

Problems in Development of Micro-credit Loans to Farmers in China and Countermeasures

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Abstract There are problems of inadequate natural endowment and weak stamina in the development of micro-credit loans to farmers in China. Specifically, existing problems include narrow profit space, serious non-agricultural trend of funds, high dependence on government support, short life cycle, and constantly increasing operating risks. These problems are related to endogenous drawback in design, defect in operating procedure, lagging in relevant policies and measures, and vacancy in risk compensation mechanism.

Key words Micro-credit loan to farmers, Risk compensation mechanism, Rural China

1 Introduction

As a new loan mode for helping rural economic entities, especially small farmer households with family as unit, the micro-credit loan to farmers has already adapted to seasonal, timely and small amount demands of agriculture for financial services. It has also effectively cooperated with implementation of rural economic and industrial development policies. Therefore, it has provided considerable financial support for rural economic development. Since its initial pilot in Wuyuan of Jiangxi Province in 2000, the micro-credit loan to farmers, as a project favorable for the whole country, farmers and the society, has been rapidly developed and popularized in China. At present, it has established the interactive development pattern with credit cooperatives as leaders, government support as prop, and wide participation of farmers as foundation. Thus, it solves fund bottleneck of rural areas and farmers and insufficient financial support in a better way. However, there are problems of inadequate natural endowment and weak stamina in the development of micro-credit loans to farmers in China. Specifically, existing problems include narrow profit space, serious non-agricultural trend of funds, high dependence on government support, short life cycle, and constantly increasing operating risks. These seriously influence sustainability of its development. This study will analyze factors influencing development of micro-credit loans to farmers, discuss difficulties in development of micro-credit loans to farmers in China, and find out causes for development difficulties, in the hope of seeking effective countermeasures for promoting sustainable development of micro-credit loans to farmers.

2 Difficulties in development of micro-credit loans to farmers in China

2.1 Imbalance in cost and profit leading to narrow profit space and weak profitability

Rural micro-credit loans generally

are small amount loans, objects involved are complex, and rural areas are decentralized. As a result, the cost for micro-credit loans is relatively high. Related researches indicate that the comprehensive cost rate of micro-credit loans reaches 6.77%^[1]. In the world, it generally increases rate of interest to guarantee survival and development of micro-credit institutions. In China, the establishment of micro-credit loans features poverty alleviation. Government generally stipulates that the rate of interest of micro-credit loans should not exceed official rate of interest (generally, the rate of interest for one-year micro-credit loans is about 8%). There is only a difference of 6 percentage points between the rate of interest of one-year deposit, rather than 10 percentage points or higher. Besides, most government-leading rural micro-credit loans are discount small amount loans or interest-free small amount loans. In China, the return of assets for rural micro-credit loans is low. The highest return of assets for rural micro-credit loans in China is 7–9%, much lower than the international standard; the return of assets for government-leading micro-credit loans is only 2%^[1]. Serious imbalance between cost and profit leads to narrow profit space, inadequate growth, high dependence on government and nongovernmental organizations (NGOs).

2.2 Growth space of demanding market obstructed and target market not developed well

Rural economic development has highly seasonal and flexible characteristics, and demands of farmers for financial services take on diverse and composite structure. However, micro-credit loans grant at present stage are mainly oriented towards fund demand of family-based small planting and cultivation and service content is single. In small agricultural machines and tools, agricultural production service, house building, and education, the grant of micro-credit loans fails to have considerable breakthrough. In line of credit, there is no discrimination, no classified guidance, and separate credit granting. Profit driving leads to inclination towards high-income large farmer households. In consequence, the credit demand of about 80% middle and low income farmers fails to be satisfied. This seriously restrains growth of demand market and development of target mar-

ket. In some areas, there are even problems of farmers transferring or lending loan note to build large households. In addition, non-agricultural trend of funds is increasingly significant. According to relevant survey, 33% farmer households use loan fund for non-agricultural production, and some even use the loan fund for private lending, paying fines of family planning, or buying funds or stocks. All of these are deviating from path of agricultural development.

