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Looking beyond the 'middle class' for other Chinas

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Looking Beyond the 'Middle Class' for the Other Chinas

A new perspective on China's consumer population.

by Qian Forrest Zhang

There are high hopes for China's middle class. Thanks to their rising disposable income, this group of Chinese is expected to unleash a consumer revolution in the domestic market. However, I argue that the 'middle class' as a concept provides at best a partial understanding of the Chinese consumer population; at worst, it can even provide a misleading perspective that brings us to erroneous conclusions about its profile and size. Instead, I propose the notion of 'three Chinas' as an alternative way to make sense of China's consumers. 'First China' comprises residents in medium and large-sized cities, 'Second China' consists of those living in small cities and towns, and 'Third China' refers to those in rural areas.

DESPERATELY SEEKING THE 'MIDDLE'

The middle class is not a new thing, even in China. In any society, there are always some middle strata. Even in Maoist China during the 1960s and 1970s, when the entire urban population was miserably poor, there was still what scholars have called the "Maoist middle class".[1] Of course, the image of this group clad in their blue and grey Maoist suits, riding bicycles to work at state-owned enterprises hardly generated any interest from businesses and marketers then.

The middle class that is of interest today consist of consumers who have attained, to use the official Chinese parlance, at least the level of 'moderate prosperity' (小康 or *xiao kang*). These moderately prosperous consumers have disposable income to spend on all kinds of discretionary goods and services, such as movies, massages, and restaurant meals. They are the 'fantastic beasts' that fascinate businesses all over the world. The challenge is, however, locating them.

Try using income for a start

Let us start with what is often thought to be an obvious yardstick—the income tax collections, on which China's government must have good data. The problem is that while the government does have good data on who pays the tax and how much they pay, the information at best gives us an incomplete picture of the income distribution in the country.

The threshold for paying personal income tax in China is RMB 5,000 a month (after social security deductions). A RMB 5,000-monthly income, thus, may very well be a useful standard to locate the middle class. How big a middle class would this criterion give us? In 2021, only 8.6 percent or 64 million of China's labour force paid any personal income tax. While 64 million is a big number, when juxtaposed against a national population of 1.4 billion, it is a huge disappointment.

A sizeable portion of the Chinese population does not pay personal income tax for three reasons. First, 80 percent of the population earn less than RMB 3,745 a month, and thus are not eligible to pay income tax. Second, nearly all farmers in China—somewhere between 200 and 300 million people—are small proprietors operating their own farms who have been exempt from paying agricultural tax, the equivalent of income tax for agricultural producers, since 2006. Third, an equally large proportion of the rural population, while no longer farming, have gone to live and work in urban settlements, working as delivery riders, construction workers, and restaurant servers in cities, to name a few occupations. In 2021, this population of 290 million people mostly toiled in the informal sector, working as contract workers who

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were self-employed, and not on regular payroll. Only a small proportion of them paid income tax. That being said, according to the National Bureau of Statistics, the average monthly income of this group of workers has reached RMB 4,432 in 2021.[2]

Do business analysts have better luck with this?

Apart from the issue that the estimates of China's middle class by business analysts are so much larger than those derived from official statistics, they are also never consistent. For example, McKinsey & Company estimated in 2013 that "by 2022… more than 75 percent of China's urban consumers" would fall into either the "upper middle class" or "mass middle class".[3] However, there is no justification for why 75 percent of the urban population living in cities of all sizes across the country could all be in the middle income bracket. In a more recent report, the income threshold for the middle class was revised upward to an annual household disposable income of RMB 138,000 (in 2018 real RMB terms), and the size of the so-called middle class in 2018 was estimated to be 400 million, comprising nearly half of the urban population.[4]

In fact, no matter whether the label is middle class or moderately prosperous consumers, those attempting to estimate the size of this consumer population in China face two inherent challenges. The first, as we have discussed, is the reliability of income data. And the second is regional disparities in income distribution. I will use the example of two provincial-level regions—Shanghai and Qinghai—to illustrate this issue. Shanghai is a metropolis on the east coast, while Qinghai is a vast province with a large ethnic minority population in the far west. In 2021, the disposable income per capita for residents in Shanghai was RMB 78,027; in Qinghai, it was about a third of that at RMB 25,919. While the income in Qinghai may seem hopelessly low, its residents enjoy a much lower cost of living. For example, the price for housing, which is the largest consumption item for most people, is RMB 9,876 per square metre in Xining, the capital city of Qinghai; in Shanghai, it is more than six times higher at RMB 67,714 per square metre. The level of income that qualifies one for middle class status, therefore, will be much lower in Qinghai than Shanghai. Hence, when results are so divergent as to be 344 million[5] on one end and 707 million[6] on the other end of the spectrum, any given number seems to be as good a guess as another, but none is particularly useful.

