

## Chinese Rural Financial Exclusion

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### Abstract

Financial exclusion is a social problem. It will affect the economic and social development, causing Matthew Effect and regional financial desertification. There is a serious financial exclusion phenomenon in Chinese rural areas, such as few outlets of financial institutions network, harsh financing conditions, high interest rates and serious gap in marketing. All these problems' genesis is low income of farmers and the lagging of economic development. Specifically, it can be accounted for the agricultural production risks, farmers' lacking of financial knowledge. At present, the rural financial exclusion can be eased mainly by strengthening of government financial supervision, popularization of farmers' financial knowledge, development of micro financing institutions and the coordinated development of the rural economy.

**Key words:** Financial exclusion; Rural finance; Financial supervision

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### INTRODUCTION

In recent years, the financial exclusion in rural areas of China is becoming more and more serious. It not only inhibits the development of rural economy, but

also further expands the gap between the rich and the poor, exacerbating social inequality. Therefore, it is extremely urgent to alleviate and then eliminate rural financial exclusion.

Research on financial exclusion began in nineteen nineties. Professor Leyshon and Thrift (1995), two Englishmen, first put forward the concept of financial exclusion from the angle of financial geography. Then Morrison and O'Brien (2001) expanded the denotation of financial exclusion to the nonphysical rejection. Kempson and Whyley (1999) ascertained the criteria of financial exclusion—"six dimension indexes" through their research. At present, the domestic research mainly focuses on the discussion of the causes and influencing factors of Chinese Rural financial exclusion. For example, Wang (2007) analyzed the causes and summarized solutions based on financial exclusion in Britain, mirroring the way to avoid and weaken the financial exclusion in China. Tian (2007) analyzed the influencing factors of the financial exclusion from the perspective of regional differences, which differ from one region to another in China.

## 1. FINANCIAL EXCLUSION AND ITS INFLUENCE

### 1.1 Definition of Financial Exclusion

Financial exclusion is a compound concept, which is multi-dimensional and dynamic. The current definition about financial exclusion is a status that there are few financial services which could share in the financial system, including that the vulnerable groups have no access to financial institutions and that there are many difficulties and obstacles when they try to use them.

### 1.2 Influence of Financial Exclusion

There are two strong harmful aspects of financial exclusion under market economy condition:

### 1.2.1 Matthew Effect

Financial system is a carrier of modern economic life, in which we could make a fortune. We couldn't be without finance, and it would be difficult once financial exclusion occurs. Once economic participators couldn't get necessary funds from banks and other formal financial institutions, they have no choice but borrow money from informal financing institutions, such as illegal private banks. The cost of production rose sharply because of high interest rates. As a result, production and daily life could no longer function well. Further deterioration of the financial exclusion would result in the polarization of social wealth distribution, poorer the poor, richer the rich, which is called Matthew Effect.

### 1.2.2 Regional Financial Desertification

Financial exclusion would reduce positive effect of Finance to the economy, restraining economic growth hence putting off the regional economic development. Financial institutions would give up rural, remote and poor areas, considering risk control and increasing profit, which makes financial resources further scarce in these areas. The outflow of funds and low level of services would greatly weakened investment, which means financial desertification. And the regional desertification would further slow down the regional economic growth and exacerbate financial ecological environment, resulting in more severe financial exclusion.

## 2. STATUS OF CHINESE RURAL FINANCIAL EXCLUSION

For a long time, shortage of financial supply and financial exclusion has been common phenomena in Chinese rural areas. Even worse, they are going bad with the commercial banking reform.

### 2.1 Few Outlets of Financial Institutions Network

In the distribution map of Chinese financial institutions, we could find that most of them scatter mainly in the developed city, relatively less in rural areas and even not any branch in some poor and remote rural areas. Due to the commercial banking reform, many branches of banks have merged in rural areas, which means the number of them has greatly reduced, let alone securities and insurance institutions. According to the relevant data issued by China Banking Regulatory Commission and the PBC, the number of branches of the National County banking is up to 127,000 by the end of 2010, accounting for 65.7% of total, but this number is only 75,935 in rural areas. At the same time, there are 8,723 towns only has one financial branch, another 2,868 villages has none. Clearly, the people have been suffering serious geographical financial exclusion in Chinese rural areas.

### 2.2 Harsh Financing Conditions

Competition being increasingly fierce, banks and other financial institutions are very cautious about loan, which is the main source of their profit. There is not only a complicated investigate and review process, but also a strict implementing of credit management policy and independent customer evaluation system. The borrowers usually have to provide corresponding proofs of creditworthiness and mortgage required by financial institutions. Other detailed requirements would be put forward in view of the term, type, repayment ability and the purpose of the loan. Seemingly reasonable, these requirements make borrowers in current China rural areas have no access to loan because credit system has not been established. Lots of financing needs of farmers are excluded from the financial service system for they can't achieve the requirements of financial institutions. Data show that, only 16.3% of loan is borrowed from formal financial institutions in Chinese rural areas.

