



GLOBAL JOURNAL OF MANAGEMENT AND BUSINESS RESEARCH: C  
FINANCE

Volume 14 Issue 3 Version 1.0 Year 2014

Type: Double Blind Peer Reviewed International Research Journal

Publisher: Global Journals Inc. (USA)

Online ISSN: 2249-4588 & Print ISSN: 0975-5853

## The Study of Chinese Farmer's Personal Loan

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**GJMBR-C Classification :** *JEL Code: H81, Q14*



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# The Study of Chinese Farmer's Personal Loan

Xinmin Zhang<sup>α</sup> & Chaoxiang Jia<sup>σ</sup>

**Abstract-** The personal loan between farmers is a kind of personal loans, which is widespread in rural and has a long history. Since three decades of reform and opening-up, the farmers' economic conditions are getting better. Although the formal financial institutions has been covering the whole cities and counties, the farmer's personal loan have never stopped. The motivation of farmers' personal loan has been gradually changed from the living consumer loan to the production operation loan. And the practical application of the use shows a trend of non-agricultural loan. In economically developed areas, the farmers are more willing to borrow money from the informal financial institutions, thus raises many legal issues. Specification the behavior of farmers' personal loan mainly starts with the acquaintance of the loan policy and government regulation.

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With the deepening of the reform and opening-up, the rural economy is going through tremendous changes. Today, as the financial mechanism is increasingly sophisticated, although the formal financial institutions has provided safe and guaranteed lending channel for the development of rural economy and society, including rural credit cooperatives loan and state-owned commercial bank loan, personal loan between farmers which is ancient and informal is still enduring, so it must has its unique value. From the existing literature, studies of the behavior of farmer's personal loan are more, but further study of the personal loan between farmers is less. Based on the existing literature data, this paper tries to analyze the inevitable reasons, development tendency and countermeasures of long-standing farmer's personal loan.

## I. OVERVIEW OF FARMER'S PERSONAL LOAN

### a) Definition of Farmer's Personal Loan

When defining the concept of personal loan, foreign scholars used to see whether it belongs to the national financial regulatory system as standard. Traherne considers that the key to distinguish between personal loan and formal finance is whether it is necessary to rely on social law system to perform financial activities, which means that personal loan refers to some kind of financial activities without social law system as specification.<sup>1</sup> Domestic academic circles

have different opinions about the definition of personal loan. And most of them use the law or official standard for reference. Some scholars believe that personal loan is all for-profit capital raising activities between individuals, or enterprises, or individual and society, which has always been free from the official regulation and mainstream finance research field.<sup>2</sup> Other scholars believe that personal loan is sort of financial activity which is not recognised by the law and other official forms, including financial activities which have not been officially recognized by law performed by the formal financial body, also some innovative financial activities which are not recognized by the laws and regulations temporarily. Besides some scholars believe that personal loan is a kind of financing behavior which is without legal regulation and lack of legality.<sup>3</sup>

Although among domestic academic circles, the definition of personal loan has no final conclusion, scholars have converged on the connotation that personal loan is kind of informal loan.<sup>4</sup> According to the loan body, it can be divided into the generalized personal loan and narrow personal loan. Narrow personal loan refers to the loan behaviors between natural persons in accordance with the contract. However, generalized personal loan also include loan behaviors between natural person and legal person, natural person and other organizations. It usually refers to the narrow personal loan in the real life. The author thinks that, farmer's personal loan refers to kind of narrow personal loan which is not participated by farmers and not recognized by the law and regulations.

Personal loan is very common in our country. Chinese family financial investigation and research center of Southwest University of Finance and Economics released *The Bank and The Family Financial Behavior* in July this year. It showed that the participation rate of personal loan in our country is high. There are 33.5% of family participating in the activities of personal loan. And the total amount of loan reach 8.6 billion yuan, in which 3 billion yuan is used for agriculture and industry and commerce. Such a large figure also reflects

<sup>2</sup> See Jianjun Zhang, Zhonghong Yuan, Ping Lin, "From Personal Loan to Private Finance: Industrial Organization and Trade Rules", *Financial Research*, 10<sup>th</sup>, 2002.

