

Impacts of Household Consumption on Economic Growth

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Abstract. As China shifts from an investment- and export-driven economy to a domestic demand-oriented one, household consumption has emerged as the major driver of economic growth. By reviewing the historical development of China's economy, this paper reveals the significance of household consumption during this transformation period. This paper finds that the increase in household consumption not only stimulates market demand but also motivates companies to expand production and increase investment, thereby propelling a virtuous economic cycle. Meanwhile, it promotes the optimization and upgrading of consumption structure, specifically manifesting as the transformation of the consumer pattern from spending more on essential items to spending more on high-quality, personalized goods and services. This process has significantly improved people's quality of life and facilitated the innovative development of relevant industries. Based on the analysis of China's current economic development, this paper proposes that the government should emphasize the optimization of the consumer environment and introduce inclusive policy, thereby effectively driving consumption upgrading and economic growth.

Keywords: household consumption, economic growth, income gap, virtuous economic cycle

1. Introduction

Since the reform and opening-up, China's economy has been expanding rapidly, achieving a continuous and steady gross domestic product (GDP) growth from 1979 to 2023. With deepening policies, continuously expanded opening up, and remarkable achievements through market-oriented reforms, China's economy, a relatively closed planning system, has quickly emerged as the second largest economy worldwide. Particularly, China's GDP has been the second largest worldwide since 2010, becoming one of the major drivers of global economic growth.

In recent years, China's economy has entered the stage of high-quality development, shifting from an investment- and export-oriented economy to a domestic demand-oriented economy with a focus on household consumption. China's residents have seen continuous improvement in their incomes and an acceleration in urbanization. Against such background, household consumption, as the core component of the demand side, can directly promote economic growth by driving the demand for goods and services. Additionally, it indirectly promotes the optimization and upgrading of industrial structure, transforming the consumer pattern from spending more on essential items to spending more on high-quality, personalized goods and services. This has fostered the transition of the manufacturing industry to high-end intelligent technologies and boosted the development of the service sector. Household consumption is gradually rising as an important driving force for the sustainable development of China's economy.

Meanwhile, the digital economy, e-commerce, and the sharing economy have introduced new consumption patterns that are advancing quickly, reshaping the global consumption landscape with new sources of economic growth. During the COVID-19 pandemic period, the explosive growth of online consumption became a significant feature of global consumer behaviors, which facilitated the digital transformation of economies. Under the ever-changing global and domestic economic landscape, an in-depth analysis of the relationship between household consumption and economic growth enables the understanding of modern economic growth's core driving forces, providing insights for future economic development.

There have been studies about household consumption's positive effects on economic growth. For instance, Liu and Zhu analyzed the distribution features of Chinese household consumption's effect on economic growth, pointing out that in different periods, the promoting effect of consumption on economic growth varies significantly between urban and rural areas, as well as across different regions, which has provided vital basis for formulating policies to promote consumption and optimize economic structure [1]. Chen and Wang had an in-depth discussion on the persistent stagnation and notable structural differentiation of China's household consumption in recent years [2]. However, most existing literature focuses on specific consumption areas,

adopting empirical analysis. Summaries and commentaries of existing studies are relatively lacking, as well as systematic comparisons of different studies and comprehensive commentaries. This has led to a failure to reveal the profound impact of emerging trends on economic growth. Hence, this paper aims to systematically review and summarize current literature, and further discuss the long-term effects of consumption on economic growth, especially the driving effects of household income and consumption structure changes on economic growth.

2. Relationship between Household Consumption and Income Distribution

2.1. Household Income in China

According to statistics of the National Bureau of Statistics, in the first half of 2024, the nationwide per capita disposable income is 20,733 yuan, a year-on-year increase of 5.3%; the per capita disposable income of urban residents is 11,272 yuan, a year-on-year increase of 6.6%, indicating an overall growth trend of Chinese residents' income. However, there are significant differences between urban and rural areas, as well as across different regions.

In many rural areas, agriculture is still the pillar of the economy. The main source of rural residents is crop planting and animal breeding, susceptible to the influence of natural conditions and market price fluctuations. Due to historical reasons and unequal distribution of education resources, rural residents are usually less educated. Most farmers lack essential vocational skills and creativity, making them unable to obtain adequate vocational training and growth opportunities [3]. These social phenomena not only reflect the unbalanced development between urban and rural areas but also reveals the singular economic structure in rural areas. In response to these problems, many scholars have proposed constructive suggestions, including accelerating rural reform, improving the income of rural residents, achieving full employment, and enhancing the social security system, thereby guaranteeing the basic needs of low-income groups in society.

The unbalanced distribution of residents' income is also unignorable across different regions. Liu and Chen used the mean log deviation (MLD) index, proving that the eastern region has a more diverse industrial structure, and more developed capital- and technology-intensive industries due to the early start of economic development [4]. This has attracted a substantial amount of foreign investment and advanced technologies, promoting and sustaining the rapid growth of its economy [4]. During this process, the eastern region has developed influential industrial clusters and modern service industries, which have contributed to both the economic growth and residents' income. Meanwhile, residents in the western region have lower incomes due to a relatively weak economic foundation and less optimized resource allocation. In the northeast region, the dependence on heavy industry has led to the loss of competitive advantages during the structural transformation of the global economy. Therefore, the income gap between residents in the northeast region and the eastern region is widening year by year.

