Per capita consumption function for China
- An empirical exercise -

Author*: Wang YANG

Abstract. An attempt is made in the present exercise to examine the empirical validity of the Keynesian consumption function for the Chinese economy for the period from 1978 to 2009 by fitting both linear and log linear per capita consumption functions underlying the assumption that there is one way causation between per capita consumption expenditure and per capita disposable income. The empirical results show that the Per capita Marginal propensity to consume is less than unity showing the pretence of marginal propensity to save. Further the results show that the Per capita elasticity of consumption expenditure with respect per capita disposable income is found to be unity both in linear and log linear per capita consumption functions in China.

Keywords: consumption function, incomes, Keynes.

Jel Classification: C10; E25; E12.

1. Introduction

It is known fact that the important contribution of Keynes to macro-economics was his absolute income hypothesis. The empirical validity of his absolute income hypothesis has been tested using both cross-section data and time series data for different countries in the world. The rate of change in consumption expenditure per unit change in disposable income varies from

* Wang Yang, Post Graduate Student, Dept. of Economics, Osmania University, Hyderabad-50007, (AP) India, E-mail: indiawangyang@yahoo.com.
country to country. The empirical knowledge on marginal propensity to consume [mpc] and elasticity of consumption expenditure with respect to the changes in disposable income [Epcce.pcdi] are required to comprehend the behavior of the consumers of the Economy. An attempt is made in the present exercise to test the empirical validity of the Keynesian absolute income hypothetic for China Economy using time series data.

2. Empirical Model

The empirical validity of Keynesian absolute income hypothesis is tested by fitting the both linear and log-linear per capita consumption functions to the time series data. With a view to examine the impact of rising population on consumption expenditure for the Economy of China the following forms of per capital consumption functions have been fitted to the time series data under the assumption that there is a one way causation between per capita consumption expenditure and per capita disposable income by ordinary least squares method. In order to correct the problems of autocorrelation and hetroscedasticity newey-west HAC standard errors have been used.

1. Linear Per Capital Consumption Function

\[
(C/P)_t = b_0 + b_1 (Y/P)_t
\]  

(1)

2. Log Linear Per Capital Consumption Function

\[
\log(C/P)_t = \log b_0 + b_1 \log(Y/P)_t
\]  

(2)

where:

\((C/P)_t\)=Per Capital Consumption Expenditure in current year [in RMB]
\((Y/P)_t\)=Per capital Disposable Income in current year [in RMB]

Per capita Marginal propensity to consume and per capita elasticity of consumption expenditure with respect per capita disposable income have been workout as follow:

1. Linear per capita consumption function

\[
\text{MPC} = \frac{d(C/P)_t}{d(Y/P)_t} \leq b_1 < 1
\]  

I(a)

Per Capital Elasticity of Consumption Expenditure with Respect to Per Capita Disposable Income

\[
\text{Epcce.pcdi} = \frac{d(C/P)_t}{d(Y/P)_t} \frac{d(Y/P)_t}{(C/P)_t} \geq \text{or} \leq \text{unity}
\]
2. Log Linear Per Capital Consumption Function

\[ E_{pcce, pcdi} = \frac{d \log(C/P)_t}{d \log(Y/P)_t} = b_1 \geq 1 \text{ or } \leq \text{ unity} \]

MPC = \( b_1 \cdot \frac{(C/P)_t}{(Y/P)_t} = b_1 < 1 \)

3. Data

Table 1. (1978-2009)

<table>
<thead>
<tr>
<th>Years</th>
<th>Annual Per Capita Consumption Expenditure of Urban Households (RMB)</th>
<th>Annual Per Capita Disposable Income of Urban Households (RMB)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PCCE</td>
<td>PCDI</td>
</tr>
<tr>
<td>1978</td>
<td>311</td>
<td>343</td>
</tr>
<tr>
<td>1980</td>
<td>424</td>
<td>478</td>
</tr>
<tr>
<td>1982</td>
<td>471</td>
<td>535</td>
</tr>
<tr>
<td>1984</td>
<td>559</td>
<td>651</td>
</tr>
<tr>
<td>1986</td>
<td>799</td>
<td>900</td>
</tr>
<tr>
<td>1988</td>
<td>1103</td>
<td>1181</td>
</tr>
<tr>
<td>1990</td>
<td>1279</td>
<td>1510</td>
</tr>
<tr>
<td>1992</td>
<td>1826</td>
<td>2027</td>
</tr>
<tr>
<td>1994</td>
<td>3179</td>
<td>3496</td>
</tr>
<tr>
<td>1996</td>
<td>3919</td>
<td>4839</td>
</tr>
<tr>
<td>1998</td>
<td>4332</td>
<td>5342</td>
</tr>
<tr>
<td>2000</td>
<td>4998</td>
<td>6280</td>
</tr>
<tr>
<td>2002</td>
<td>6030</td>
<td>7703</td>
</tr>
<tr>
<td>2004</td>
<td>7182</td>
<td>9422</td>
</tr>
<tr>
<td>2006</td>
<td>8697</td>
<td>11759</td>
</tr>
<tr>
<td>2008</td>
<td>11243</td>
<td>14781</td>
</tr>
</tbody>
</table>

The required time series data on consumption expenditure, disposable income in current prices and population for the period from 1978 to 2009 has been collected from the National Bureau of Statistics of China. The data collected has been converted into per capita form to perceive the impact of rising population with the changes in disposable income on consumption expenditure of the urban households.