<sup>3</sup> See Tian Zheng, Longfeng Wang, Yun Xiao, "The Harmonious Development of The Middle and Small-sized Enterprises and Private Financial", *Enterprise Economy*, 3<sup>rd</sup>, 2006.

<sup>4</sup> See Zheng Chen, Yun Li, "Research Review of Modern Chinese Rural Personal Loan in Thirty Years", *The History of Chinese Farmers*, 2<sup>nd</sup>, 2013.

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<sup>1</sup> See Xin Wang, *Financial Law*, China University of Political Science and Law Press, 2007, p.167.

from the side that, formal credit industry can not fully meet people's needs of financing in our country.

### b) *Nature of Farmer's Personal Loan*

In the legal relation, farmer's personal loan is classified as a loan contract relationship. On the other hand, personal loan contract is practical contract, which means that loan contract goes into effect when lender pay the money as the requirement of validity of contract. In real life, as the custom of personal loan, lender usually pays the money first, then borrower issues IOU(I owe you). Therefore, in determining the effectiveness of personal loan behavior, as long as in case the intention of both parties is real, and the loan behavior is legal and delivered, then it can be considered valid.

There are no uniform legislation about farmer's personal loan in our country, so in practice it is used to apply the relevant provisions of the *General Principles of The Civil Law* and *Contract Law*. *General Principles of The Civil Law* prescribed in article 90: "Legitimate loan relationships shall be protected by law." *Contract Law* stipulated in article 210: "A loan contract between natural persons shall come into force as of the time when the lender extends the loan." *Contract Law* also stipulated in article 211: "If there is no agreement in a loan contract between natural persons as to the payment of interest or such agreement is unclear, it shall be deemed as non-payment of interest. If the payment of interest is agreed in a loan contract between natural persons, the loan interest rates shall not violate the provisions of the State on the restriction on loan interest rates." Thus it can be seen that loan between natural persons have legal nature.

Private financial institution is more prevalent where private economy is more advanced. When farmers encounter cash flow difficulties, they would also lending to such institutions. *Criminal Law* in China definitely stipulate that, without approval of the national authorities, no one will be allowed to set up financial institutions. Even if someone set up a legal financial institution, there still exist risks when conduct loan practice, such as illegal fund-raising, and illegally or in disguised form, absorbs savings deposits from the public, and illegal possession. As a result, the author thinks that the state have reservations about the development of private financial institutions.

### c) *Characteristic of Farmer's Personal Loan*

The main characteristics of farmer's personal loan are freedom and legitimacy. It also reflects that the constraints of current laws and regulations are quite loose about the personal loan relationship. Principle of autonomy embodies particularly obvious in farmer's personal loan. For example: there are a large number of interest-free loans in farmer's personal loan. But in the formal financial institutions, it is basically interest-bearing loan.

In the terms of loan body, it is usually between farmers, farmers and enterprises (excluding informal financial enterprises), farmers and other financial institutions. The form of loan often appears as written or verbal form. The debtor-creditor relationship is based on equality and voluntary of two sides. But there is no distinction on the loan purposes. Commercial credit and consumer credit are nothingness. The only rule is that it can not be used for illegal purpose. In terms of loan amount and credit, it is completely different from the formal financial institution loan. Farmer's personal loan generally is unsecured, small loan amount, based on rural customs and personal credit, and less than two years.

## II. STATUS QUO AND REASON ANALYSIS OF FARMER'S PERSONAL LOAN IN CHINA

### a) *Basic Situation of Farmer's Personal Loan in Different Areas*

#### i. *The Situation of Farmer's Personal Loan in The Western Region—Take Shaanxi Province as Example*

The needs of farmer's personal loan have always been relatively high. According to the survey, northern Shaanxi, Guanzhong, southern Shaanxi, 11 villages in these 3 regions have 42.58% of farmers who have the intention to get loan from the bank, credit union and private sources.<sup>5</sup> Specific to the survey sample of Xianyang City as an agricultural base in Shaanxi Province, the rate of personal loan between farmers reaches 74.38%. The rate of getting loan from the formal financial institution reaches 12.5%, informal financial institutions accounts for 7%, including interest-free loans which accounts for 85.71%.<sup>6</sup> In the total sample, the proportion of farmer's personal loan is more than half, which means farmers prefer informal loan. Farmers prefer to borrow money from relatives and friends, mostly because farmers lack the confidence of getting loan from formal financial institutions successfully, the low expectation of getting loan, red tape, and higher interest costs. It is worth mentioning that the majority of the sample think that there is no bearing borrowing in the local. However, in fact bearing borrowing between farmers have quietly begun.

