

Credit for Peasant Households and Private Lending

WEN TIEJUN

Background and Problems

Under the double impact of macro conditions of the 1990s and prevailing internal factors, agricultural efficiency, rural employment, peasant income and investment went through a three-year period of sluggish growth since 1997. The long-standing question of incongruence between the rural economy and the national economy has gradually come into the open, and has become more complicated. There are five aspects to the problem.

1. Rising costs of agriculture

According to the Ministry of Agriculture and the State Statistics Bureau, since the 1990s, as a result of the freeze in growth of arable land and the inability of village labourers to switch to non-agricultural jobs, the cost of agricultural production increased by about 10 percent annually, while the cost of services increasing by 9 percent. The lack of demand for agricultural productions, which in turn is linked to the urban economy, has further aggravated the problem. The index for agricultural products is negative for the years after 1998, and the range of its decline is larger than the national consumer's price index. The decline in the price of agricultural products, in turn, puts limits on demand just as the increase in the price of agricultural products in 1994 pushed up the national consumer's price index.

The present problems cannot be resolved by the usual practice of further readjustment of agricultural structure and increase in agricultural

investment. What needs to be discussed is the effects of the subsidies to 900 million rural population in the form of the state setting the purchasing price of agricultural products – the effects are limited and ephemeral in leveling off the differences in gains within and outside agriculture, but this policy in effect pushes up the price of major agricultural products, rendering it impossible for competition in the international market.

2. *Negative efficiency in agriculture*

Bound by factors that cannot be changed, costs increase while prices go down. The result is a continuing decline in the ratio of agricultural output to input since 1997.

According to research conducted by the Ministry of Agriculture, under the impact of large increases in the prices of agricultural products as set by the state, the rate of increase of household income for peasants and the increase of income in the planting sector in proportion to that of borrowings for production is a factor of 4.83 and 1.05 respectively. Up till now, there is no reliable figure as to the effectiveness of borrowings for production. However, using the concept of marginal utility, one can say that an increase of one yuan in borrowings for production will bring an increase of 4.83 yuan in family income, and 1.05 yuan in the income of the farming sector. That is to say, in 1996, efficiency in agriculture was still positive. But things began to go wrong in 1997 and in 1998, with family income for peasants down by 3.25 percent. In 1999, family income further decreased by 64 yuan, while that of the sector by a staggering 552 yuan. Borrowings for production no longer brought increased income, but decreases. Farmland was abandoned. Since the reform began twenty years ago, per capita income for peasants went through a four-year fall for the first time.

3. *Village and township enterprises tend to depart from agriculture*

Although statistics show that the increase in the value of products in recent years still meets targets, in 1998, the increase in income and taxes was lower by 50 percent than the increase in value. There was a slight increase in 1999. The true picture is that investments in village and township enterprises have been falling since 1997. The problem of cash flow has forced many firms to stop production, or even to close down. Those that are still in production are less and less efficient. With firms having already switched to being capital intensive, it is impossible for them to absorb any increase in labour power. Moreover, the practice of turning village and township enterprises into share-holding companies (or privatised companies) is in itself one more step away from agriculture.

In the first place, the number of workers employed decreases by three to four million annually. Secondly, enterprises no longer commit themselves to subsidise agriculture, and to provide social security in rural areas or other forms of public goods that cannot be provided by the state. The abandonment of these roles, in turn, leads to the cancellation by the state of previous policy concessions. The net result is the quickening of the pace of turning enterprises from being employment-oriented to being profit-oriented. That is the reason why peasants' income is down, and local government debt is up.