### 2.3 High Cost of Financing

According to the Chinese current laws, autonomous right on interest rate is partly owned by financial institutions, that is interest rates are allow to float up and down within a certain range which is based on the rate setting by People's Bank of China. At present, financial institutions in rural areas usually means the RCC (the Rural Credit Cooperative), who could set its highest interest rates at 230% of the based rate. That is far higher than the non-rural loan rate, which could float up 30%-50%. A survey shows that, 63.8% farmers couldn't accept the based rate, which is the lowest, while that rate of RCC is obviously higher. Some of them are higher than commercial banks'; some are even higher than the private financial institutions' loan rates. It is thus clear that most of the farmers have been rejected by bank from the aspects of loan prices.

### 2.4 Serious Gap in Financial Marketing

Employees of financial institutions are the important carrier of marketing activities. Only they reached a certain scale, will marketing be carried out. Financial marketing activities are impossible in the background that branches of formal financial institutions in rural areas are continued drawing back. The RCC, who should root in rural areas, are taking a strategy which separates themselves from the agriculture, rural areas and famers towards the city market step by step, according to their own point of view on development. Rural financial service atlas of 2010 issued by CBRC (China Banking Regulatory Commission) shows that financial institutional coverage per million people within county is respectively 1.85, 1.7 in Beijing and Shanghai, while the numbers of Qinghai and Gansu are respectively 1.33, 1.55. The lowest is Guangxi, for a minimum of 0.77. Personnel density of

rural financial service staff in Beijing and Shanghai are respectively 26.01 and 20.55, while Qinghai and Gansu are respectively 15.64 and 9.43. The lowest is Guangxi, for a minimum of 7.8. This result clearly reflects the imbalanced status of financial development in rural areas.

### **3. CAUSES OF CHINESE RURAL FINANCIAL EXCLUSION**

The financial exclusion is a reflection of market failure, who rooting in the allocation of social resources. It is the result of joint action of multi aspects in Chinese rural areas.

#### **3.1 High Risk of Agricultural Production**

Agriculture production is still the dominant industry in Chinese vast rural areas. On the one hand, the agricultural production is fragile for being easily affected by natural factors. China is so a natural disaster-prone country that agriculture production is always facing great natural risk. On the other hand, agricultural production is also facing the market risk. The income depends on the market price of agricultural products for small scale, while the cost could be high for low agricultural mechanization level and backward production pattern. The risk of agricultural production could be consisted of the strike of the international grain market or agricultural policy lagging behind. Financial institutions would raise loan threshold in rural areas in order to reduce the operation risk and cost in considering of all these factors. Otherwise, they would transfer financial products and services to cities, where is relatively developed, resulting in financial exclusion in rural areas. Financial institutions would apply themselves to product design, customers' development and marketing target in non-rural areas.

#### **3.2 Lack of Financial Knowledge and Information Among the Farmers**

With the rapid development of economy, science and technology, financial products and service tend to networking, electronic, virtualization because of constantly innovation. But farmers are lack of high education, financial knowledge and information, so they hardly accept the financial concept and new financial products. Besides, the financial institutions network distribution is unreasonable and communication channels are too single. The insurance or securities institutions are unlikely to set up business in the rural areas for farmers, who influenced by traditional ideas, never considering buying insurance, a stock or fund apart from deposits. Due to undertaking the social responsibility, some banks set up branches in rural areas, but they would take measures to cut down the business to reduce the cost for their own good. Financial exclusion is taking a turn for the worse in rural areas, because financial institutions tend to deviate from the poor quality customers with the concept of "market segmentation" and "customer classification" emerging.

#### **3.3 Growing Population Aging in Rural Area**

The degree of aging in rural areas is higher than urban. Structure of labor force in rural areas has greatly changed in the past ten years. The aging degree is more serious in rural areas, since most of the youths who born between 1980 and 1999 are no longer engaged in agricultural production, instead, they usually choose to go to work and stay in the city. On the one hand, the elderly who are left-behind in the rural areas tend to never need any financial products or financial services, which lead to financial institutions reducing services. On the other hand, the elderly usually exclude themselves from finance for years of consumption habit, and for that they are usually lack of financial knowledge, information and they know little about financial product and service. In addition, the elderly would never meet the requirement which financial institutions proposed, because the low level of income and the corresponding collateral constraints.

