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## **Sustaining China's Rural Development under Global Economic Instability: Some Critical Issues**

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### **Introduction**

China's exports shrank by 16 percent in 2009 amid the global financial crisis originated in the US. The incomplete recovery of the US economy in 2010 is followed by the debt crisis in Europe. Tightening fiscal expenditure by European governments implies tapering growth in those countries and Europe as a whole. Accompanied with depreciating euro, China's exports will be unavoidably affected adversely as Europe has been the biggest export market of China. The impact of European debt crisis on China's enterprises and employment may not be less severe than that of the US sub-prime mortgage crisis. Global economic instability prompts China's central leaders to reorient China's growth strategy towards more domestic consumption. This paper argues that the success of the new growth scenario rests not only on urban

consumption, but also on its rural counterpart. The increased budget expenditures in the countryside on infrastructure development, compulsory education and medical services in recent years have lightened the burden of rural dwellers, but the rural-urban gap, in both income and consumption remains substantial. This paper propounds that a clear delineation and enforcement of property rights and prompt development of rural financial markets is a key to sustain China's rural economic growth, which has direct bearing on government's recent efforts on promoting domestic demand to cushion the economy from global financial instability.

### **From Asian to Global Financial Crisis: China's Policy Responses**

Compared with its Asian neighbours, China was less affected by the Asian financial crisis in 1997, but China was not completely insulated from the financial contagion. Its exports showed a meagre growth of 0.41 percent in 1998, which was a record low since the implementation of economic reforms in the late 1970s.<sup>1</sup> The average annual growth rate of industrial production, measured in real term, declined from 16.85 percent for the period 1991-1996 to 11.3 percent in 1997 and the figure dropped further to 8.9 percent in 1998.<sup>2</sup> The central leaders were alarmed by the figures released by the State Statistical Bureau (now National Bureau of Statistics of China) that the GDP growth in the first half of 1998 could only barely reach 7 percent, instead of the pre-set target of 8 percent (Brahm 2002: 101). This one percent fall short of the pre-set target might mean a substantial rise in unemployment.<sup>3</sup>

To contain the repercussion of the crisis, China adopted measures to safeguard its external sector. However, China refrained from devaluing its currency to stimulate exports lest it would generate another round of currency devaluation in the region. Instead, China turned to the still-booming Western economies through a series of trade missions to overseas markets to encourage large corporations to purchase from

Chinese export enterprises (Chance 2010: 57).<sup>4</sup> On the other front, China toughened its efforts in WTO (World Trade Organization) admission. A milestone was reached in 1999 that China signed a bilateral trade agreement with the US, through which China was granted a “permanent normal trade relations”. China agreed to lower its average tariff from 22.1 percent to 17 percent in exchange for US support for its WTO admission (Xiao and Fang 2000: 209). Domestically, China boosted exports by granting rebates on export tax, through which broaden the profit margin of exporting enterprises. The export promotion policies proved to be successful, as evident by substantial rebound of export growth of 6.2 percent and 27.7 percent in 1999 and 2000 respectively.<sup>5</sup> In terms of export markets, China’s exports had tilted towards Western markets after the 1997 Asian financial crisis. On the eve of Asian financial crisis, Asian countries consumed 60.4 percent of China’s exports and the figures declined continuously during the post-crisis period. On the contrary, the share of Western markets, in particular the European countries, has demonstrated steady growth (Table 1).

**Table 1: Percentage Share of China’s Export Markets 1990-2008**

	<i>1990</i>	<i>1996</i>	<i>1998</i>	<i>2000</i>	<i>2005</i>	<i>2008</i>
<b>Asia</b>	71.75	60.40	53.43	53.09	48.09	46.42
<b>Africa</b>	2.09	1.70	2.21	2.02	2.45	3.58
<b>Europe</b>	15.01	15.80	18.19	18.25	21.74	24.00
<b>Latin America</b>	1.26	2.07	2.90	2.88	3.11	5.02
<b>North America</b>	9.03	18.73	21.82	22.18	22.92	19.17
<b>Other</b>	0.86	1.30	1.45	1.57	1.69	1.81
<b>Total</b>	100	100	100	100	100	100

Source: Calculated based on the data from *ZGTJNJ* 1992: 632-634 ; 1997: 594-596; 1999: 583-585; 2001: 591-593; *ZGTJNJ* CD-ROM (2006: Table 17-8; 2009: Table 17-8)

The 2008 global financial crisis alerted China's central leaders that the predominant reliance on exports to maintain growth and to create employment could be very fragile and unstable. Along with the global financial turmoil, China's export dropped 16.8% and net exports declined 10.1 percent in 2009.<sup>6</sup> Uncertainty hangs once again over China's external sector amid Europe's debt crisis in 2010. Numerous European countries have started its tightening in fiscal expenditure.<sup>7</sup> If the substantial cut in fiscal budget in Europe is realised, economic contraction will certainly be considerable, which will cause a decline in demand for imports. The impact on China's exports will not be less severe than that brought about by the sub-prime mortgage in the US, as Europe is China's second largest export market (Table 1). The share of net exports (NX) in China's GDP was only 2.24 percent in 1990 and peaked at 7.74 percent in 2007, though it experienced a downturn in 2008 and 2009.