4. Per Capita Consumption Function for China: Empirical Results

Visual Plot

The movements in Per Capital Consumption Expenditure [PCCE] in the current year and Per Capital Disposable Income [PCDI] in the current year in China during the period from 1978 to 2009 can be observed in Figure 1.

*Figure 1. In PCCE and PCDI in China: 1978-2009*

*Source:* Author’s calculations.
From the above figure it is clear that both Per Capital Consumption Expenditure in current year and Per Capital Disposable Income in current year in China during the period under consideration are moving in the same direction. The movements in Per Capital Consumption Expenditure are found to be somewhat as compared to the Per Capital Disposable Income in China during the period under consideration. The gap between Per Capital Consumption Expenditure and Per Capital Disposable Income is found to be increasing since 1994 leading to conclude that the per capita propensity to save of the households is rising in China.

**Per capita Consumption Function**

The regression results of the simple linear and log linear per capita consumption functions based on time series data are given in Table 2.

**Table 2: Regression Results of Per Capita Consumption Function For China: 1978-2009**

<table>
<thead>
<tr>
<th>Form of Equation</th>
<th>Estimated per capita consumption function</th>
<th>mpc</th>
<th>Epcce.pcdi</th>
<th>Annual Growth rate of Per capita consumption expenditure</th>
<th>Annual Growth rate of Per capita disposable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Linear</td>
<td>(\frac{(C/P)t}{(Y/P)t^<em>} = 156.82 + 0.76(Y/P)^t^</em>)</td>
<td>t = (2.17)</td>
<td>(r^2 = 0.991)</td>
<td>d = 1.52</td>
<td>0.76</td>
</tr>
<tr>
<td></td>
<td>(t = 1.52)</td>
<td>(37.09)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Log-Linear</td>
<td>(\log(PCE/PCDI) = 0.23 + 0.95\log(Y/P)^t^*)</td>
<td>t = (3.74)</td>
<td>(119.91)</td>
<td>(r^2 = 0.988)</td>
<td>d = 1.06</td>
</tr>
</tbody>
</table>

**Notes:**
1. * = Statistically significant at one percent level; 2. Figures within the brackets are t values based on Newey-West HAC standard errors and covariance; 3. Mpc = Per capita marginal propensity to consume; 4. Epcce.pcdi = Per capita elasticity of consumption expenditure with respect to per capita disposable income; 5. d = Durbin-Watson statistics

**Source:** Author's calculations.
The result is of the representation results shown in Table 2 show that the coefficients of per capital disposable income are found to be significant both in linear and log linear per capita consumption functions fitted to the time series data. The numerical values of the marginal propensity to consume both in linear and log linear consumption function are found to be less than unity confirming that these values are in line with consumption function. It is 0.76 in case of linear per capita consumption function and 0.74 in e of log linear per capita consumption function evincing the fact that a one unit in increase is per capita disposable income will lead to increase the per capita consumption expenditure by more than 0.74 units during the period under consideration in China. The proportion of explained variation in per capita consumption expenditure is very high due to per capita disposable income.

The responsiveness of the per capital consumption expenditure to the changes in per capita disposable income is found to be close to unity in case of log linear per capita consumption function and unity in case of linear per capita consumption function evincing the fact that a one percent increase in per capita disposable income will lead to increase the per capital consumption expenditure by the same one percent during the period under consideration in china. This shows that the annual growth rate of per capita consumption expenditure and per capita disposable income are found to be more or less equal.

**Shift in the per capita consumption function**

China joined the WTO in 2001 to have more freedom with foreign countries so far trade is concerned. There is a need to see the presence of structural shift [in terms of mpc and elasticity] in the per capita consumption function of the Chinese economy. Therefore chow break point test is calculated to search the presence of structural shift both in linear and log linear per capita consumption functions of the Chinese economy. The values of the chow test [F test] are given in Table 3.

<table>
<thead>
<tr>
<th>Form of equation fitted</th>
<th>F-test</th>
<th>Shift in the per capita consumption function</th>
</tr>
</thead>
<tbody>
<tr>
<td>(C/P)t=b0+b1(Y/P)t</td>
<td>1.26</td>
<td>No Shift</td>
</tr>
<tr>
<td>log(C/P)t=log b0+b1 log(Y/P)t</td>
<td>2.14 ns</td>
<td>No Shift</td>
</tr>
</tbody>
</table>

*Note:* ns=Not significant.

*Source:* Author’s calculations.
It is clear from the value of the F-Statistics that there is no shift in per capita consumption showing the presence of stability in the per capita consumption function in China during the period under consideration. Therefore there is no shift either in per capita marginal propensity to consume or per capita elasticity of consumption expenditure with respect to per capita disposable income in Chinese economy.

5. Conclusion

The present paper examines the empirical validity of the Keynesian consumption function for the Chinese economy for the period from 1978 to 2009 by fitting both linear and log linear per capita consumption functions underlying the assumption that there is one-way causation between per capita consumption expenditure and per capita disposable income. The results based on chow test show that there is no structural change in the per capita consumption function despite the fact that China joined the WTO in 2001 to have more freedom with foreign countries so far trade is concerned. The empirical results show that the per capita marginal propensity to consume is less than unity showing the presence of marginal propensity to save. Further the results show that the per capita elasticity of consumption expenditure with respect to per capita disposable income is found to be unity both in linear and log linear per capita consumption function showing that the proportionate change in per capita consumption expenditure is approximately equal to the proportionate change in per capita disposable income in China.

References