

## Sustaining China's Rural Development Under Global Economic Instability: Key Policy Issues

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### ABSTRACT

China's exports shrank by 16% in 2009 during the global financial crisis originating in the US. The incomplete recovery of the American economy in 2010 was followed by a debt crisis in Europe, prompting a tightening of fiscal expenditures by European governments that led to tapering economic growth in Europe and a depreciating euro. China's exports will be adversely affected by these recent developments as Europe has been China's largest export market. In light of continued financial instability in the global economy, China's central leaders have tried to emphasize more domestic consumption as part of a new growth strategy. This paper argues that the success of this strategy rests not only on urban consumption, but also on its rural counterpart. In recent years, increased budget expenditures in the countryside on infrastructure development, compulsory education, and medical services have lightened the burdens of rural dwellers, but the rural-urban gap, in terms of income and consumption levels, remains substantial. This paper posits that a clear delineation and enforcement of property rights and prompt development of rural financial markets is the key to sustaining China's rural economic growth, as it has direct bearing on the government's recent efforts to promote domestic demand to cushion the economy from global financial shocks.

### FROM ASIAN TO GLOBAL FINANCIAL CRISIS: CHINA'S POLICY RESPONSES

Compared with its Asian neighbors, China was less affected by the Asian financial crisis of 1997, but it was not completely insulated from the financial contagion. Its exports showed a meagre growth of 0.41% in 1998, 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 terms, declined from 16.85% for the period 1991-1996 to 11.3% in 1997, and the figure dropped further to 8.9% in 1998.<sup>2</sup> The country's central leaders were alarmed by figures released by the State Statistical Bureau (now the National Bureau of Statistics of China) showing that GDP growth in the first half of 1998 would barely reach 7%, instead of the pre-set target of 8% (Brahm, 2002, p. 101). This one percent shortfall of the target meant a potentially significant rise in unemployment.<sup>3</sup>

To contain the repercussions of the crisis, China adopted several measures to safeguard its export sector, refraining, however, from devaluing its currency, lest it would generate another round of currency devaluation in the region. Instead, China turned to the Western

\*The material presented by the authors does not necessarily portray the viewpoint of the editors and the management of the Asia Journal of Global Studies (AJGS).

economies for a solution through a series of trade missions to encourage large corporations to purchase from Chinese export enterprises (Chance, 2010, p. 57).<sup>4</sup>

On another front, China toughened its efforts at gaining WTO (World Trade Organization) admission. A milestone was reached in 1999, when China signed a bilateral trade agreement with the US through which China was granted "permanent normal trade relations." China agreed to lower its average tariffs from 22.1% to 17% in exchange for US support for its WTO admission (Xiao & Fang, 2000, p. 209). Domestically, China boosted exports by granting rebates on export taxes, broadening the profit margins of exporting enterprises. Its export promotion policies proved to be successful, with export growth rebounding from 6.2% in 1999 to 27.7% in 2000.<sup>5</sup>

In terms of its export markets, China gravitated towards Western markets after the 1997 Asian financial crisis. On the eve of the crisis, Asian countries consumed 60.4% of China's exports, but the figures declined continuously during the post-crisis period. China's share of Western markets, on the other hand, particularly those in Europe, demonstrated steady gains (Table 1).

**Table 1**  
Percentage Share of China's Export Markets, 1990-2008

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

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

The 2008 global financial crisis alerted China's central leaders that a reliance on exports to maintain growth and create employment had potential pitfalls. During the global financial turmoil, China's exports dropped 16.8% and net exports declined 10.1% in 2009.<sup>6</sup> Uncertainty loomed again over China's export sector during Europe's debt crisis in 2010, when numerous European countries commenced reducing fiscal expenditures.<sup>7</sup> If the substantial cuts in fiscal budgets in Europe are realized, economic contraction will be considerable, and there will be a decline in demand for imports, including those from China. The impact on China's exports will be no less severe than that brought about by the sub-prime mortgage crisis 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% in 1990 and peaked at 7.74% in 2007, declining in 2008 and 2009 (Table 2).