It is worth noting that the impact of exports in China's economy should not be perceived merely from the contribution of NX to GDP. Empirical evidence indicate that demand for China's exports triggers significant linkages effects, including production, consumption, investment, and employment in others sectors. Using panel data of China's 27 provinces, Cui, Shu and Su (2009) estimate that 1 percent increase in export stimulates 0.1 percentage point increase in production, 0.18 in investment, 0.04-0.06 in consumption, and 0.05 to 0.32 in employment. The impact is stronger for those provinces with large exposure to exports. Based on input-output datasets for 1995 and 2005, Chen *et. al.* (2009) estimate that for every US\$1,000 of Chinese exports, domestic value-added and employment were increased by US\$466 (US\$545) and 0.242 (0.375) person-year in 2002 (in 1995). Chin (2010: 19) shows that manufacturing employment in China has a significant correlation with new export orders. Though the results vary among these empirical studies, they consistently

reveal the noteworthy impacts of China's exports on domestic production and employment. The findings are consistent with the massive factory closure in Guangdong, China's largest manufacturing and exporting base, under the global economic crisis in 2008. It was reported that about 62,420 businesses was shut down in Guangdong in 2008.<sup>8</sup> About 20 million migrant workers lost their jobs, about 15.3 percent of total migrant workers, returned to their hometown in the countryside, which intensified the already pressing problem of surplus labour in rural areas.<sup>9</sup>

**Table 2: China's Net Exports and its Share in GDP 1990-2008 (billion US\$)**

Year	Exports (X)	Imports (IM)	Trade Surplus (NX= X-IM)	NX/GDP (%)
1990	62.09	53.35	8.74	2.24
1995	148.88	132.08	16.70	2.29
2000	249.20	225.09	24.11	2.01
2003	438.23	412.76	25.47	1.55
2004	593.32	561.23	32.09	1.66
2005	761.95	659.95	102.0	4.56
2006	968.94	791.46	177.48	6.68
2007	1217.78	955.95	261.83	7.74
2008	1430.69	1132.56	298.13	6.89
2009	1190.0	922.0	268.0	5.45

Source: *China Statistical Abstract* (2006: 168); *ZGTJNJ CD-ROM* Table 2-1 & 17-1; 'China Trade Statistics 2009' <http://import-export.suite101.com/article.cfm/china-trade-statistics-2009> (accessed on 8 June 2010); 'China's GDP Growth 1952-2009' <http://www.chinability.com/GDP.htm> (accessed on 8 June 2010)

The dynamic growth of the Chinese economy cannot be detached from its external sector, but the central leaders were alerted by the economic crises that China can be very vulnerable to external shocks if it continues to rest its growth on export drive. To establish a more balanced growth model, China has recently stressed the importance of enhancing domestic consumption to buffer potential external disturbances. On top of launching the 4-trillion yuan stimulus plan to boom domestic investment, the Chinese government has initiated policies, such as subsidizing the purchase of low-emission cars and electrical appliance in rural areas, to entice

household consumption since 2009. The preliminary result is positive, with domestic consumption rising by 15.5 percent, which amounted to 12.53 trillion yuan in 2009.<sup>10</sup> Majority, about 54.3 percent, of the population is still residing in rural areas,<sup>11</sup> but the urban-rural consumption ratio has remained at a high level of 3.1 in 2008 (Table 3). The huge consumption gap is largely due to the yawning urban-rural income ratio, even though the government has designed and implemented policies to improve the livelihood of rural residents and promote development in the countryside in recent years.<sup>12</sup> More wealthy urban residents, in general, has lower marginal propensity to consume (MPC), while their rural counterparts demonstrate a higher MPC. However, the relatively low-income rural residents had already spent about 43 percent of their household income on food consumption, as indicated by the Engel's coefficient (Table 4),<sup>13</sup> which constrained their spending on consumer durables. To tap into the potential of rural consumption, the crucial step is to ensure stable and sustainable income growth in the countryside.

**Table 3 Urban-Rural Income and Consumption Ratio 2005-2008**

Year	Urban-Rural Income Ratio	Urban-Rural Consumption Ratio
2005	3.22	3.11
2006	3.27	3.07
2007	3.32	3.10
2008	3.36	3.07

Source: Calculated based on the data from *ZGTJNJ* 2005, p. 335; *ZGTJNJ* 2008 (CD-ROM); China

'Rural-urban Income Gap Up As Economy Slows,' CBS News.com

<http://www.cbsnews.com/stories/2009/01/16/ap/business/main4726425.shtml> (accessed

on 5 Jan 2010); USDA (United States Department of Agriculture) Economic Research Service Data Set

<http://www.ers.usda.gov/data/china/NationalResults.aspx?DataType=1&DataItem=15>

[8&StrDatatype=Rural+per+capita+consumption&ReportType=2](http://www.ers.usda.gov/data/china/NationalResults.aspx?DataType=1&DataItem=15&StrDatatype=Rural+per+capita+consumption&ReportType=2) (accessed on 4 Jan 2010)