#### ii. *The Situation of Farmer's Personal Loan in The Central Region—Take Shanxi Province as Example*

In the central region, it takes six counties in Shanxi as example, including Shanyin County, Yangche-

<sup>5</sup> See Rong Niu, Jianchao Luo, Hang Zhang, "Studies of Shaanxi Farmer's Loan Behavior", *The Agricultural Technology Economy*, 4<sup>th</sup>, 2012.

<sup>6</sup> See Leiling Wang, Jianchao Luo, "Investigation and Analysis of Farmer's Loan Needs: Take Shaanxi Province As Example", *Agricultural Economy*, 1<sup>st</sup>, 2012.

ng County, Jiaocheng County, Dai County, Xia County, Shilou County (take samples according to net income level). Shanyin County got the highest average income of 7,532 yuan, the lowest average income of 1,410 yuan is Shilou County. The results showed that 300 household farmers who were investigated reached 70.33% of lending rate. Farmer's personal loan accounted for 71.43% of the sample, in which getting loan from rural credit cooperatives (formal financial institutions) was 16.71%, from private lenders (informal financial institutions) accounted for 5.57%.<sup>7</sup> In terms of the sample, farmer's personal loan is still much higher than the formal financial institution, in which interest-free loan rate is higher, reaching 62.95% as dominant. Although interest-free loans are common among relatives and friends, at today, as the economic concept is stronger, the author thinks that interest-bearing loan will take the dominant position in the future.

iii. *The Situation of Farmer's Personal Loan in The Eastern Region—Take Fujian Province as Example*

The level of economic development in Fujian Province is relatively high. National Bureau of Investigation Corps Fujian released data shows that rural per capita cash income is 5,671 yuan in Fujian Province in the first half of 2012, up 12.7% from a year earlier. The actual increase is 10.6 % after deducting price factors.<sup>8</sup> But there is still farmer's personal loan. According to the data, which covers the city of Fuzhou, Quanzhou, Zhangzhou, Ningde, Sanming, it shows that the lending rate of farmers is 70.9%, in which farmer's personal loan is top of the list, reaching 49.8%. However, the ratio of getting loans from financial institutions significantly increased, compared with the above-mentioned areas, which reaching 31.5 %, and reaching 18.7 % of getting loan from informal financial institution. But formal financial institutions failed to meet the farmers' loan needs. The survey indicates that the farmers who already borrowed the money, especially large-scale, would get more loan from formal financial institution. The reasons are also diverse, the most important one is the formal lending rate is too high, increasing their repayment pressure.<sup>9</sup> And the interest rate of farmer's personal loan is acceptable. In Fujian district, it has become a widespread phenomenon that farmer's personal loan would charge interest, interest-bearing loan rate reaching 40 % or more basically. Besides, the so-called interest-free loan is basically

occurs only in non-commercial investment loan between friends and relatives, and interest-free loan is often accompanied by "debt of gratitude", which shows in many ways, such as gifts, treat, unpaid workers and other economic benefits help, which could be seen as hidden interests.<sup>10</sup> So, the real interest-free loan is rare.

iv. *The Situation of Farmer's Personal Loan in The Economic Developed Area —Take Wenzhou City in Zhejiang Province as Example*