It is worth noting that the impact of exports upon China's economy should not be perceived merely from the contribution of NX to GDP. Empirical evidence indicates that demand for China's exports triggers significant linkage effects, improving levels of production, consumption, investment, and employment in other sectors. Using panel data from China's 27 provinces, Cui, Shu and Su (2009) estimate that a 1% increase in export stimulates a 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 significant exposure to exports. Based on input-output datasets for 1995 and 2005, Chen et al. (2008) estimate that for every US\$1,000

of Chinese exports, domestic value-added and employment increased by US\$466 (US\$545) and 0.242 (0.375) person-years in 2002 (from 1995). Chin (2010, p. 19) shows that manufacturing employment in China correlates significantly with new export orders. Though the results among these empirical studies vary, they consistently reveal the noteworthy impact of China's exports on domestic production and employment. The findings are consistent with the impact of the massive factory closure in Guangdong (China's largest manufacturing and exporting base) during the global economic crisis in 2008. Approximately 62,420 businesses were shut down in the region in 2008<sup>8</sup> and about 20 million migrant workers lost their jobs, with around 15.3% of total migrant workers returning to their hometowns in the countryside. This development intensified the already pressing problem of surplus labor in rural areas.<sup>9</sup>

**Table 2**  
*China's Net Exports and its Share in GDP 1990-2008 (in billions 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, p. 168); *ZGTJNJ CD-ROM* (2009, Table 2-1 & 17-1); "China Trade Statistics 2009" at <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 separated from external demand, but the country's central leaders were alerted by the recent economic crises that China is vulnerable to external shocks if it continues to depend on exports to drive economic growth. To establish a more balanced growth model, China has recently stressed the importance of enhancing domestic consumption. As well as launching a 4-trillion yuan stimulus plan to boost domestic investment, the Chinese government has since 2009 initiated policies to entice household consumption, such as subsidizing the purchase of low-emission cars and electrical appliances in rural areas. The preliminary results are positive, with domestic consumption rising by 15.5%, amounting to 12.53 trillion yuan in 2009.<sup>10</sup>

The majority of China's population, about 54.3%, reside in rural areas,<sup>11</sup> but the urban-rural consumption ratio was 3 to 1 in 2008 (Table 3). This huge consumption gap is largely due to serious urban-rural income disparities, despite the government's recent policies to improve the living standards of rural residents and promote development in the countryside.<sup>12</sup> Wealthier urban residents, in general, have a lower marginal propensity to consume (MPC), while their rural counterparts demonstrate a higher MPC. However, relatively low-income rural residents spend about 43% of their household income on food consumption, as indicated by Engel's coefficient (Table 4),<sup>13</sup> which constrains their spending on consumer durables. To tap into the potential of rural consumption, it is crucial 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:** Calculations based on data from *ZGTJNJ* 2005, p. 335; *ZGTJNJ* 2008 (CD-ROM); "Rural-urban Income Gap up As Economy Slows," CBS News.com, at: <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, at: <http://www.ers.usda.gov/data/china/NationalResults.aspx?DataType=1&DataItem=158&StrDatatype=Rural+per+capita+consumption&ReportType=2> (accessed on 4 Jan 2010).

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

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

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

Rural residents derive their incomes from either farming or non-farming activities. Income from farming depends on secure land rights, which encourage farmers to invest more in long-term productive projects. Higher land productivity, in turn, translates into higher income. However, land expropriations without proper compensation by local governments not only create hardships for peasants, but hinder their willingness to invest. Underdeveloped financial markets in rural China further impede farmers' investments.

On a related front, inadequate financial services inhibit the development of non-farming activities, and rural industry in general, which slows the absorption of rural surplus labor. Income enhancement in China's countryside therefore depends on the securing of property rights, specifically, land rights, by farmers, and prompt development of rural finance.

## LOOSELY ENFORCED PROPERTY RIGHTS: HINDRANCE TO INCOME GROWTH

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 were the first important documents, prescribing a 15-year contract period for rural land use rights (OECD, 2009, p. 127). The Land Management Law (LML) enacted in 1998 further stipulated that farmers are entrusted with a 30-year usage right of the contracted land. A survey indicates that three years after the implementation of the LML, 47% of farm households had entered into a 30-year contract.<sup>14</sup> This 30-year contract was a milestone in the course of the development of China's land contract system, as it allowed farmers sufficient time to make investments and earn potential returns. The Rural Land Contracting



Law (RLCL) passed in 2002 clearly outlines the land use rights of 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 farm households (Zhu & Li, 2007, p. 24). To enhance flexibility of participation in non-farming activities by farmers, the RLCL details farmers' right to lease (i.e., transfer) their contracted land, and to transfer these rights to capture potential income and retain their land rights after the transfer period.

