



Microfinance, self-employment, and entrepreneurs in less developed areas of rural China



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ABSTRACT

China is experiencing a transformation, as vast numbers of rural laborers move toward off-farm employment. In such a transformation, the role of credit is unclear. The overall goal of this study is to examine the impact of access to credit by rural households on employment decision-making by rural laborers in China. Based on longitudinal data concerning 1992 rural households in China, this study finds that the use of credit is immense in rural China. Among different types of credit, access to microfinance significantly increased farmers' time working on self-employment activities, especially for the poor households. Credit from formal financial institutions and informal networks had no such effect.

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1. Introduction

Economic transformation around the world has been a remarkably uniform process of movement of agricultural laborer to off-farm employment. The declining share of output and labor force in agriculture is pervasive in both developed and developing countries. Development in many aspects is defined by the transformation of the labor force – from agriculture to non-agriculture (Huffman, 1991). Available off-farm employment creates job opportunities, promotes entrepreneurs, and contributes to poverty reduction by enabling engagement in income-generating activities in developing countries (Kijima, Matsumoto, & Yamano, 2006; Zhang et al., 2006).

The expansion of off-farm employment has clearly been happening in China. The exact numbers vary perhaps due, in part to the exact definition of off-farm labor. However, during the 1980s and 1990s, approximately 200 million in the rural labor force found jobs off the farm, with the increased number at more than 6 million per year (NBS, 2010). Estimates of the rise in the share of the rural labor force employed in off-farm sectors range from 35% to 40% during that time. By the mid-2000s, of China's more than 500 million-strong rural labor force, 265 million (more than 50%) had off-farm employment (Zhang, Huang, Li, & Rozelle, 2008).

Off-farm laborers in China are employed mainly in wage earning and self-employment. Between the early 1980s and 2000, the number of rural laborers who left home and found wage-earning jobs in the city (or another rural area) rose from 9.3 million to 56 million (de Brauw, Huang, Rozelle, Zhang, & Zhang, 2002). During that time, the number of rural laborers who began small in self-employing enterprises rose from 26.1 million to 79.5 million. While self-employment expanded quickly in the 1980s and

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1990s, it was falling by the 2000s. At the same time, wage-earning migration increased steadily and became the primary off-farm employment in rural China (Wang, Huang, Zhang, & Rozelle, 2011).

While the share of self-employment decreases as an economy grows, its role in poor areas is important. In poor economies, more than one billion people run their own businesses. Most of them do this because they have no other option. Some of them do this well enough to survive and self-employment incubates the nascence of entrepreneurs (Banerjee & Duflo, 2011). Self-employment should not be regarded as an inferior sector, as it functions as a self-help safety net in less developed areas (Woodruff, 2007). Huang, Wang, Zhi, Huang, and Rozelle (2011) found that the probability of losing jobs during the financial crisis in 2008 was 10% higher for wage-earning laborers than for self-employed laborers. Self-employment can cushion a crisis when the economy is depressed.

While off-farm employment plays an important role in agricultural transformation, credit constraint has been considered a primary obstacle. Knight and Li (1997) examined the rural industrialization in rural villages of China and concluded that capital market imperfections caused unequal opportunities for off-farm employment. The costs associated with the search for a job and initial moving expenses could present barriers to migration for poor farmers (Rozelle, Li, Shen, Hughart, & Giles, 1999; Zhao, 1999). Investing in self-employment also demands capital funds (Li, Rozelle, & Zhang, 2004). The lack of credit has been found to be the primary constraint to the empowerment of the poor through engaging in off-farm employment during agricultural transformation.

Credit rationing is pervasive in rural China, particularly for the poor. The state-owned formal financial institutions play dominant roles in providing institutionalized loans in the rural economy. However, these programs, target primarily rural industry and entrepreneurs (Han, 2007). Empirical studies reveal that credit programs of formal financial institutions provide credit mainly to the wealthy (Jia, Heidhues, & Zeller, 2010). Given the large unmet demand for credit in rural China, the rural poor heavily depend on informal credit networks (i.e. friends, relatives, and usurers).

Alongside the constraints in both formal and informal credit markets, the development of microfinance in China is just developing. Microfinance was introduced in China in the mid-1990s, through international aid programs for poverty alleviation (Sun, 2004), but it had not been significantly scaled up. The stress of emerged financial risks and the priority of government's control over financial resources through state-owned banks caused depression of microfinance in the late 1990s (Holz, 2001). Since the early 2000s, China's government has started to promote microfinance through formal financial institutions and non-governmental organizations (NGOs). Governmental microfinance has performed poorly in targeting, financial sustainability and program impacts (Park & Ren, 2001). NGO microfinance is expected to be pro-poor.

For a long time, restructuring the rural financial market has been viewed as the central policy in China's rural development strategy. The No.1 State Council document for each year between 2004 and 2010 highlighted a liberalized and diversified rural financial market. While these policy initiatives clearly encouraged a shift in the structure of the rural financial market, it is unclear what the role of the rural credit market is, in affecting the rural labor market. Specifically, we would like to know how farmers' access to different forms of credit affects their decision-making about employment. Does credit from different sources—institutional lender or formal credit, informal credit network or microfinance—have different impacts on farmers' length of employment in farming, wage earning, and self-employment? Which credit source has a larger effect on farmers' off-farm employment, particular self-employment?

The overall goal of this paper is to fill the gap. Specifically, we focus on two objectives. First, we examine farmers' credit access from various sources and their time allocation to different activities. Second, we analyze and compare the effects of credit access from different sources on farmers' off-farm employment in the wage-earning and self-employed sector.

Because of the ambitious nature of the goals and the high cost of data collection for the entire microfinance sector, we necessarily must limit the scope of the paper. In particular, in this study we examine mostly farm-level credit access in the North and Northeastern sections of China; we did not survey enterprises and non-farm residents. Second, this is not a study of all microfinance in China. We focus on China's NGO microfinance, as it has more implications for the rural poor. Third, as an ex post evaluation study, we could not create a baseline survey, a well-defined control group, or other means of identification. Instead, based on fundamental events of the credit history of surveyed households, retrospective panel data were relied on.¹

To meet the goals and objectives of the study, the rest of the paper is organized as follows: To begin with, we introduce data collection and sampling. The next section describes the dynamics of farmers' credit access and off-farm employment in the sample villages. We precede the multivariate analyses with a conceptual basis of self-employment. Then we estimate the impacts of credit access on farmers' off-farm employment time. In the final section, we draw our conclusions.

2. Data and research design

To compare farmers' credit access from various sources, we needed study areas that had both microfinance and other forms of financing. A random sampling strategy might have kept us from having enough samples of microfinance, due to its small coverage and regional differences. Therefore, we selected areas where China's largest NGO microfinance—CFPA microfinance—operated.²

As the largest NGO dealing in microfinance, CFPA microfinance was transformed from a governmental pilot program to an institutionalized NGO. From 2000 through 2004, CFPA piloted microfinance services in poor rural areas of Sichuan, Shanxi, Guizhou, and Fujian provinces. During those five years, it was by nature a government charity project; capital was highly subsidized and the business was run as a government program. In 2005, CFPA microfinance was approved to be independent

¹ Although some studies evaluate the effectiveness of microfinance ex ante to implementation (Kaboski & Townsend, 2011; Karlan & Zinman, 2010, 2011), recent research on microfinance shows that, when designed appropriately, retrospective panel data are able to provide accurate measures of the impacts (McIntosh, Villarain, & Wydick, 2011).

² CFPA is registered with the Ministry of Civil Affairs and under the superintendence of the State Council Leading Group Office of Poverty Alleviation.

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