4. *The worsening situation of debt in rural areas*

Since the policy of fiscal decentralisation in the mid 1980s and the tax reforms of 1994, local governments at both the village and the township levels were endowed with various fiscal powers, and the number of personnel paid by their budget grew. The burden put on peasants could then only be heavier. In recent years, budget deficits at grassroots-level governments have become widespread, and government investment in agriculture as a ratio of expenditure has fallen sharply to the lowest on record. In most agricultural areas, the transaction cost between government and the 900 million peasants has increased to such an extent that makes any transaction almost impossible. However, not only is agriculture unsustainable; it is also unable to pay taxes to the local government. Hence, the problem facing peasants becomes one of non-tax contribution.

Furthermore, due to the fact that local governments expand and the number of village organisations grows, money is borrowed under the thinnest pretext. The amount of debt begins to mount and to spread at great speed. According to the 1997 research conducted by the Ministry of Agriculture in seven provinces, the average amount of debt for a township level government is roughly two million yuan, and for the village level, 200 thousand. But in 1999, research conducted in some provinces indicated that the highest figure of 40 million was reached. In some places, peasants' means of production were forcibly taken away in order to make them pay various taxes. Cash-rich units and individuals seize the opportunity to lend at usury rates. Village committees are forced to borrow from these loan sharks to pay tax. To make matters worse, there is no reliable account of assets belonging to village collectives, so these assets are easily lost. 89 percent of the rural population has an income below average. The gap between rich and poor is widening. Security and unity are hard to maintain. As public goods are delivered from top down, even community self governance cannot manage internal affairs.

5. *Financial institutions continue to function as channels of rural capital outflows*

Faced with the above situation, official financial institutions are in a dilemma. On the one hand, as official institutions, banks and credit associations should, in principle, provide credit to peasants engaged in both agricultural and non-agricultural activities. But on the other hand, in accordance with the provision to avoid risky loans, small peasant productions do not qualify for loans. As a result, growth in agricultural credit is inevitably slow or even negative, and money flows out of rural areas which are constantly short of capital. This is not only seen from statistics compiled over the years, but also evidenced in the strong demands put forward by villages and the large amount of individual cases.

From observations at selected sites, in 1999, the average annual balance of deposits for the peasant household was 4,956 yuan, while the balance for loans was 1,726 yuan. The balance of deposit was much greater than that of loans. Compared to the 1995 figures, the balance of deposit grew by 80.6 percent while that of loans by 69.2 percent. The growth in the balance of deposit was quicker than that of loans. It is hence clear that there is a net outflow of capital at the present phase.

The Basic Conditions of Case Research

Our research consists of three parts. The first part is survey of the general economic conditions of villages. The second part is of those who have borrowed money, while the third is of those who have lent money. In fifteen provinces altogether, we obtained 57 cases of people who had borrowed money, but only 27 cases of people who had lent money, as some lenders refused to be interviewed.

Seen from our research, private lending, including usury, is both beneficial and harmful to the development of rural economy and the livelihood of peasants.

Villages covered by our research, and the interviewees

Our case research involved 41 villages spread throughout the eastern, central and western parts of China, covering 24 counties in 15 provinces. The villages chosen included those from the relatively well-off eastern part and from city suburbs in the central and western parts. Cases from these villages illustrate the condition of private lending in more developed areas. As the shortage of capital in these areas is less obvious, we do not focus on them in our analysis. As for the less developed villages in the

eastern part as well as the central and western parts, the shortage of capital is quite obvious, and can serve to illustrate the general condition.

As can be seen from our research, the relationship between lack of capital and economic backwardness is quite obvious. Poor resources, low level of economic development, and small-scale production are the pre-conditions for private lending to occur.

Our research shows that when peasant households have to engage in more diverse activities and when the scale is small, per-capita production is comparatively low (in our sample, the annual income for the household varies from 200 yuan to 5,000 yuan, but the majority falls within the 800-2,000 yuan range). For those households planting staple crops in particular, the per capita income is around 1,000 yuan. In most cases, the figure is reached because some members of the household work in the cities. Those with per capita income approaching 2,000 yuan are generally engaged in non-agricultural work such as animal husbandry, or vegetables and cash crops. Some are engaged in forestry with special products.