Wenzhou is a coastal port city, which economic development among the best in the country. So farmers' loan data here have a typical research value. According to the data of Wenzhou Municipal Bureau of Statistics, it shows that in 2012, Wenzhou rural residents per capita net income were 14,719 yuan, and Wenzhou rural residents per capita consumption expenditure are 10,820 yuan.<sup>11</sup> Went around 15 villages in Wenzhou and investigated, only 20.8% farmers made a positive reply to the question of "whether to get loan from the bank or credit union", nearly 80% farmers said they did not apply or get loan from a bank or credit union, in which 47.25% farmers said clearly that they had personal loan, 39.8% farmers participated in the bidding clubs and other informal financial institutions. Interest-free loan still exists, but varying rates of interest-bearing loan is more.<sup>12</sup> It can be seen that, in Wenzhou informal financial organizations ( Bidding ) are more developed, and farmers are also very willing to participate in this financing. It has become the second form of loan after farmer's personal loan. This phenomenon has something to do with the some reasons such as regional economic and rural social structure. But, it has to admit that, either in developed area or less developed area, there all have a large number of farmer's personal loan.

b) *Comparison of Different Areas of Farmer's Personal Loan*

By the above data, it can be seen that, with the development of the regional economic, farmer's personal loan rate tend to decline gradually, and the lending rate of financial institutions tend to rise gradually. But in the developed area (e.g. Wenzhou), the lending rate of financial institutions decline significantly, and yet the lending rate of non-formal financial institutions rise basically, which is particularly evident in the developed area (e.g. Wenzhou). See table 1.

<sup>7</sup> See Lina Yan, "Study of Factors Affecting Farmer's Loan in Shanxi Province", Master Thesis, Department of Agricultural Economic Management, 2012, p.21.

<sup>8</sup> See Kai Lin, "The Rural Per Capita Cash Income Rose by 12.7% During the First Half", *Fujian Daily*, on July 18, 2012.

<sup>9</sup> See Xingming Zheng, "An Empirical Study of Farmer's Lending Behavior and Its Influencing Factors - Based On the Investigation of the Rural Areas in Fujian Province", *Fujian Agriculture and Forestry University (Philosophy and Social Sciences)* 5<sup>th</sup>, 2011.

<sup>10</sup> See Birong You, "Investigation and Analysis of Farmer's Lending Needs in Fujian Province", *Fujian Agriculture and Forestry University (Philosophy and Social Sciences)* 3<sup>rd</sup>, 2009.

<sup>11</sup> See Wenzhou Municipal Bureau of Statistics, "The City's Per Capita Net Income of Rural Residents are 14,719 Yuan in 2012", January 23, 2013, the last access date: December 26, 2013. [http://www.wenzhou.gov.cn/art/2013/1/23/art\\_3598\\_253599.html](http://www.wenzhou.gov.cn/art/2013/1/23/art_3598_253599.html).

<sup>12</sup> See Shuitu Qian, Hui Lu, "The study of development of rural informal finance and farmer's financing behavior-based on investigation and analysis of rural areas in Wenzhou", *Financial Research*, 10<sup>th</sup>, 2008.



Table 1

	Western representatives	Central representatives	Eastern representatives	Developed area representatives (Wenzhou)
Farmer's personal loan	74.38%	71.43%	49.8%	47.25%
Formal financial institution	12.5%	16.71%	31.5%	20.8%
non-formal financial institution	7%	5.57%	18.7%	39.8%
Rate of interest-free loan	85.71%	62.95%	58%	/

c) *The Reasons of Farmer's Long-standing Personal Loan*

i. *Loan Cost of Formal Financial Institution is High*

The cost here do not refer only to the cost of capital, but also the time cost, satisfaction cost. It is a hard fact that the lending rate of formal financial institution is high. In the terms of time cost, according to the author's survey of the customer, for most customers, it needs a month or so to get the loan. If in the case of complete procedures, it may be faster. But preparing the the documents that the bank needed is also a extremely time-consuming thing. The author considers the satisfaction cost as the most important cost because it directly related to customers' choices on borrowing. Many customers reflect the bank staff has bad attitude, deliberately making things difficult. For instance, they claim that some businesses can only be dealt with at the opening bank, but in fact it can be dealt with at any sub-branch. Also, there are lots of people standing in line, but there are several business windows closed. Those facts above will make the customers very unsatisfied, paying anxiety cost.