**Table 4 Engel's Coefficient in Urban and Rural Areas 2005-2008 (%)**

<b>Year</b>	<b>Urban Areas</b>	<b>Rural Areas</b>
<b>2005</b>	36.7	45.5
<b>2006</b>	35.8	43.0
<b>2007</b>	36.3	43.1
<b>2008</b>	37.9	43.7

Source: ZGTJNJ 2008 (CD-ROM: Table 9-2)

Rural residents derive income from either farming or nonfarm activities. Income from farming depends on secure land rights, which incentivize farmers to invest more in long-term productive projects. Higher land productivity, in turn, translates into higher income. However, land expropriation by local governments without proper compensation not only creates hardship to peasants, but also hinders their willingness to invest. The underdeveloped financial market in rural China further impedes farmers' investment. On a related front, inadequate financial services have inhibited the development of nonfarm activities, mainly rural industry, which slows down the absorption of rural surplus labour. Income enhancement in China's countryside therefore lies critically on securing property rights, more specifically land rights, to the farmers, and prompt development of rural finance.

### **Loosely Enforced Property Rights: Hindrance to Income Growth**

The inauguration of rural reforms in the late 1970s was followed by a number of documents and laws to endow farmers with long term contracts for land use rights, with an aim to motivate farmers to invest more on their contracted land. The No.1 Documents issued in 1984 was the first important document prescribing a 15-year contract period for rural land use rights (OECD 2009: 127). The Land Management Law (LML) enacted in 1998 further stipulates that farmers are entrusted with 30-year use right of the contracted land. A survey indicates that three years after the implementation of the LML, 47 percent of farm households had entered into 30-year

contract.<sup>14</sup> This 30-year contract was a milestone in the course of development of China's land contract system, as it allows a long enough contract for farmers to make their investment and more importantly, to capture the returns on their investment. The Rural Land Contracting Law (RLCL) passed in 2002 states clearly the land use rights of the farm households and eliminates possible grounds for readjustments and expropriations by local governments. The RLCL requires that contracts and full documents must be issued to confirm the land rights possessed by the farm households (Zhu and Li 2007: 24). To enhance the flexibilities of participating in nonfarm activities by the farmers, the RLCL details farmers' right to lease (i.e. transfer) their contracted land. It enables farmers to transfer the land rights to capture potential income and retained their land rights after the transfer period.

Even with a firmer legal foundation, the effective implementation of the RLCL is hampered by a lack of land registration system in the countryside, unlike their urban counterparts who can register their land and structures with the local offices of Ministry of Land and Resources. According to the LML and the RLCL, farmers should be issued contracts and certificates containing the details of their contracted land and the rights they are entitled.<sup>15</sup> However, a 2005 survey revealed that 63 percent of the farmers received very brief documentation for their contracted land. Among those documents, only about 10 percent of these farmers receive legally compliant documentation containing the details, such as names of households, contract duration and land description) of the contracted farmland (Zhu and Li 2007: 24). A follow-up survey by Prosterman *et. al* (2009)<sup>16</sup> indicates that 41.8 percent of farm households were not issued any documents regarding their land rights. This result shows that marginal progress was made towards the protection of the famers' entitlement to land rights. The loose implementation of RLCL largely explains the

rampant land expropriations by local governments with partial and/or delayed compensation. The survey exposes that 34.1 percent of farm households had experienced land readjustments and most of these readjustments are illegal.<sup>17</sup> On top of land readjustment, land taking poses even a bigger threat to farmers. Since the implementation of the LML in 1998, 29.2 percent of farm households reported that they had encountered one or more land takings. The LML allowed local governments to requisition land for development “in the public interest”, but empirical evidence revealed that about one third of the purposes of land takings can hardly be categorized as projects for public interest (Table 5).<sup>18</sup> Since “public interest” is ambiguously defined in the LML, the local governments are entrusted with plenty legally justifiable reasons to requisition farmland (Kwong 2007: 403).

**Table 5 Purpose of Land Seizure 2008**

<b>Purpose</b>	<b>Percentage</b>
Road Construction	47.4
Development zone/industrial park	12.9
Factory	9.1
Urban housing	6.4
School	5.9
Planned for non-agricultural use but currently vacant	4.0
Irrigation facility	2.7
Gas station	0.9
Others	10.7

Source: Prosterman et. Al. (2009: 17)