Even with a firmer legal foundation, the effective implementation of the RLCL is hampered by the lack of a land registration system in the countryside; in comparison, urban residents can register their lands and buildings with local offices at the 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 to which they are entitled.<sup>15</sup> However, a 2005 survey revealed that 63% of farmers received only sketchy documentation for their contracted lands. Among the documents in question, only about 10% of farmers received legally compliant documentation containing details (such as names of householders, contract duration and land description) of the contracted farmland (Zhu & Li, 2007, p. 24). A follow-up survey by Prosterman et al. (2009)<sup>16</sup> indicates that 41.8% of farm households were not issued any documents regarding their land rights. This shows that marginal progress has been made toward the protection of farmers' land rights. The loose implementation of RLCL largely explains rampant land expropriations by local governments with partial and/or delayed compensation. The survey reveals that 34.1% of farm households experienced land readjustments and most of them were illegal.<sup>17</sup> On top of land readjustment, land seizures pose an even greater threat to farmers. Since the implementation of the LML in 1998, 29.2% of farm households reported that they had encountered one or more land seizures. The LML allowed local governments to requisition land for development "in the public interest," but research reveals that about one-third of land seizures can hardly be categorized as projects for public interest (Table 5).<sup>18</sup> Since "public interest" is ambiguously defined in the LML, local governments are entrusted with plenty of counterproductive but legally justifiable reasons to requisition farmland (Kwong, 2007, p. 403).

**Table 5**  
*Purpose of Land Seizures, 2008*

Purpose	Percentage
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, p. 17).

Local governments' land expropriations have 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 has risen to a peak of 40.5% in 1984. However, the share shrunk since 1984, reaching 22% in 1993. To ensure an adequate and stable flow of budgetary revenues into state finances, the central government

implemented the TAS, which centralizes 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 revenues grew from 22% in 1993 to 55.7% in 1994. Since that time, the central government has collected about half of total fiscal revenues.

Nevertheless, local governments have been responsible for the major share (about 70%) of total expenditures since the inception of the TAS. The TAS has imposed increased fiscal pressures on subnational, and in particular subprovincial, finance.<sup>19</sup> Table 7 explores further the fiscal conditions of local governments. The extent of budget deficits (or surpluses) is measured by the ratio of local government expenditures (LGE) to local government revenues (LGR), representing a balanced budget if the ratio is equal to 1. A ratio greater than 1 denotes a budget deficit and a larger figure indicates a larger budget deficit. A ratio less than one reflects a budget surplus and a smaller figure indicates a larger surplus.

Local governments encountered dramatic deficits for all the years from 1994 to 2004 and the magnitude of the deficits was greater than that before 1994. Stringent fiscal constraints encouraged local governments to explore other sources to finance their coffers and land requisitions by local governments became a routine means to raise local revenues.

**Table 6**  
*Central and Local Share of Budgetary Revenue and Expenditure, 1978-2008 (by 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

**Table 7**  
Budget Balance of Local Governments, 1978-2008 (in billions of 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, pp. 257-258; 2005, p. 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 been widely reported for more than a decade. Based on survey data from four provinces, Kang (2009) revealed that the net income of the majority of households (53.3%) declined while only 23.8% of households enjoyed higher net incomes after land expropriations. Approximately 87.7% of land-losing farmers regarded their compensation as too low. Findings by Prosterman et al. (2009, p. 18) further illustrate that local governments/collectives have derived considerable revenues from land requisitions

at the expense of farmers. On average, collectives received compensation of around 15,000 per *mu*,<sup>20</sup> which is five times the payment received by farmers (i.e. 2,500 per *mu*).

Though available data on land requisitions and compensation is sketchy and varies across different localities, the survey results noted above shed some light on the discontent of the farmers, and tensions 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 investments on their contracted land, which in turn adversely affects productivity. Second, land expropriations deprive farmers' rights to lease their land to capture market rentals. It is estimated that 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 the land rights of farmers are effectively protected and they can exclusively derive incomes from their land, the rural-urban income gap can be narrowed.