2.3 Single channel of fund source and insufficient fund supply from institutions of micro-credit loans to farmers At present, rural fund has serious problem of multi-directional flow. Rural credit cooperatives, as mainstay of supporting farmers, not only assume the mission of granting micro-credit loans to farmers, but also shoulder the heavy burden of granting the entire agricultural loan. However, their ability of absorbing deposit is obstructed, fund source is significant insufficient. Relying only on deposit and support of the People's Bank of China, they have single channel for obtaining funds. The Agricultural Development Bank mainly fulfills the responsibilities of purchasing agricultural and sideline products. After the reform of grain circulation system is launched, the function of the Agricultural Development Bank for agricultural loan fails to be brought into full play. The Postal Savings Bank of China has absorbed huge funds from rural areas, but it has no return channel for supporting rural economic development. Besides, agriculture has such weakness as low comparative benefit but high risk, so nearly no external funds will spontaneously flow to agriculture. What's worse, funds accumulated by rural area and agriculture also flow to non-agricultural fields through various channels. As a result, micro-credit loans are short of funds.

3 Causes for difficulties in sustainable development of micro-credit loans to farmers

3.1 Endogenous drawback in design of micro-credit loans to farmers In China, the development of micro-credit loans to farmers starts late. It fails to fully consider characteristics of market demand in corresponding product design, rate of interest, period structure, which not only influences its service quality, but also limits its growth space. Firstly, in product design, micro-credit loans to farmers mainly consider traditional planting industry, while neglect development demand of new agricultural sectors in the adjustment of agricultural industrial structure. For example, the input is insufficient in high benefit industrial crops, agricultural and sideline product processing, sales and circulation, and it is lack of diversified large amount credit loans. Secondly, period structure is not perfect. The period of micro-credit loans to farmers is not long, generally 3 months to 6 months, the maximum is one year. The period structure is single. However, production cycle of crops is varied. For breeding milk cow or planting fruit trees, the production cycle is as long as 2 to 3 years. Fish breeding also has in-season and off-season. Therefore, single and short loan period runs counter to agricultural production cycle and increases repayment difficulty and credit risks. Thirdly, the design of rate of

interest is not perfect. The definition of rate of interest for micro-credit loans is not clear. Some rural credit cooperatives apply the highest rate of interest when granting loans to farmers, generally up to 12.83% (more than 130% of the benchmark rate of interest, some even up to 200–300% of the benchmark rate of interest)^[2]. Such high rate of interest seriously dampens farmers' enthusiasm of applying loans. By contrast, some areas overstress poverty alleviation function of micro-credit loans and set the rate of interest at only 8%. Government-leading rural micro-credit loans are mainly discount loans or interest-free small amount loans, which can not make up for their cost.

3.2 Defect in operating procedure of micro-credit loans to farmers On the one hand, most micro-credit loans to farmers conduct credit granting in the form of joint guarantee team. Weak farmers have low ability of economic repayment and few articles that can be mortgaged, so it is difficult for them to join the joint guarantee team. Strong farmers with certain economic strength form the joint guarantee team, while weak farmers attract no interest and no other farmers are willing to cooperate with them. As a result, weak farmers fail to obtain benefit from national supporting credit policy. Finally, there comes the embarrassing situation that qualified farmers can solve their fund problem without the support of micro-credit loans, while farmers with lower credit level fail to get loans. These influence sustainable development of micro-credit loans to a certain extent. On the other hand, some rural credit cooperatives, due to lack of understanding of credit clerks, especially those reside in villages, overstress the risk prevention, and fear responsibility investigation in case of delayed repayment, so they grant no loan to farmers without certificates of credit worthiness, and refuse to grant loans to weak farmers, which limits cultivation of customers of micro-credit loans and growth of market.

3.3 Lagging of relevant policies and measures As important policy and measure of the state for supporting agriculture and farmers, the business of micro-credit loans to farmers should be provided with corresponding supporting policies and measures, to create loose policy environment for rural credit cooperatives and promote implementation of this business. For example, it should cancel discriminatory measure for funds of rural credit cooperatives, and agriculture-related financial funds should have an account in rural credit cooperatives. Besides, it is recommended to provide fund support, financial subsidy, interest compensation, and tax reduction or exemption for credit cooperatives that grant micro-credit loans to farmers. In addition, it should create loose external environment for input and recovery of micro-credit loans. Nevertheless, there are few supply policies and measures for supporting rural credit cooperatives, and some preferential policies are not well implemented. These have already affected normal operation and benefit of rural credit cooperatives.