Local governments' land expropriation has become more frequent since the mid-1990s when the central government implemented the tax-assignment system (TAS, *fengshuizhi*). Since 1978, the central share of national budgetary revenues had been rising and reached its peak at 40.5 percent in 1984. However, the share had shrunk since 1984, reaching a trough at 22 percent in 1993. To ensure an adequate and stable flow of budgetary revenues into the state finances, the central government implemented the TAS which centralized the major revenue sources of turnover taxes (value-added and consumption taxes), but lacks a concomitant centralization of expenditure responsibilities. Table 6 indicates that the central share of total budgetary revenue escalated from 22 percent in 1993 to 55.7 percent in 1994. Since then, the central government has collected about half of the total fiscal revenues. Nevertheless, local governments have been responsible for the major share, about 70 percent, of the total expenditure since the inception of the TAS. The TAS has imposed increased fiscal pressures on subnational, in particular subprovincial, finance.<sup>19</sup> Table 7 explores further the fiscal conditions of local governments. The extent of budget deficit (or surplus) is measured by the ratio of local government expenditure (LGE) to local government revenue (LGR) [column (4)], which represents a balanced budget if the ratio is equal to one. A ratio greater than one denotes a budget deficit and a larger figure indicates a budget deficit of greater extent. A ratio less than one reflects a budget surplus and a smaller figure registers a larger surplus. Dramatically, local governments encountered deficits for all the years from 1994 to 2004 and the magnitude of the deficits was more immense than that before 1994. Stringent fiscal constraints trigger local governments to explore other sources to finance their coffers. Land requisition by local governments becomes a commonly used means to raise local fiscal revenue.

**Table 6 Central and Local Share of Budgetary Revenue and Expenditure 1978-2008 (Percent)**

Year	Revenue Share		Expenditure Share	
	Central Government	Local Governments	Central Government	Local Governments
1978	15.5	84.5	47.4	52.6
1979	20.2	79.8	51.1	48.9
1980	24.5	75.5	54.3	45.7
1981	26.5	73.5	55.0	45.0
1982	28.6	71.4	53.0	47.0
1983	35.8	64.2	53.9	46.1
1984	40.5	59.5	52.5	47.5
1985	38.4	61.6	39.7	60.3
1986	36.7	63.3	37.9	62.1
1987	33.5	66.5	37.4	62.6
1988	32.9	67.1	33.9	66.1
1989	30.9	69.1	31.5	68.5
1990	33.8	66.2	32.6	67.4
1991	29.8	70.2	32.2	67.8
1992	28.1	71.9	31.3	68.7
1993	22.0	78.0	28.3	71.7
1994	55.7	44.3	30.3	69.7
1995	52.2	47.8	29.2	70.8
1996	49.4	50.6	27.1	72.9
1997	48.9	51.1	27.4	72.6
1998	49.5	50.5	28.9	71.1
1999	51.1	48.9	31.5	68.5
2000	52.2	47.8	34.7	65.3
2001	52.4	47.6	30.5	69.5
2002	55.0	45.0	30.7	69.3
2003	54.6	45.4	30.1	69.9
2004	54.9	45.1	27.7	72.3
2005	52.3	47.7	25.9	74.1
2006	52.8	47.2	24.7	75.3
2007	54.1	45.9	23.0	77.0
2008	53.3	46.7	21.3	78.7

Source: ZGTJNJ (2000: 267-68; 2001: 257-258; 2005: 276); ZGTJNJ 2008 CD-ROM (Table 7-3 & 7-4); ZGTJNJ 2009 CD-ROM (Table 7-3 & 7-4)

**Table 7 Budget Balance of Local Governments 1978-2008** (billion yuan)

Year	LGR (1)	LGE (2)	LGR – LGE (3)	LGE/LGR (4)
1978	95.65	56.00	39.65	0.59
1979	91.50	62.67	28.83	0.68
1980	87.55	56.20	31.35	0.64
1981	86.47	51.28	35.19	0.59
1982	86.55	57.82	28.73	0.67
1983	87.69	64.99	22.7	0.74
1984	97.74	80.77	16.97	0.83
1985	123.52	120.90	2.62	0.98
1986	134.36	136.86	-2.5	1.02
1987	146.31	141.66	4.65	0.97
1988	158.25	164.62	-6.37	1.04
1989	184.24	193.50	-9.26	1.05
1990	194.47	207.91	-13.44	1.07
1991	221.12	229.58	-8.46	1.04
1992	250.39	257.18	-6.79	1.03
1993	339.14	333.02	6.12	0.98
1994	231.16	403.82	-172.66	1.75
1995	298.56	482.83	-184.27	1.62
1996	374.69	578.63	-203.94	1.54
1997	442.42	670.11	-227.69	1.51
1998	498.40	767.26	-268.86	1.54
1999	559.49	903.53	-344.04	1.61
2000	640.61	1036.67	-396.06	1.62
2001	780.33	1313.45	-533.12	1.68
2002	851.50	1528.14	-676.64	1.79
2003	984.99	1722.98	-737.99	1.75
2004	1189.33	2059.28	-869.95	1.73
2005	1510.07	2515.43	-1005.36	1.67
2006	1830.36	3043.13	-1212.77	1.66
2007	2357.26	3833.93	-1476.67	1.63
2008	2864.98	4924.85	-2059.87	1.72

Source: Calculated based on the data from *ZGTJNJ* (2001: 257-258; 2005: 276); *ZGTJNJ 2008 CD-ROM* (Table 7-3 & 7-4); *ZGTJNJ 2009 CD-ROM* (Table 7-3 & 7-4)