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, and this depends on a sound legal/court system in the countryside. Local courts have so far been embedded in local governments, which financially control the courts and reduce the impartiality of court rulings. Even when local courts issue rulings in favor of farmers, local governments often ignore court rulings (OECD, 2009, p. 122). The ineffective court system in the countryside is the weakest link in protecting the land rights of the farmers. Once the land rights of farm households are secured, farmers will have robust incentives to invest in their lands and maximize productivity. Secured land rights also endow farm households with an option to lease out their land to higher value users, which not only increases land values in the countryside, but more importantly enhances rural household incomes.

#### Rural Finance: A Development Bottleneck

Aside from farmland income, non-farming activities (mainly rural industry) have become another main source of rural income since the mid-1980s. In 1985, farming generated 75.4% of rural household income; that total diminished to 43.9% in 2008. In comparison, non-farming income has gained as a share of rural income from 24.6% in 1985 to 56.1% in 2008, indicating that rural residents rely increasingly on non-farming activities to maintain income growth (Table 8).

In addition, the proliferation of rural industries in the 1980s and 1990s assumed the important function of absorbing surplus labor released from agriculture. Rural enterprises employed 30 million 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, p. 121). Employment creation by rural enterprises was impeded by the implementation of banking reforms in 1994 that were aimed at commercializing the four state-owned specialized banks (SOCBs)<sup>23</sup> by separating commercial lending from policy lending, unintentionally resulting in noticeable capital constraints for small- and medium-sized private enterprises, particularly those in rural areas. Since SOCBs were required to operate on commercial principles, 44,000 county branches of SOCBs ceased to operate during 1998 to 2001 to cut operation costs.<sup>24</sup> Loans extended to township/village enterprises (TVEs) and private enterprises (PEs) increased in absolute terms from 1985 to 2008, but this share in total lending by financial institutions demonstrated a downward trend (Table 9), reaching a historic low of 2.16% in 2008. Compared with the output share of rural enterprises in GDP, which held at about 25% from 2000 (Naughton, 2007, p. 286; OECD, 2009, p. 64), the negligible share of total lending acquired by rural enterprises exemplified the difficulty of accessing credit in the countryside, where enterprises must use their accumulated profits to finance production and investment.

However, rural enterprises face keen competition among flourishing TVEs and the state-owned enterprises (SOEs) that have easier 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, impairing their ability to absorb rural labor. The growth rate of employment in rural enterprises has decreased since 1995 and negative growth was recorded for two consecutive years in 1997 and 1998. Though the figure rebounded to 4.5% in 2005, it tapered off once again in recent years (Table 10). It is worth noting that years with low employment growth corresponded to years with relatively low-income growth for rural households, in particular for the second half of the 1990s. This implies that non-farming employment has a direct bearing on household income, which in turn determines consumption levels.

**Table 8**  
*Farming and Non-farming Income in Rural China, 1985-2008*

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

Note: \*Transfer income is not included in non-farming income.

Source: Calculations based on data from ZGTJNJ (1986, p. 647) and ZGTJNJ 2009 CD-ROM (Table 9-20).

**Table 9**  
*Share of Loans to Rural Enterprises, 1985-2008 (in billions of yuan)*

	Total lending by financial institutions	Loans to agriculture	Loans to TVEs	Loans to PEs and self-employed individuals
1985	643.09	41.66 (6.48)*	32.13 (5.0)^	n.a.
1990	1683.78	103.81 (6.17)	83.13 (4.94)	n.a.
1995	5398.90**	192.16 (3.56)	110.04 (2.04)	n.a.
2000	13548.37	488.90 (3.61)	606.08 (4.47)	65.46 (0.48)
2005	30204.28	1152.99 (3.82)	790.18 (2.62)	218.08 (0.72)
2008	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 loans from the four SOCBs, while figures since 2000 covered all financial institutions.