3.4 Vacancy of risk compensation mechanism Agricultural production has high risk due to multiple pressures of natural disasters and market competition. According to international practice, to ensure sustainable operation, most micro-credit loan projects

should have perfect risk sharing and compensation mechanism. Generally, risks are shared jointly by state finance and agricultural insurance institutions. However, due to system reason, on the one hand, both risks and losses of micro-credit loans are assumed by rural credit cooperatives along. On the other hand, the development of agricultural insurance in China lags behind and the supply of agricultural insurance is insufficient. According to *China Rural Finance Service Report* issued by the Peoples' Bank of China, by the end of 2012, only 25 insurance companies had agricultural insurance business, their premium income was 24.013 billion yuan, and they provided risk security for 183 million farmers. Among agricultural insurances, finance subsidized insurances take up the leading part (about 97.8%)^[3], showing high dependence on government support. There is a great gap between agricultural insurance market in China and mature agricultural insurance market in developed countries.

4 Countermeasures for promoting sustainable development of micro-credit loans to farmers

4.1 Improving credit granting mode and internal management of micro-credit loans Micro-credit loans to farmers should adapt to changes in demands of farmers for funds, reinforce the adjustment in use, object and line of credit, and expand operating space. Firstly, it is recommended to adjust credit granting mode and accrediting amount. Rural credit cooperatives should apply differential credit granting or increase accrediting amount according to production, operation and credit situation of farmer households. For rural credit cooperatives in areas with better production operation and credit environment, the line of credit may be adjusted to 50 000 to 100 000 yuan; for rural credit cooperatives in areas with poor production operation but good credit environment, the line of credit may be controlled in 10 000 to 30 000 yuan; for those with worse credit environment, the line of credit may be controlled within 10000 yuan. Through this, it is able to really help farmers with loans. Secondly, it is recommended to improve management of the credit period. In principle, the credit period should keep consistent with production cycle of agricultural products. Micro-credit loans should be granted according to seasons and production cycle, to realize excellent turnover and benign cycle of micro-credit loans. Thirdly, it is recommended to increase application of loan supply. In *Instructions for Management of Rural Financial Institutions in Small Amount Credit* issued by the People's Bank of China, it clearly stated that micro-credit loans can be used for agricultural production of planting and breeding, small agricultural machines and tools, services for agricultural pre-production, production, and post-production. Therefore, it is required to increase uses of micro-credit loans and increase loan granting fields, to fully manifest functions and effects of micro-credit loans to farmers. Fourthly, it is recommended to expand service levels. Financial institutions should credit conditions and reduce threshold, provide micro-credit loan business for individual proprietors, private enterprises, individual peddlers, to solve the

conflict of high demand of farmers for funds and extend performance of micro-credit loans.

4.2 Effectively promoting standardization of operating action On the one hand, both the line of credit and the credit period should be loose and flexible. In condition limitation, it is required to treat different cases in different way, never apply a single solution for all cases. For simple, well-behaved and faithful farmers, the line of credit may be properly eased, or loans may be granted in the form of joint households or mortgage. As for the credit period, it should combine with agricultural production realities, make appropriate credit period, link the agricultural production cycle and agricultural fund turnover rate in a better way, and properly increase annual loan and medium and long term loans. For loans not repaid due to disasters, it should allow reasonable extension, to adapt to demands of modern agricultural development. On the other hand, it is recommended to establish and improve incentive mechanism, encourage marketing action of credit clerks, seek the balance between popularization of micro-credit loans and prevention and mitigation of credit risks, and scientifically establish objectives of micro-credit granting management, recovery responsibilities and ways of rewards and punishment. For entities or individuals with high quality, high benefit, and no risk in granting micro-credit loans, rewards should be provided to stimulate enthusiasm of credit clerks for promoting micro-credit loans.