Rural protests over land disputes have widely been reported for more than a decade. Based on survey data from four provinces, Kang (2009) revealed that the net income of the majority, 53.3 percent, of households declined while only 23.8 percent of the households enjoyed higher net income after land expropriation. 87.7 percent of land-losing farmer regarded their compensation too low. The findings by Prosterman et. al. (2009: 18) further illustrates that local governments/collectives have derived considerable fiscal revenue from land requisition at the expenses of land-losing farmers. On average, collectives received compensation of 15,000 per *mu*,<sup>20</sup> which is five time of the payment received by the farmer (i.e. 2,500 per *mu*). Though available

data on land requisition and compensation is sketchy and varies across different localities, the above survey results shed some light on the discontent of the farmers, and the tension between land-losing farmers and their local governments. Loosely enforced property rights on farmland generate two negative impacts on rural productivity. First, farmers are reluctant to make long-term investment in their contracted land which in turn adversely affected productivity. Second, land expropriations deprive farmers' rights to lease their land to capture the market rental. It is estimated that the land value per hectare was about 10,000 yuan in 2008.<sup>21</sup> With 120 million hectares of farmland in China, the total land value amounts to about 1.2 trillion yuan. If land rights of the farmers are effectively protected and they can derive their exclusive income from their land, the rural-urban income gap can be narrowed. It will certainly lift the disposable income and consumption of rural residents.

China has enacted and amended a series of land laws and regulations to secure farmers' land rights,<sup>22</sup> but the enforcement of property rights requires an effective implementation of the relevant rules, which in turn relies on a sound legal/court system in the countryside. Local courts have so far been embedded in local governments, which have dominant control on finance of the courts. The financial dependence of local courts on local governments adversely affects the impartiality of court rulings. Even when the local courts issue rulings in favour of the farmers, it is not uncommon that the local governments just neglect the courts' ruling (OECD 2009: 122). The ineffective court system in the countryside is the weakest link to protect the land rights of the farmers. Once the land rights of the farm households are secured, farmers will have robust incentives to preserve and invest in their land to maximize productivity. Secured land rights also endowed farm households with an option to lease out their land to higher value users, which not only increases the land value of

the countryside, but more importantly enhances rural household income.

### **Rural Finance: A Development Bottleneck**

Aside from deriving income on farmland, nonfarm activities, mainly rural industry, has become another main source of rural income since the mid-1980s. In 1985, farming generated 75.4 percent of rural household income and the figures diminished to 43.9 percent in 2008. On the contrary, nonfarm income has been gaining its share in rural income from 24.6 percent in 1985 to 56.1 percent in 2008, which indicated that rural residents have relied increasingly on nonfarm activities to maintain their income growth (Table 8). In addition, the proliferation of rural industry in the 1980s and 1990s assumed an important function of absorbing surplus labour released from the agriculture. Rural enterprises employed 30 million of workers in 1980 and the number skyrocketed to 111.69 million in 1990, demonstrating a growth of 2.72 times during the 1980s (*ZGTJNJ* 2005: 121). However, employment creation by rural enterprises was impeded by the implementation of banking reform in 1994, which aimed at commercialising the four state-owned specialised banks (SOCBs)<sup>23</sup> by separating commercial lending from policy lending, unintentionally resulted in noticeable capital constraints facing the small- and medium-sized private enterprises, particularly those in rural areas. Since the SOCBs were required to operate on commercial principles, 44,000 county branches of SOCBs ceased to operate during 1998-2001 to cut operation costs.<sup>24</sup> Loans extended to township-village enterprises (TVEs) and private enterprises (PEs) increased in absolute term from 1985 to 2008, but its share in total lending by financial institutions demonstrated a decreasing trend (Table 9), which reached a historic low of 2.16 percent in 2008. Compared with the output share of rural enterprises in GDP, which maintained at about 25 percent since 2000 (Naughton 2007: 286; OECD 2009: 64), the negligible share of total lending acquired by rural enterprises exhibited the difficulties of accessing credit in the countryside. The enterprises have to utilise their accumulated profits to finance their production and

investment. However, rural enterprises face keen competition among flourishing TVEs and the state-owned enterprises (SOEs) that have much more easy access to bank credit. Rural enterprises are less likely to acquire ample capital to invest in product design and quality improvement. The expansion of rural enterprises is thus constrained and it impairs the ability of rural enterprises to absorb rural labour. The growth rate of employment in rural enterprises has been decreasing since 1995 and negative growth was recorded for two consecutive years in 1997 and 1998. Though the figure rebounded to 4.5 percent in 2005, it tapered off once again in recent years (Table 10). It is worth noting that the years with low employment growth corresponded to the years with relatively low income growth of rural households, in particular for the second half of the 1990s. It implies that nonfarm employment has direct bearing on household income, which in turn determines the level of consumption.