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

n.a.= not available

Source: Calculations based on data from ZGTJNJ (1991, p. 643; 1996, p. 614; 2001, p. 638) and 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*

	Workers employed in rural enterprises* (million)	Growth rate (%)	Per capita net household income (yuan)	Growth rate (%)
1990	111.69	19.2	686.3	14.1
1991	113.41	1.5	708.6	3.25
1992	124.87	10.1	784	10.64
1993	145.42	16.5	921.6	17.55
1994	148.84	2.4	1221	32.49
1995	163.87	10.1	1577.7	29.21
1996	173.67	6.0	1926.1	22.08
1997	171.72	(1.1)	2090.1	8.51
1998	171.29	(0.25)	2162	3.44
1999	175.00	2.2	2210.3	2.23
2000	168.93	(3.5)	2253.4	1.95
2001	169.02	0.05	2366.4	5.01
2002	171.73	1.6	2475.6	4.61
2003	175.87	2.4	2622.2	5.92
2004	179.56	2.1	2936.4	11.98
2005	187.61	4.5	3254.9	10.85
2006	194.59	3.7	3587	10.20
2007	199.49	2.5	4140.4	15.43
2008	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 co-operatives (RCCs) have become the most important financial institution in rural areas to meet credit demand from rural enterprises. However, the merger of rural credit co-operatives in recent years has further decreased the number of county financial institutions. At 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 were most adversely affected by this development: at the end of 2005, only 3.28% of administrative villages had financial institutions.<sup>25</sup>

Despite an increase in deposits in RCCs, funding is increasingly channelled out of rural areas through funds deposited into the People's Bank of China or bonds for which returns are less risky. Even with central leaders emphasizing the importance of rural finance in rural development, loan totals extended to agriculture and rural enterprises are still disproportionately small. Banking reforms since 1994 have focused on the institutional overhaul of the banking sector in urban areas. But after three decades of reforms, rural financial improvements are still sluggish, creating a risk for the further expansion of rural enterprises and development as a whole.

In the meantime, concerted efforts have been made to ensure adequate financial services are offered to the countryside. The China Postal Savings Bank (CPSB) was established



in 2007 to manage rural financial services previously provided by post offices. The new bank provides a network of 37,000 branches with banking services, including small loans to individuals, in rural areas (Kwong, 2009, p. 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 has adequate expertise in credit and risk evaluation. In addition, the China Banking Regulatory Commission (CBRC), China's banking regulator, designed a plan to establish 1,294 new financial institutions in rural areas over a three-year period (2009-2011) to cater to escalating demand for financial services in the rural sector.

Nevertheless, the response of local and foreign banks has been lukewarm as the average size of each loan application in rural areas remains small,<sup>27</sup> lowering the cost-effectiveness of processing loan applications. Further, lack of collateral from farmers increases the default risks of these loans. Lower profitability and higher risks deter banks from taking bold steps to support rural businesses, particularly in poor regions. Setting up an extensive credit-reporting system is a necessary step to allow lenders to better manage risks in rural lending by reducing information asymmetry,<sup>28</sup> enabling financial institutions to increase loans to underserved areas. A further relaxation of interest rates charged by rural financial institutions can provide adequate risk premiums for lenders and induce more loans to risky borrowers.<sup>29</sup> Regardless of this, higher interest rates may deter farm households from borrowing from financial institutions. The problem of inadequate financial services in rural China cannot be solved solely by market means. Government initiatives, such as government-subsidized microfinance, tax exemptions, and concessionary land rent for financial institutions must be created to promote lending to rural households and enterprises.

## CONCLUSION

China's exports are crucial for the Chinese economy in terms of their contribution to GDP, and more importantly their effects upon domestic production and employment creation. However, financial instability in global markets in recent years has raised China's central leaders' awareness that relying on trade to promote growth can make the economy vulnerable to external shocks. The Chinese government has thus revamped its growth strategy from an export-driven model to a more balanced one with greater emphasis upon domestic consumption. It is unlikely that China can detach its growth from the export sector in coming years, but increasing consumption in the domestic economy can provide a buffer against unexpected shocks from abroad. The success of this paradigm shift depends on whether rural consumption can be bolstered and sustained in coming years. In this regard, bringing secure land rights to farmers is crucial to ensure farm households can derive income from their contracted lands. Stable incomes from farmland are the key to generating adequate purchasing power for rural consumption. The enforcement of property rights requires a concerted effort to implement relevant land laws and regulations, necessitating a more sound and impartial legal system. Another major source of rural income is derived from non-farming activities, which have long been constrained by capital shortages. Lack of credit access for farmers and rural enterprises cannot be resolved merely through market solutions. Government initiatives, such as tax exemptions or concessionary land rents, are needed to offer incentives to local and foreign banks to invest in rural areas, especially in remote regions. Without addressing land issues and credit problems in the countryside, stable and sustainable income increases cannot be achieved and rural household consumption will continue to lag behind its urban counterpart.