2.2. The Impact of Income Gap on Consumer Demand

According to the consumption function theory, resident's consumption and income are positively correlated. It means that a higher income indicates stronger consumption capacity and willingness. In China, changes in residents' income have a direct impact on the growth of consumption demands and the upgrading of consumption structure. Although China sees increases in per capita disposable income, the substantial gap in residents' income between urban and rural areas, as well as across different regions has produced a significant impact on consumption.

Dai revealed the current relationship between income gap and consumption demand among Chinese residents using a simple simultaneous equation model of residents' income disparity and consumption demand and statistical method [5]. The research results show that the widening income gap leads to a declining consumption tendency, which is consistent with the findings of Qiao and Kong. According to Dai, although social wealth increases as the economy advances, the distribution of wealth is becoming increasingly uneven [5,6]. High-income groups can obtain greater earnings due to their favorable positions in resource allocation, whereas low-income groups face the problem of slow income growth. The uneven distribution caps the consumption capacity and expectations of low-income groups, resulting in an overall decline in the consumption tendency.

The uneven distribution mode has imposed challenges on the sustainable development of society and the economy. The inadequate satisfaction of the low-income groups' consumption demands restricts the expansion of the consumer market and the potential of driving economic growth via consumption. Meanwhile, although high-income groups possess strong consumption capacity, their consumption demands are relatively satisfied, thus narrowing the space for further consumption growth. To promote the sustainable development of the economy, the government should introduce effective policies and measures to adjust income distribution, improve the income of low-income groups, and promote the expansion of the consumer market, thereby driving economic growth.

3. Relationship between Household Consumption and Economic Growth

3.1. The Impact Pathway of Household Consumption on Economic Growth

As one of the core driving forces of modern economic growth, household consumption has a remarkable, direct impact on aggregated demand. According to Keynes's theory of consumption, the aggregated demand consists of consumption, investment, government spending, and net exports. Among them, consumption is the key factor that can directly promote the expansion of market demand due to its features of stability and sustainable growth. Furthermore, it propels the cycle of production, investment, employment, and income across the entire economy, making household consumption a key driver of modern economic growth.

Liu and Meng argued in their study that China has effectively enhanced the stability of domestic demands by promoting the growth of domestic demands. Especially after the global financial crisis, China withstood the impacts of the global economic downturn by employing the strategy of driving economic growth through domestic demand [7]. This has fully demonstrated the significance of consumption in promoting domestic demands and stabilizing the foundation for economic growth. From a logical perspective, increases in consumption directly stimulate the market demand for goods and services, thereby promoting companies to expand production and investment. The rise in market demand boosts both employment and residents' income. In addition, it promotes household consumption, developing a virtuous cycle of "consumption-production-income". It corresponds with the results of Dai et al., who found that as the consumption demand increases, the market expands production and introduces new technologies to meet the demand, which, in turn, promotes production efficiency and income growth, ultimately driving consumption growth and economic expansion [8].

3.2. Imbalanced Interactions Between Economic Growth and Household Consumption

Over the past decades, the rapid development of China's economy is mainly attributed to investment and exports. With the accomplishment of large-scale infrastructure development and industrialization, its growth mainly benefited businesses and government sectors instead of directly transforming into disposable income for residents. This has significantly restricted the capacity of economic growth to boost consumption, leading to a lag in economic growth [9].

Liu et al. conducted in-depth research on the coordinated relationship between Chinese household consumption and economic growth, conducting an empirical analysis of data from 1995 to 2012 using a Data Envelopment Analysis (DEA) model. By establishing a rating system, they analyzed the coordination degree between household consumption and economic growth, as well as the alignment between economic growth and the state of household consumption. The results show that the supportive role of economic growth on consumption is significantly weaker than the effects of consumption in driving economic growth, namely that there is room for improving the overall coordination degree between household consumption and economic growth [10]. The findings reveal a key problem exists during China's economic development, which is the imbalanced interactions between economic growth and household consumption. Although household consumption has an evident driving influence on economic growth, economic growth is unable to support consumption to the same degree, leading to a low coordination degree. This has increased the uncertainty of the economy regarding the external environment.

To address this problem, scholars have suggested that policymakers should recognize the importance of improving residents' disposable income, especially that of the low-income groups. The achievements of economic growth should benefit more people by adjusting the structure of income distribution. Additionally, the government should increase investment in public service sectors including medical care, education, and elderly care, and improve the coverage and quality of the social security system. These measures will reduce residents' concerns about future spending, lower precautionary savings, and ultimately encourage household consumption.

4. Conclusion

This paper comprehensively reviews and analyzes current literature, and explores the complex relationship between household consumption and economic growth. It finds that as China transforms into a high-quality economic development, household consumption, as the core driving force of the demand side, significantly drives economic growth. Consumption not only directly boosts market demand for goods and services but also indirectly propels the optimization and upgrading of industrial structure. It promotes the transition of the manufacturing industry to high-end intelligent technologies and advances the service sector. The emerging consumption patterns, such as those in the digital economy, e-commerce, and the sharing economy, have also bolstered economic growth.

As China enters the post-pandemic era, the impacts of shifts in consumer behaviors on economic recovery are becoming increasingly complex and diversified. The consumption pattern of the post-pandemic era will emphasize more on personalization, convenience, and safety, requiring the government to pay more attention to consumer environment optimization while promoting consumption growth. In the future, promoting consumption upgrading through technical innovation will become an important task with a focus on how to provide residents with a higher-quality consumption experience through new technologies and new

patterns. Meanwhile, the government should introduce more inclusive policies for development regarding the changes in social structure brought by the digital economy, thereby avoiding the exacerbation of consumption inequality due to the digital divide.

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