**Table 8 Farm and Nonfarm Income in Rural China 1985-2008**

	<b>Income from Farming (yuan) (1)</b>	<b>Income from Nonfarm Activities * (yuan) (2)</b>	<b>(1) + (2)</b>	<b>(1)/ (1) + (2) (%)</b>	<b>(2)/ (1) + (2) (%)</b>
<b>1985</b>	263.2	86.3	349.5	75.3	24.7
<b>1990</b>	456.0	201.4	657.4	69.4	30.6
<b>1995</b>	956.5	563.3	1519.8	62.9	37.1
<b>2000</b>	1090.7	1083.9	2174.6	50.2	49.8
<b>2005</b>	1469.6	1637.0	3106.6	47.3	52.7
<b>2008</b>	1945.9	2491.5	4437.4	43.9	56.1

Note: \*Transfer income is not included in nonfarm income.

Source: Calculated based on the data from *ZGTJNJ* (1986: 647); *ZGTJNJ 2009* CD-ROM (Table 9-20)

**Table 9 Share of Loans to Rural Enterprises 1985-2008 (billion yuan)**

	<b>Total Lending by Financial Institutions</b>	<b>Loans to Agriculture</b>	<b>Loans to TVEs</b>	<b>Loans to PEs and Self-employed Individuals</b>
<b>1985</b>	643.09	41.66 (6.48)*	32.13 (5.0)^	n.a.
<b>1990</b>	1683.78	103.81 (6.17)	83.13 (4.94)	n.a.
<b>1995</b>	5398.90**	192.16 (3.56)	110.04 (2.04)	n.a.
<b>2000</b>	13548.37	488.90 (3.61)	606.08 (4.47)	65.46 (0.48)
<b>2005</b>	30204.28	1152.99 (3.82)	790.18 (2.62)	218.08 (0.72)
<b>2008</b>	53840.60	1762.90 (3.27)	745.40 (1.38)	422.1 (0.78)

Note: \*Figures in parentheses are the respective share in total lending.

\*\* Figures before 1995 were total lending from the four SOCBs while figures since 2000 covered all financial institutions.

^ Figures from 1985 to 1995 were combined loan amount to TVEs, PEs and self-employed individuals.

n.a.= not available

Sources: Calculated based on the data from *ZGTJNJ* (1991: 643; 1996: 614; 2001: 638); *ZGTJNJ* CD-ROM (2007: Table 20-2; 2009: Table 19-2)

**Table 10 Growth of Employment in Rural Enterprises and Per Capita Net Household Income 1990-2008**

	<b>Workers in Rural Enterprises*</b> (million)	<b>Employed</b>	<b>Growth Rate (%)</b>	<b>Per capita Net Household Income</b> (yuan)	<b>Growth Rate (%)</b>
<b>1990</b>	111.69		19.2	686.3	14.1
<b>1991</b>	113.41		1.5	708.6	3.25
<b>1992</b>	124.87		10.1	784	10.64
<b>1993</b>	145.42		16.5	921.6	17.55
<b>1994</b>	148.84		2.4	1221	32.49
<b>1995</b>	163.87		10.1	1577.7	29.21
<b>1996</b>	173.67		6.0	1926.1	22.08
<b>1997</b>	171.72		(1.1)	2090.1	8.51
<b>1998</b>	171.29		(0.25)	2162	3.44
<b>1999</b>	175.00		2.2	2210.3	2.23
<b>2000</b>	168.93		(3.5)	2253.4	1.95
<b>2001</b>	169.02		0.05	2366.4	5.01
<b>2002</b>	171.73		1.6	2475.6	4.61
<b>2003</b>	175.87		2.4	2622.2	5.92
<b>2004</b>	179.56		2.1	2936.4	11.98
<b>2005</b>	187.61		4.5	3254.9	10.85
<b>2006</b>	194.59		3.7	3587	10.20
<b>2007</b>	199.49		2.5	4140.4	15.43
<b>2008</b>	203.98		2.2	4760.6	14.98

Note: \*Figures include workers employed in TVEs, PEs and self-employed individuals.

Source: Calculated based on the data from *ZGTJNJ* (1991: 295; 2005: 121); *ZGTJNJ* CD-ROM (2009: Table 4-20)

Since the retreat of SOCBs in the countryside, rural credit cooperatives (RCCs) become the most important financial institution in rural areas to meet the credit demand by the rural enterprises. The merge of rural credit cooperatives in recent years, however, further decreased the number of county financial institutions. As of the end of 2007, the number of county financial outlets dropped by 9,811 or 7.3% since 2004, declining to a total of 124,000 outlets.

Towns and villages are most adversely affected areas. At the end of 2005, only 3.28% of the administrative villages had financial institutions.<sup>25</sup> Despite increase in deposit in RCCs, a rising amount of funds has been channelled out of rural areas through depositing funds into the People's Bank of China or purchasing bonds for which the returns are more stable and less risky. Even with the repeated emphases by central leaders on the importance of rural finance in rural development, the amount of loans extended to agriculture and rural enterprises is still disproportionately small. Banking reform since 1994 has focused on the institutional overhaul of banking sector in urban areas. After three decades of reform, the rural financial reforms still lag behind, thus creating the risk of slowing down further expansion of rural enterprises and rural development as a whole.