## NOTES

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

2. Calculations based on data from ZGTJNJ (2002, p. 53).

3. The urban unemployment rate increased from 3.1% in 1998 to 3.6% in 2001, rising to 4% in 2002 (ZGTJNJ 2002, p. 117; 2003, p. 123).

4. Wu Yi led a series of trade missions to improve access to Western markets after the 1997 Asian financial crisis. She successively held the posts of Deputy Minister of Foreign Economic Relations and Trade, from 1991 to 1998.

5. Calculations based on data from ZGTJNJ (2005, p. 626).

6. Calculations based on data from Table 2.

7. Greece planned to cut its budget deficit from 12.7% to 8.7% of GDP in 2010, and further cut it to 5.6% and 2.8% of GDP in 2011 and 2012 respectively. Other southern European countries have followed suit. Spain plans to cut its budget deficit to 3% of GDP by 2013 and Italy has approved a three-year budget cut of €24 billion. Wealthier European countries such as Britain face similar fiscal problems. The UK's current coalition government has decided to speed up its budget reductions in response to the accumulated deficit of £69 billion, representing 11% of its GDP. See "Greece Vows to Cut Budget Deficit in Bid for Stability" at <http://moneynews.com/Economy/greece-cut-deficit-budget2010/01/14/id/346323> (accessed on 8 June 2010) and "Geithner Turns Focus on World Economy," *South China Morning Post* 27 May 2010, B10.

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

9. 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" at [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).

10. 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 2010).

11. According to official statistics, the rural population was 721.35 million, or 54.3% of China's total population in 2008 (ZGTJNJ CD-ROM 2008, Table 3-1).

12. 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 specifies measures to develop a "New Socialist Countryside," addressing a wide range of pressing issues such as agricultural production, rural infrastructural development, and democratic governance. See Kwong (2010) for a preliminary evaluation of these policies.

13. Engel's co-efficient is a measure of the proportion of income spent on food. In general, a country's Engel's co-efficient will fall when incomes rise. Therefore, the co-efficient indicates the level of living standards in a region or country. The Food and Agricultural Organization of the United Nations defines an Engel's co-efficient above 59% as absolute poverty, 50-59% as barely enough food and clothing, 40-50% as a "moderately well-off" standard of living, 30-40% as a "well-to-do" standard of living; and below 30% as a "wealthy" life. See "Beijingers Enjoy a Well-to-do Life."

<http://www.china.org.cn/english/Life/108777.htm> (accessed on 5 October 2009).

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

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

16. The survey covered 1,773 households in 1,657 villages and 945 counties in 17 provinces. For details, see Prosterman et al. (2009).

17. According to the RLCL, only natural disasters constitute a valid reason for readjustment of contracted land. However, the survey results indicated that only about 1% of land readjustments were due to natural disasters. See Prosterman et al. (2009, pp. 9, 14).

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

19. For a detailed discussion of the impact 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 data from 2008. The mean rental of the transfer-in and transfer-out land was 538 yuan per hectare. With an estimated return of 5% 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, p. 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 at: <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 reforms on rural enterprises, see Kwong and Lee (2005).

<sup>25</sup> See "Rural Finance in China" at [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" at <http://www.forbes.com/feeds/afx/2008/08/06/afx5297723.html> (accessed on 9 June 2010).

<sup>27</sup> He (2008, p. 8) indicates that average loans to rural households in low income provinces, such as Guizhou, were 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, about one-third of China's rural households (See Gale, 2009, p. 71). The proportion of households is calculated based on data from ZGTJNJ CD-ROM 2007 (Table 3-4, 3-8 & 3-14).

<sup>29</sup> Since 2003, the government has allowed the RCCs to charge interest rates 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 the benchmark rate (Gale, 2009, p. 75).

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