The widespread nature of private lending and borrowing

Our research is not based on sampling, but on taking statistics from the cases we gathered from 24 different locales in 15 provinces. We found that only in two locales were there private loans that were interest-free. In all other locales, private loans came with high interest rates. We may conclude from this that incidences of private loans are as high as 95 percent, while incidences of loans at high interest rate reach 85 percent. Although the north-east region is not covered in the present research, previous research on the region shows that a similar high transaction cost between official financial institutions and the peasant masses means that the demand of the latter is never met, and loans at usury rates among the peasants are the norm, with monthly interest rates as high as 20-40 percent. It can be concluded that private lending, especially lending at high interest rates, is a country-wide phenomenon; and our research suggests that the widening gap in income is one of the major factors. It is closely connected to the level of economic development, and the level of per capita income among peasants. The gap in income is especially pronounced within the same village. Figures show that incomes for two-thirds of peasant households are below the national average.

Complexity of the problem

From our research, it can be seen that private loans are no longer a simple economic problem.

In the first place, the problem has already affected various organisations at both the township and the village level. Many village cadres have acted as guarantors for loans. Some of them have in this way incurred heavy debts themselves. Some village committees lent to households at interest rates higher than those of banks. The problem is at the very heart of village organisations.

However, there are also cases where poor peasant households received loans from village collectives without any interest. Others borrowed from village co-operative savings associations at minimal rates. Hence, the participation of village organisation in private lending is not completely negative.

Secondly, private lending and borrowing have also affected the non-economic realms; and its influence is growing by the day. It is easy for conflicts to arise out of private loans. In our research, there are five incidents of conflicts, with three of them leading to scuffles, in one of which, people got injured. Another thing is that it leads to lawsuits. We encountered three such incidents, with only one having been resolved. The other two are considered by the court as too trivial since the sums involved are small. Some peasants even try divorce as a way to avoid payment of debts.

The third point to be noted is that borrowing, especially borrowing at usury rates, is often connected to gambling. Some lenders are gamblers. They recruit fellow gamblers to lend to their fellow gamblers. Gambling and usury are often inseparable.

Fourthly, the background of lenders as well as the sources of their capital are by no means simple. Besides rich peasants and relatives of cadres, some retired cadres use their pensions as capital for loans. Some have relatives abroad, and their regular remittances become capital for loans. Some farm equipment companies borrow at rates as high as 4 percent per month; and the sum involved amounts to 300,000 yuan. They also take other not-yet-due loans, and pay extra interest which amounts to 1.5 percent per month.

In some cases, money was first borrowed from private sources and deposited into a peasant household's account, so the household concerned qualifies for loans from the village credit association. When loans from official channels require loans from private sources in the first place, the latter spread further.

There are also cases which are quite troubling. When some borrowers are unable to pay back the loans, they are required to perform, without payment, certain tasks designated by the lenders. Some borrowers have to provide free service on a long-term basis.

Analysis and Recommendations

Whether seen from history, or from concrete research in villages, the conclusion one can come to is that given the fragmented nature of small-scale farming, formal financial institutions operating on a commercial basis cannot meet the diverse needs of peasant households since the transaction cost involved is much too high. With such a view, private loans are inevitable in a setting where capital is in short supply, and where people are tied to forms of subsistence or semi-subsistence farming which must endure long production cycles, low return and high risk.

One-third of private loans is co-operative in nature, and comes with low interest or even no interest. However, in an environment of privatisation in which the profit motive is the overriding factor, private lending at high rates is again inevitable.

Hence the way forward as regards financial policies for rural areas is to maintain and enhance the growth of community-based co-operative funds, which were once established in rural areas.