ii. *Farmer's Personal Loan Has Its Own Advantages*

Farmer often has times when money is urgent needed, such as purchase of means of production, purchase of house, seeing a doctor and so on. Due to the structure of rural acquaintance relationship, it is quite convenient to borrow money from relatives and friends. Without almost any time cost, it is very timely, easy procedure, with only a IOU.<sup>13</sup> It is usually interest-free. However, farmer choose their relatives and friends to borrow money not because the interest-free privilege. The main reason is convenience.

iii. *Farmer's Personal Loan Has Reasonable Existence of the Social Environment*

Farmer's loan can be divided into living consumer loan and production operation(investment) loan. Living consumer loan include housing, medical care, weddings and funerals, school, basic living expenses, and so on. Production operation(investment) loan include agriculture, livestock breeding, transportation, product processing, individual business, and so on.

In less developed areas, the main farmer's personal loan is living consumer loan. The survey points out that many farmers are plagued by education expenses, housing, weddings and funerals, medical care. Although these four purpose of loan are essential needs in everyday life, the loan conditions set by the rural credit cooperatives for such purposes are extremely harsh. "Micro-credit" basically does not support this type of loan. Therefore, when they lack of capital accumulation, farmers can only turn to non-formal financial institutions for help. In less developed areas, non-formal financial institutions are rare. So most of the time, farmers choose to borrow money from relatives and friends.

However, in the developed areas, the purposes of farmer's personal loan have some changes. With the adjustment of industrial structure in rural areas showing a variety of features, the tendency of non-agriculturization of the purpose of the loan is increasingly apparent.<sup>14</sup> The author thinks that the non-agriculturization of the purpose of the loan fits the rule of economic development. Traditional agriculture and planting have great risks. It should consider many factors, like natural disasters, personal cultivation management technology, market price fluctuations, personal identification capability about seeds fertilizers pesticides. If any part of it goes wrong, it will be a complete failure. So formal financial institution is very cautious about the loan for farmer's purchase of agricultural production. Therefore, the state introduced a policy, known as "farmers microcredit loans". Nevertheless, because of "information asymmetry" and "financial repression", farmer is often unable to obtain loans from formal financial institutions or has no intention to. However, with respect to loans for business purposes, because the risk is relatively low and the return is relatively high, then probability of farmers to obtain loans is much higher. So the thing is, it is hard for farmer to obtain loan for agricultural purposes. And there is no motivation for formal financial institutions to lend to farmers. Besides, farmers microcredit loan is not common. In the end, farmers cannot but borrow money from informal financial institutions or relatives and friends for agricultural purposes. In the meantime,

<sup>13</sup> See Chaoxiang Jia, Xinmin Zhang, "Legal Strategies of Farmer's Personal Loan Issues", *Chinese Rural Finance*, 5<sup>th</sup>, 2014.

<sup>14</sup> See Birong You, "Investigation and Analysis of Farmer's Lending Needs in Fujian Province", *Fujian Agriculture and Forestry University (Philosophy and Social Sciences)* 3<sup>rd</sup>, 2009.

formal financial institution is negligent in lending money to farmer, which conversely help the informal financial institution to develop.

In the previous section of the paper, the author cited data from different regions of different domestic economic development level, which illustrate that farmer's personal loan happens in various regions, and has dominate position in the rural informal financial markets. The author believes that the root cause of farmer's personal loan is adaptation of the rule of market economy. In less developed areas, the main purpose is still the agricultural production and living consumption. On the other hand, in developed areas, the main purpose is non-agricultural production and operation, because the risk is relatively low with relatively high income. So no matter where farmer is, he struggles to achieve financial freedom. But because of the credit policy of formal financial institution, it is inevitable of farmer to borrow money from informal financial institution or relatives, neighbors, and friends.

Since the reform and opening-up policy, it has emerged some developed regions. While more than half of China are less developed regions. Everything doesn't happen at once. It is a slow process, just like initially the purpose of loan was agricultural production and now non-agricultural production and business has emerged. As a result, farmer's personal loan will exist for a long time.