The problem is not that the consumer population in China is too small, or that there are too few consumers in the inland provinces. It is that the middle class is the wrong conceptual tool for this purpose. This search for some statistical distribution that yields a middle in fact misses the real target: the growing population of *xiao kang* consumers who straddle multiple income strata and live in all kinds of locations.

For a complex society like China with such a huge population that spans vast geographies, we should try a different approach. Instead of chasing an elusive number that accurately captures the size of the consumer population or nailing down how much individuals earn, it is at least equally important to know where they live.

However, there is also a prevailing misconception that they are overwhelmingly concentrated in the largest cities, known in China as the first- and second-tier cities. For example, another recent report from McKinsey claims that "China's 30 largest cities are home to 25 percent of the nation's population, who drive 45 percent of total household consumption".[7] This claim reflects an inadequate understanding of China's system of territorial administration. In a sense, nearly everyone in China 'lives' in a city because almost all settlements are under the administration of city governments. But even in the largest and most developed cities like Beijing and Shanghai, a sizable population can be found in small towns and rural areas that are under their jurisdiction. A city's population, from an administrative point of view, is thus invariably inflated.

Take Chengdu, the capital of Sichuan Province, for example. With a population of 21 million, Chengdu has under its jurisdiction 12 urban districts, three counties, and five county-level cities. However, only five districts constitute the city centre and they account for only 30 percent of its population. The rest largely live in rural areas and small towns outside the city centre. Thus, the real urban population physically residing in the city of Chengdu is actually far smaller than the population that is placed under the administration of the city government.

CONSUMERS IN THE OTHER CHINAS

Subsuming the rural population living within a city's administrative boundaries under its urban population is one mistake that leads to a more egregious one—not noticing that there is an additional and distinct stratum of the

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population that neither lives in the countryside nor is found in medium or large cities; they reside in small cities and towns.

One useful way to understand China is to see it as an aggregation of close to 3,000 county-level administrative units, comprising city districts, county-level cities, and counties.[8] The 948 city districts constitute the core urban built-up areas in medium to large cities. Their residents are what people commonly think of as the urban population in China. The situation in the county-level cities and counties is even more complicated. Under them are more than 38,000 towns and townships, and each in turn has a number of rural villages under their administration. Their population can either be urban residents living in small towns or rural ones residing in villages.

To give a sense of the figures for these groups, in 2020, the rural population numbered 510 million or 36 percent of the total population. The urban residents living in small towns and cities should be close to 400 million, almost 30 percent of the total population. This means that the vast majority resided in small towns and cities, as well as the rural areas. Hence, the rest, which is about 500 million or 35 percent of the total population, lived in medium to large cities.

I have therefore proposed segmenting the consumer population into three Chinas. First China comprises residents in medium and large cities, while Second China are those living in small cities and towns, and Third China refers to those in rural areas. When thinking about

consumers, most observers focus on First China. For example, in a recent analysis of new consumer trends which identified 'young free spenders' as today's growth engine, the scope was still limited to medium and large cities across Tiers 2, 3, and 4,[9] ignoring the development that the consumer population has also been growing in the Other Chinas found in the small towns and rural areas.

Let me first elaborate on the most neglected group that has contributed to the expansion of the consumer population in the other two Chinas in recent years—the rural population in Third China.

Third China

The rural population has been largely under-represented in consumer research on China. Many observers still equate this group with smallholding family farmers, who are struggling to make ends meet with meagre incomes from their harvests. This imagery is in urgent need of updating.

First, there is the rapid growth of large-scale farmers stemming from a series of fundamental changes that have taken place in China's agricultural sector.[10] It should be noted that, by 2020, over four million farmer households across the country have officially registered as 'family farms', which in the Chinese context requires them to be of a certain scale.[11] During my field work in rural China, I visited a farmer who had consolidated rice paddies over 700 hectares (close to the size of 1,000 soccer fields) in the outskirts of Chengdu, a dairy cow farm owner in Ningxia with a stock of 500 cows, and a vegetable farmer in

Jilin Province who exported a large quantity of asparagus to South Korea. Entrepreneurial farmers like them can be found everywhere in rural China, producing any agricultural product we can think of. Xiangzhai Village in central Henan Province, for example, is the largest koi fish production site in the country, where nearly every household runs koi ponds and sells its output on Taobao and other e-commerce platforms; annual household incomes over RMB 10 million are not uncommon in such villages.