The function of private loans in maintaining the reproduction of small-scale agriculture

Although the practice of lending at high rates is the norm for private loans and therefore constitutes exploitation of labour by capital, the fact is that the state has neglected to establish a system of social security for peasants; and insurance companies have long since departed from the rural scene, leaving most peasants with nothing to fall back on. Given the fragile nature of small-scale production, a small mishap can turn out to be a major disaster for peasants. In most cases of borrowing at high rates, the decision is taken precisely to forestall a small mishap becoming a major disaster. Despite their dire conditions, peasants do have labour power in abundance; and both the creditors and they themselves know very well that when their abundant labour is harnessed, the payment of interest will be met.

International experience: establishing local credit systems through "market internalisation"

Throughout mainland China, Japan, Korea and Taiwan, agricultural production in rural areas, where blood ties are the single most important factor of social integration, is characterized by small-scale farming. These countries, as well as their local governments, have long realised that such

a method of production, which involves long cycles, high risks and comparatively low returns, is unfit for competition in international markets. If forced to take part, the already scarce capital in rural areas will only be further drained. Such problems can only be resolved by means of market internalisation. With the exception of China, governments of countries in East Asia have all implemented policies to protect peasants, and have exempted them from taxes. There is also a complete overhaul of the system of rural finance, and community financial co-operatives serving the needs of small-scale agricultural production are set up.

In addition, in the developed countries of Europe and America as well as developing countries such as Mexico, India and Thailand, NGOs in the countries have developed a wide range of alternative money and local currency, such as Ithaca Hours and Times Dollar in America, the popular LETS in Great Britain and Canada, and Tlaloc in Mexico. We have also made studies on these.

Although China formally dissolved community co-operative funds in 1997, the ensuing growth of private loans has vindicated its desirability. Precisely in places where such funds still operate, the drain of capital from rural areas is much less acute, and private lending at high rates is held in check. Such funds have achieved the one thing that cannot be achieved under normal market conditions - that is to use capital that comes from peasants for the betterment of peasants.

Transform private finance, develop community cooperation

In traditional rural areas, the subjects of rural economy and investment have changed from that based on the government and banks, to that which is based on peasant households and village organisations. Objectively speaking, peasants are now required to go their own independent way. We should learn from the experience of other countries in East Asia and by means of market internalisation, to transform private financial bodies that have already become quite common into well-regulated community financial co-operatives.

In this regard, the government must pass laws that would legally bind financial co-operatives to operate within a certain community and to model themselves not as banks, but as alternative financial institutions that do not treat profit-seeking as the overriding principle. At the same time, the government can channel funds earmarked for agriculture through these co-operatives or encourage them to work with the agricultural banks. In this way, government funds are guaranteed to reach the grassroots level and at the same time help to quicken the pace of institutionalisation of financial co-operatives.

As regards credit guarantees, it is not necessary for community financial co-operatives to set aside a special precaution fund or to meet the stringent requirement of commercial banks. Instead, what is required will be to carry out a general audit of collective assets, and turn debts still owed to the collective into the form of loans. With the finances of the collective completely transparent, the foundation is laid for transforming collective assets into capital for development. As villagers are closely connected by kinship ties and once everyone becomes a member, to borrow from the co-operative is tantamount to borrowing from the entire village. As everyone in the village has vested interest, non-payment of loans will be something unthinkable. Besides, there is the authority of the village committee and the government.

We think the most pressing problem at the moment is, taking as reference the cooperative principles in international experience, to quicken the promulgation of the cooperative law, and implement a set of comprehensive policies that would address the problems of operation of scale for small-scale farming, so that cooperatives will be instrumental to developing institutions that are external to agriculture, such as institutions of finance, insurance, processing and marketing.

Translated by Ma Kwok Ming, John

This paper appeared in Chinese in the "Forum of 50 Scholars", at website www1.cei.gov.cn/forum50/doc/50cyfx/200107311731.htm. The chief investigator and writer of this project was Wen Tiejun, at the time Research Fellow of Rural Research Centre, Ministry of Agriculture. Co-investigators included Feng Kaiwen from University of Agriculture of China, and others.