#### **3.4 Huge Income Gap Between Urban and Rural Areas**

Huge income gap which is caused by unbalanced development of regional economy would bring financial exclusion. It is acknowledged that the demand for financial services emerge with the increase of income, that is only income reached a certain level, will financial demand be generated. The law of decreasing marginal cost tells us that we shouldn't invest if the demand couldn't meet the point that the cost could compensate by profit. Thus, it would be easy to understand why the quality and quantity of financial services are so difference between rural and urban. In the great pressure of competition, financial institutions, who tend to interest, and commercialize, will develop their business in non-rural areas where is developed rather than lower income rural area.

### **4. COUNTERMEASURES OF CHINESE RURAL FINANCIAL EXCLUSION**

It would fundamentally reduce the gap between the rich and the poor and coordinate the development of urban and rural economy in China, if financial exclusion has been alleviate and eliminate in rural areas. To solve the problem requires the joint efforts of all sectors of the community.

#### **4.1 Strengthen the Government Supervision on Finance**

Financial exclusion is a manifestation of market failure in the end. Government has the responsibility and obligation to alleviate and govern it by strengthening financial supervision.

##### **4.1.1 Strengthen Government Supervision on Formal Financial Institutions**

In accordance with the relevant financial theory, the degree of financial exclusion is usually inverted to the number of branches of financial institutions. Therefore, the government must strengthen the supervision

of financial institutions, preventing them from withdrawing their branches in the rural areas especially in poor areas. Meanwhile, the government should encourage them to fulfill their social responsibilities. The key point is to bring bank deposit and loan services in rural areas into the evaluation system of financial institutions. Thus, the government could urge financial institutions to increase their lending to farmers, rather than set too high requirement.

#### **4.1.2 Strengthen Government Supervision on Informal Financial Institutions**

The informal financial institutions are important parts of rural financial system, strongly supplementing to the formal financial institutions. The government should establish the corresponding laws and regulations to regularize them as soon as possible while there is a severe shortage of financial supply and formal financial institutions couldn't deal with it in the short term. Informal financial institutions would ease the financial exclusion in rural areas with their products and services, if there is a good environment for them.

### **4.2 Unfold Financial Publicity and Education Among Farmers**

It would effectively alleviate the financial exclusion especially the self exclusion caused by asymmetric information, if financial education had been strengthened and financial knowledge had been popularized.

#### **4.2.1 Take Various Forms to Strengthen Financial Policy and Propaganda**

The government should bring rural financial policy and knowledge into the public cultural issues. Bring about a variety of art form which farmers would love to see and hear, and tour in rural areas, so that farmers would fully understand the financial policy. With the credit education of the farmers strengthened, better finance credit environment would come.

#### **4.2.2 Provide Expert Guidance of Rural Financial Practice**

The branches of financial institutions in rural areas should arrange professionals to give on-site presentations for farmers regularly, demonstrating the bank business operation process, helping farmers understanding of financial products and services better and mastering relevant financial business operation. On-site presentations would demonstrate farmers the right way to use them, especially for some of the emerging high-tech business.

### **4.3 Develop Microfinance in Rural Areas**

Microfinance, which primarily aiming at the low income, special groups and micro businesses, is a special financial

service system. MFIs (micro finance institutions) are small sizes, flexible and convenient, and they have got successful development in some countries and regions. For example, the Grameen Bank of Bangladesh helped large numbers of poor groups through the promotion of microfinance business in rural areas. It reduced the default risk and transaction costs with the help of the internal group supervision, thereby reducing cost of bank supervision. In fact, MFIs' operation can effectively alleviate the farmers' self-rejection, marketing rejection and requirement rejection. Therefore, it would be a good plan to develop MFIs in rural areas in China to govern financial exclusion.

### **4.4 Promote the Coordinated Development of the Rural Economy**

To eliminate rural financial exclusion perpetual lies in the development of rural economy, improvement of economic conditions and credit conditions. In view of the vulnerability of agricultural production and disasters irremediable, on the one hand, the government should create conditions for the development of financial institutions by trying hard to adjust the economic structure in rural areas to increase not only the proportion of industry and services but also income of farmers. On the other hand, the government should establish agricultural production insurance system to compensate the risk of farmers. This system could guarantee the income of farmers, increasing the availability of financial resources.

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## **CONCLUSION**

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The financial exclusion is a reflection of financial and social imbalance, who rooting in the allocation of social resources. Generally, the degree of financial exclusion is usually inversely related to the economic development level. Chinese rural financial exclusion' genesis is low income of farmers and the lagging of economic development. To solve the problem would play an important role in eliminating the gap between rich and poor, coordinating economic development and promoting social justice. At present, it would be eased if we strengthen the government supervision, popularize financial knowledge, vigorously develop the MFIs and promote the coordinated development of the rural economy. In the long run, only vigorously promoting and building an inclusive financial system of urban and rural areas and ensuring that everyone can get equal financial rights, could financial exclusion and other forms of social exclusion be completely eliminated.

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