4.3 Expanding financing channels of micro-credit loans and promoting development and use of township banks and star funds To alleviate the difficulty of farmers in obtaining loans, it is recommended to encourage main domestic commercial banks and rural cooperative banks to set up affiliated companies to engage loan business specially (not allowed to absorb deposit). Besides, it may allow rural farmers and small enterprises to set up community-based credit cooperatives to provide services for cooperative members and implement democratic management. Credit cooperatives set up in townships or towns should have registered capital not less than 300 000 yuan; credit cooperatives set up in administrative villages should have registered capital not less than 100 000 yuan;

4.4 Speeding up construction of intermediaries for agricultural insurance in rural areas In the first place, it should actively explore diversified fund-raising channel and incentive mechanism of agricultural insurance. For example, local finance may provide funds for building policy-related agricultural insurance companies or provide subsidy and tax preference for agricultural insurance institutions. At present, the rice planting insurance introduced jointly by the Ministry of Finance and China United Insurance Holding Company remains at the pilot stage in 6 provinces in the whole country. Financial department assumes 60% premium. The performance is excellent, so it can be popularized in the whole country. In the second place, it is recommended to carry out pilot project of small amount agricultural insurance. The small amount insurance is mainly an insurance service oriented towards

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transport and others.

The production equipment and technology of flue-cured tobacco in Weng'an County are still in phase of modern improvement, and some old and new ways coexist. There is no unified standard for the management of tobacco curing process, and the curing energy and manpower are greatly wasted, with low input effectiveness.

Table 4 The main cost structure of tobacco production

Indicators	Cultivation	Film	Field management	Tobacco curing	Energy	Grading	Fertilizer	Pesticides	Transport	Others
The share in the total cost//%	9.9	3.6	5.8	17.3	21.7	10.0	12.0	2.8	5.6	11.3

3 Conclusions and discussions

The survey and analysis results show that the large-scale tobacco growers in Weng'an County have become an important subject of tobacco production, and the main way for them to obtain economic benefits is to concentrate wide land, capital, labor, production materials and management and use economies of scale to reduce costs, thus yielding high economic benefit.

It indicates that the integration of tobacco market, human resources, capital and connections, can not only meet the interest needs of large-scale growers, but also promote the construction and development of modern tobacco agriculture [7].

However, the cost reduction arising from economies of scale is related to the complexity of production and management, and the integration of resources is on the premise that the management and supervision are effective, so that there are no the problems of confusion in the market, excess capacity, and production – income contradictions [8].

Therefore, during production process of large-scale growers, it is necessary to carry out fine management and standardized management, build the standard-based management system, and improve the resource input effectiveness and tobacco growers' human capital stock, to continue to improve the tobacco yield and quality, and reduce capital, goods and management costs.

By analyzing the production cost structure of large-scale tobacco growers, we divide the key influencing factors into three levels as follows:

- (i) The primary key influencing factor: Curing link of tobacco;
- (ii) The secondary key influencing factors: Cultivation, grading and fertilizer;
- (iii) The tertiary key influencing factors: Film, pesticides, transport and others.

The material and labor inputs to tobacco curing account for

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low-income groups. Characterized by moderate guarantee, low premium, and simple underwriting and settlement of claims, the small amount insurance is an effective financial poverty-alleviation method.

In addition, energy is the only way to eventually form the quality of tobacco, and the curing process will greatly affect the flue-cured tobacco production results, so the tobacco farmers have strong willingness to invest. Therefore, regulating the process of the curing operation, and improving the input effectiveness of materials and labor, have become the key to enhancing the production benefit of large-scale tobacco growers.

39% of the total production costs, having the greatest impact on the production benefit of large-scale tobacco growers.

It is proposed to build the specialized curing service platform for the tobacco growers so as to facilitate the unified tobacco curing and process management; rely on the forms of cooperatives and companies to carry out the specialized curing services for the tobacco growers; improve the supporting equipments and technologies under the guidance of tobacco companies; carry out different forms of specialized tobacco curing services in various tobacco-producing areas according to the actual situation.

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