Concerted efforts have been put to ensure adequate financial services rendered to the countryside. The China Postal Savings Bank (CPSB) was established in 2007 to take over the rural financial services previously provided by the post offices. The new bank provides a network of 37,000 branches providing banking services, including small loans to individuals, in rural areas (Kwong 2009: 17).<sup>26</sup> However, since the postal saving system was not allowed to extend loans to rural households and enterprises before June 2006, it is not certain whether the newly established CPSB can have adequate expertise in credit and risk evaluation. In addition, China Banking Regulatory Commission (CBRC), China's banking regulator, designed a plan to set up 1,294 new financial institutions in rural areas over a three-year period (2009-2011) to cater for the escalating demand for financial services in rural sector. Nevertheless, the response of local and foreign banks has been lukewarm as average size of each loan application in rural areas remains small,<sup>27</sup> which lowers the cost-effectiveness of processing each loan application. Further, the lack of collaterals from farmers increases the default risks of the loans. Lower profitability and higher risks deter the banks from taking bold steps to tap into the rural business, particularly in poor regions. Setting up an extensive

credit-reporting system is a necessary step to allow lenders to better manage their risks in rural lending by reducing information asymmetry,<sup>28</sup> which enables financial institutions to increase their lending to the underserved areas. A further relaxation of interest rates charged by rural financial institutions can provide adequate risk premium for the lenders, which induces more loans to risky borrowers.<sup>29</sup> Notwithstanding, higher interest rates may deter farm households from borrowing from financial institutions. Therefore, the problem of inadequate financial services in rural China cannot be solved solely by market means. Government initiatives, such as government-subsidised microfinance, tax exemption and concessionary land rent for financial institutions, must be instituted to promote lending to rural households and enterprises.

## **Conclusion**

China's exports have carried dominant significance in the Chinese economy, in terms of its contribution to GDP, and more importantly its linkage effects on domestic production and employment creation. However, global financial instability brought a sobering warning to the central leaders that relying on trade to promote growth can make China very vulnerable to external shocks. The Chinese government therefore revamps its growth strategy by transforming China from an export-driven growth model to a more balanced growth scenario emphasizing more on domestic consumption. It is unlikely that China could detach its growth from the external sector in the coming years, but increasing the share of consumption in domestic economy provides a buffer against unexpected shocks from the external sector. The success of this paradigm shift depends on whether rural consumption can be bolstered and sustained in the coming years. Bringing a secure land rights to farmers is crucial to ensure farm households to derive income from their contracted lands. Stable income from farmland is a key to generate adequate purchasing power for rural consumption.

The enforcement of property rights requires concerted effort to implement the relevant land laws and regulations, which calls for a sound and impartial legal system that is the weakest link in China. The implementation of land law is also in conflict with the interest of local government, which constitutes a force of resistance. Another major source of rural income comes from nonfarm activities, which have long been constrained by capital shortage. The lack of access to credit by farmers and rural enterprises cannot be resolved merely by market solutions. Government initiatives, such as tax exemption or concessionary land rent, are needed to offer incentives to local and foreign banks to invest in rural areas, which is especially important in remote regions. Without addressing the land issues and credit problems in the countryside, stable and sustainable income can hardly be achieved. Consumption level of rural households will probably continue to lag behind their urban counterparts.

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<sup>1</sup> Calculated based on the data from National Bureau of Statistics of China , *Zhongguo Tongji Nianjian 2003* (*ZGTJNJ* hereafter, China Statistical Yearbook ), (Beijing: Zhongguo Tongji Chubanshe), pp. 654.

<sup>2</sup> Calculated based on the data from *ZGTJNJ* (2002: 53).

<sup>3</sup> The urban unemployment rate increased from 3.1 percent in 1998 to 3.6 percent in 2001. The figures rose further to 4 percent in 2002 (*ZGTJNJ* 2002: 117; 2003: 123).

<sup>4</sup> Wu Yi was appointed to lead a series of trade mission to expand western market after the 1997 Asian finance crisis. She held successively the posts of Deputy Minister of Foreign Economic Relations and Trade, [Minister of Foreign Trade and Economic Co-operation](#) from 1991 to 1998.

<sup>5</sup> Calculated based on the data from *ZGTJNJ* (2005: 626).

<sup>6</sup> Calculated based on the data from Table 2.

<sup>7</sup> Greece planned to cut its budget deficit from 12.7 to 8.7 percent of GDP in 2010, and a further cut to 5.6 percent and 2.8 percent of GDP in 2011 and 2012 respectively. Other southern European countries followed suit. Spain planned to cut its budget deficit to 3 percent of GDP by 2013 and Italy approved a three-year budget cut of €24 billion. More wealthy European countries such as Britain faces similar fiscal problem. Its newly formed coalition government decided to speed up its budget reduction in response to the accumulated deficit of £69 billion, representing 11 percent of UK's GDP. See 'Greece Vows to Cut Budget Deficit in Bid for Stability' <http://moneynews.com/Economy/greece-cut-deficit-budget/2010/01/14/id/346323> (accessed on 8 June 2010) and 'Geithner Turns Focus on World Economy' *South China Morning Post* 27 may 2010, B10.