Second, more rural entrepreneurs are running non-farm businesses. Thanks to both the industrialisation drive in the 1980s and 1990s, and the infrastructural expansion in recent decades, Third China is probably the most industrialised rural area in the world. These non-farm businesses can be small to medium manufacturing factories or companies operating in service industries such as transportation, food and beverage, retail, hospitality, and education. In one typical village on the North China Plain where I conducted fieldwork, one-fifth of the village households were operating non-farm businesses. Most of them were in the long-haul trucking business, owing to the village's advantageous location near a provincial highway toll gate. The largest operator had a fleet of 20 semi-trailers, hiring two professional drivers for each vehicle.[12]

Additionally, thanks to the rapid improvements in infrastructure, and rapid penetration of the Internet and smartphones, a class of new tech professionals has emerged in Third China. Many of them are returning migrants who had mastered new skills during their sojourn in the cities. The e-commerce sector alone has generated countless job opportunities for these new professionals, including Taobao shop owners and other e-retailers who sell not only local farm produce but also myriads of industrial products online, shopping assistants who help villagers with their online orders, and distributors that manage the deliveries. In fact, call centres for customer service have also been relocated to rural areas. The precise size of the emerging group of prosperous consumers in the rural areas is hard to estimate. But given that the rural population of around 510 million, even 10 to 20 percent would make them a sizable group.
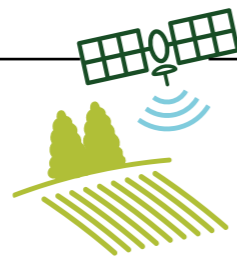
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Second China

As for small towns and counties making up Second China, many actually have vibrant economies and growing populations. These places often give people the impression that they are full of vacant high-rise buildings and have been abandoned by most young people who have migrated to larger cities for better job opportunities. While there are certainly cases like that, many are often the 'hidden champions' of various industries. The most famous example is Cao County in southern Shandong Province, which in 2021 unexpectedly became the subject of viral social media memes. Dubbed as the "No. 1 county in the universe", this county of 1.4 million became widely known for its dominant position in the costumes e-commerce market.[13] A quarter of all the costumes—used for myriad purposes such as cosplay, theatres, weddings, and festivals—sold through e-commerce platforms on the domestic market are made in Cao County. Once people started to pay attention to the booming costumes industry in Cao County, an even more fascinating story emerged. It turned out that the costumes industry in the county initially produced burial dresses, and the demand for burial dresses was created by the county's other leading industry—coffin-making. For a host of reasons, including a long tradition in carpentry and abundant supply of paulownia timber, the county has produced and sold coffins to Japan since the late 1990s. At one point, coffins made in Cao County dominated 90 percent of the Japanese market.

Many such hidden champions abound. While Cao County is probably the most well-known, it is but one of many scattered across the country. Xincheng is in Liaoning, a small, seaside, county-level city, which is a leading producer of swimwear and responsible for a quarter of the global output. Several small towns in Xuchang City, Henan Province, have become the largest production and distribution hub of hair products in the country, contributing to 80 percent of the global supply. Chang'le County in Shandong Province is the largest producer of guitars in the country, accounting for 36 percent of the domestic market share. Shaodong, a small county in the mountainous Hunan Province, produces 70 percent of the plastic lighters sold in the world. Danyang, a county-level small city in Jiangsu Province, has the most developed eyewear industry in the country, supplying 40 percent of the eyewear lenses on the global market. Nan'an, a county in Fujian Province, leads the country in sanitary ware production and has a 60-percent market share.

CONCLUSION

Outside the 200-odd medium and large cities (First China) which have attracted the most attention in consumer research on China, there is Second China consisting of residents of small towns and counties, and Third China comprising residents of rural areas. Together, this ensemble of Other Chinas has a population over 900 million. The number of moderately prosperous consumers among this 900 million-strong population can easily exceed 100 million, even reaching 200 million. To give some perspective, a country of 100 million residents would have ranked among the global top 15 in terms of consumer market size.

While these consumers may be scattered across a large number of small towns and even villages, they are not necessarily hard to reach. This is because the majority of them are located in the densely populated eastern half of the country and under the jurisdiction of a sizable city, where virtually all villages are connected by paved roads and remain within an hour's drive from the nearest town, if not the county seat. In fact, an increasing proportion of the more prosperous rural residents typically own two residences— a house on the family plot in the village and a new apartment in the county seat, which allows their children or grandchildren to register for schools in the latter. Many of them are just as digitally connected as their urban counterparts.

More importantly, this consumer population is likely to have significantly different consumption patterns and preferences from those of their cousins in medium and large cities. Although much remains to be investigated, it seems reasonable to anticipate that with considerably lower education levels and lesser exposure to global trends, these consumers are likely to be less cosmopolitan. They probably show a stronger preference for domestic brands or are simply less brand conscious. Given their limited access to physical stores, they may become more reliant on digital retail channels when these become more easily available and affordable. Obviously, we still have a lot to learn about consumers in the other Chinas. **AMI**

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Endnotes

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