from 1999 to 2004, rural respondents' average reported income rose by only 1,000 RMB.

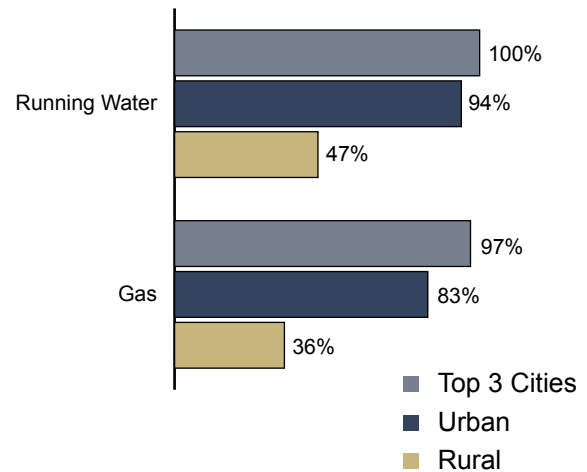
Average annual household income before taxes in RMB



But even within China's urban and rural "sub-economies," gaps between the "haves" and "have-nots" are widening. In the cities, the average income of the highest-earning 20% of urban Chinese jumped by almost 40% between 2004 and 2006, while the lowest-earning 20% of urban respondents saw a rise of about 27%. In rural areas, the average income gap between the upper and lower quintiles was stagnant until 2004, but has since widened considerably. The increase suggests the emergence of a nascent class of "rural rich" Chinese, the first beneficiaries of the country's capital-intensive growth to live outside the cities.

There are still significant quality-of-life differences between urban and rural Chinese, even regarding such basics as running water and gas for cooking. The vast majority of urban residents – 94% – say their homes have running water, but less than half of those in rural areas – 47% – say the same.

Does your home have ...
% "yes"



Consumption Barrier: Weak Social Safety Net

China's massive trade surplus partly reflects low domestic consumer consumption, and has the Chinese government trying to figure out how to get people to save less and spend more. The bad news is that, despite their already high savings rate, Chinese would like to save still more. More than two-thirds say they are either "somewhat dissatisfied" (47%) or "very dissatisfied" (21%) with the amount of savings they have. Just 2% say they are "very satisfied."

What drives Chinese to save? The primary reasons are universal worries about healthcare, retirement, and education. About two-thirds say they are saving to cover the costs of possible sickness, and to take care of themselves in their old age. The share of personal expenditures allocated to medical services has increased significantly in China. Currently, 40% of urbanites as well as 72% of rural dwellers do not have healthcare coverage, according to Chinese government statistics.¹

Public primary and middle school is supposed to be free in China, but in many cases it is not. Education is a large annual expense for most Chinese families. Nearly 6 in 10 Chinese in both rural and urban areas say providing for their children's education is one of their savings goals. It's possible that number will come down among rural Chinese; in 2006, the government announced it would exempt primary and middle

¹ Source: State Statistics Bureau of China

school students in the rural west from tuition and other education-related expenses starting in 2007.²

The increased outlay of public money into rural schools is indicative of the Chinese government's effort to increase private consumption. Currently, public programs in health, education, welfare, and pensions total only about 3% of GDP.³

As Chinese households see the government providing more social services in these areas, fewer may feel the need to put most of their discretionary income into savings.

I am going to read some of the savings goals that people have. As I read each goal, would you tell me whether it is a savings goal of yours, or not?

	URBAN		
	Urban	High	Low
For retirement	68%	59%	74%
For healthcare	66%	63%	68%
For children's education	59%	61%	47%
Buy a new home	49%	59%	40%
Buy home electronic items & other consumer durables	44%	49%	36%

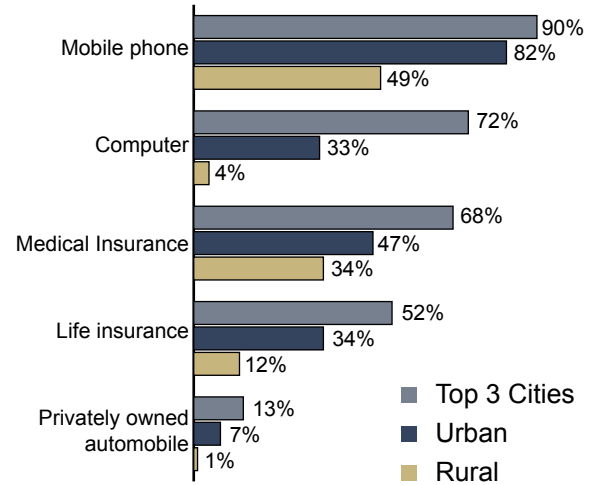
	RURAL		
	Rural	High	Low
For healthcare	67%	70%	62%
For retirement	64%	60%	58%
For children's education	58%	64%	41%
Buy home electronic items & other consumer durables	42%	47%	34%
Home remodeling	41%	43%	40%

Budding Market Opportunities

Though the urban-rural divide continues to widen, Gallup's 2006 survey points to a significant rise in the average income among rural Chinese. As consumerism in rural areas begins to grow, the huge gaps between those living in urban and rural areas in terms of consumer product ownership will present lucrative business opportunities for those savvy enough to market to the hinterlands. Currently, about

half of rural Chinese (49%) say they own a mobile phone, compared with 82% of urban Chinese. Just 4% of rural residents own a computer, versus a third (33%) of urban dwellers.

As I read each of the following, please tell me whether you have that item in your home at present, or not.



Conclusion

If China sticks to its current production-intensive and export-oriented model of growth, the following consequences are likely:

- more pressure from rural migration to cities
- an increase in pollution levels
- continued weak consumer spending without significant effort from the government to provide a viable social safety net
- growing trade imbalances

There remain formidable financial and logistical barriers to increased consumer spending in China – especially in rural China. Nevertheless, the current data give reason to believe market opportunities are growing even there. China is not an easy market, but already many companies are flourishing there. Reliable assessments of the way consumer behavior is evolving throughout the country improve the odds of success.

² http://en.ce.cn/National/Rural/200602/21/t20060221_6154334.shtml

³ China Statistical Abstract 2006, p. 52