<sup>8</sup> 'GDP Growth Declines in China's Guangdong' <http://www.huffingtonpost.com/huff-wires/20090123/as-china-guangdong-gdp/> (accessed on 9 June 2010)

<sup>9</sup> The unemployment figure is based on a survey carried out by the Ministry of Agriculture in 165 villages in 15 provinces in early 2009. See '20-million Migrant Workers Lose Jobs' [http://www.rthk.org.hk/rthk/news/englishnews/20090202/news\\_20090202\\_56\\_556548.htm](http://www.rthk.org.hk/rthk/news/englishnews/20090202/news_20090202_56_556548.htm) (accessed on 9 June 2010)

<sup>10</sup> See 'China to Further Boost Domestic Consumption this Year' <http://news.alibaba.com/article/detail/business-in-china/100252799-1-china-further-boost-domestic-consumption.html> (accessed on 10 June)

<sup>11</sup> According to official statistics, rural population was 721.35 million, which was 54.3 percent of China's total population in 2008 (*ZGTJNJ* CD-ROM 2008: Table 3-1).

<sup>12</sup> The most important policy to boost rural development was announced by the No. 1 Document issued jointly by the Central Committee of Communist Party of China and the State Council in 2006. The document specified measures to develop a "New Socialist Countryside" through which addresses a wide range of pressing issues, such as agricultural production, rural infrastructure, and democratic Governance. See Kwong (2010) for a preliminary evaluation of the policies.

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<sup>13</sup> Engel's coefficient is a measure of the proportion of income spent on food. In general, a country's Engel's coefficient will fall when income rises. Therefore, the coefficient is one of the indicators of the level of living standard of a region or country. The Food and Agricultural Organization of the United Nations defines that an Engel's coefficient above 59 percent represents as absolute poverty; 50-59 percent as barely enough food and clothing; 40-50 percent as "moderately well-off" standard of living; 30-40 percent as a "well-to-do" standard of living; and below 30 percent as a "wealthy" life. See 'Beijingers Enjoy a Well-to-do Life'

[http://english.people.com.cn/200602/20/eng20060220\\_244263.html](http://english.people.com.cn/200602/20/eng20060220_244263.html) (accessed on 10 June 2010)

<sup>14</sup> See [http://www.rdiland.org/OURWORK/OurWork\\_China.html](http://www.rdiland.org/OURWORK/OurWork_China.html) (accessed on 5 October 2009)

<sup>15</sup> A contract is signed between the collectives and the farm households while a certificate contains the details of the contract, which is issued by a higher level government (see Prosterman 2009: 21).

<sup>16</sup> The survey covered 1,773 households in 1657 villages and 945 counties in 17 provinces. For details, see Prosterman et. al (2009).

<sup>17</sup> According to the RLCL, only natural disaster constitutes a valid reason for readjustment of contracted land. However, the survey results indicated that only about 1 percent of the land readjustment was due to natural disasters. See Prosterman et. al (2009: 9, 14)

<sup>18</sup> Here, the items 'development zone/industrial park', 'factory', 'urban housing', 'gas station' are not categorized as projects mainly for the 'public interest' of local communities.

<sup>19</sup> For a detailed discussion of the impacts of TAS on local finances, see Lee and Kwong (2003), and Kwong (2007).

<sup>20</sup> 1 *mu* = 0.165 acre = 798.6 square yards = 667.8 square metres

<sup>21</sup> The calculation is based on the data in 2008. The mean rental of the transfer-in and transfer-out land was 538 yuan per hectare. With an estimated return of 5 percent per annum, the cumulative value of 30-year land right is about 10,000 yuan per hectare. For details, please see Zhu and Riedinger (2009: 53).

<sup>22</sup> A comprehensive collection of land laws and regulations since the 1980s can be found in OECD (2009: Annex 3.A2). Available online: <http://dx.doi.org/10.1787/548456516500>

<sup>23</sup> The four SOCBs are Agricultural Bank of China (ABC), Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), and Bank of China (BOC).

<sup>24</sup> For the impact of 1994 banking reform on rural enterprises, see Kwong and Lee (2005).

<sup>25</sup> See 'Rural Finance in China' ([http://www.celent.com/124\\_617.htm](http://www.celent.com/124_617.htm)) (accessed on 10 October 2009)

<sup>26</sup> See also 'China Postal Savings Bank wins approval to distribute insurance' <http://www.forbes.com/feeds/afx/2008/08/06/afx5297723.html> (accessed on 9 June 2010)

<sup>27</sup> He (2008: 8) indicates that average loan amount to rural households in low income province, such as Guizhou, was only 4,612 yuan according to a survey conducted in Guizhou in 2005.

<sup>28</sup> Credit information of 74 million rural household was recorded by 2007, which was about one-third of China's rural households (See Gale 2009: 71). The proportion of households is calculated based on the data from ZGTJNJ CD-ROM 2007 (Table 3-4, 3-8 & 3-14).

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<sup>29</sup> Since 2003, the government has allowed the RCCs to charge interest rate 2.3 times higher than the benchmark rate set by the PBOC while the new rural financial institutions, such as rural commercial banks, have been allowed to charge up to four times of the benchmark rate (Gale 2009: 75).