### III. LEGAL ISSUES OF FARMER'S PERSONAL LOAN

#### a) *Legal Status is Unclear*

In our country, there is no uniform legislation on personal loan. It is scattered in various laws and regulations, which lead to conflict among laws and regulations. And when it happens, it is difficult to choose standard reference. Another big problem is lack of content. Current laws stipulate the body, loan interest rate, guarantee style, and liability of farmer's personal loan here and there. But the rights and obligations of the parties, legal and regulatory measures and other issues are not involved.<sup>15</sup> Even in the lending body, the law should be improved as well. For example: personal loan market has various loan companies, including investment guarantee management companies, investment management companies, investment advisory management companies, real estate investment management companies. Currently the companies which are permitted to set up by the state are investment guarantee corporation and small loan company. The future of small loan company is rural bank. The development direction of investment guarantee company is large-scale and normalization. While other types of companies set up without any

<sup>15</sup> See Guopei Wu, Jianhua Weng, Zhi Geng, "Analysis of Legal Problems of Personal Loan", *Fujian Finance*, 2<sup>nd</sup>, 2009.

policy basis.<sup>16</sup> But if it is only based on the fact above to identify the loan practices invalid, it will lead to market confusion. Chinese academy of social sciences report also called on a clear legal status for personal loan to avoid the embarrass situation today.

#### b) *Form of Behavior is Not Standard*

Personal loan is know as convenience and randomness. And the following problem is that the behavior of loan form is extremely irregular. These problems include: only oral agreement, high interest rate, illegal interest calculation methods, the repayment period not standardized, turn lending issues, illegal fund-raising fraud, non-standard form of contract and other issues.

Even in written form, there are also many nonstandard problem. For example: a IOU with loan agreement as for title. While a loan agreement is just a consensus reached by two sides about loan. To prove the fact of loan, it also need a receipt. In other words, to prove the fact of loan is established, under the condition of a loan agreement, it also must have a loan receipt.<sup>17</sup> In addition, IOU written by creditors, simple remittance documents, accounting IOUs etc, all of above are non-standard. The author believes that such non-standard behavior is due to the lack of unified legislation of personal loan and the lack of loan body's awareness of the law after all. On the other hand, due to the randomness and not normative of personal loan, it would easily lead to regional economic crisis.<sup>18</sup>

#### c) *Government Regulation is Not in Place*

In developed areas, the purpose of farmer's personal loan tend to be non-agricultural. More farmers do business after they obtain the loan. Nowadays, many organizations engaged in personal loan just after registering in the business sector. Farmers are too anxious to choose such institutions. Those kind of organizations, which just register in the business sector and lack of financial license, are able to engage in personal loan because of no laws. In addition, for loans between natural persons, there are laws and regulations. But when participating in personal loan, the parties do not do things in accordance with national laws and regulations. As an example, there is a strict rule of interest rate, but many people do not comply with the rule, then it becomes usury. So in fact, there are laws and regulations. Yet they are not performed well. Therefore, it is necessary to guide and regulate these

<sup>16</sup> See Zihui Li, "The Legal Status of Many Companies in Personal Loan Market", June 7, 2012, last access date: October 20, 2013. <http://www.66law.cn/lawarticle/7766.aspx>.

<sup>17</sup> See Qiang Liu, Yan Feng, "The Identification of Effectiveness of Non-standard Constraints in Personal Loan", December 19, 2011, last access date: January 9, 2014, <http://ylzy.chinacourt.org/public/detail.php?id=2336>.

<sup>18</sup> See Xiaoming Li, Lei Zhao, "Personal Loan of Erdos Conservatively Estimated 2 Billion", *Morning News*, October 18, 2011.

personal loans how to perform in accordance with the law.<sup>19</sup>

#### IV. LEGAL MEASURES OF STANDARDIZING FARMER'S PERSONAL LOAN

Mr. He<sup>20</sup> and Mr. Li<sup>21</sup> whose study found that more than 60 percent of rural lendings are from non-formal financial institutions. And most of them are interest-free loans. In terms of the loan amount, 93.95% of them occurred between relatives, friends, neighbors (farmer's personal loan). Although the survey data was a little more than a year ago, but in previous part of this paper have proven that the rural lending practices in recent years have little change, but it mainly happens among personal loans. Thus, it triggers some legal issues which could not be ignored.

##### a) *Improve Legislation of Personal Loan, Clearly Acknowledge the Validity of Farmer's Personal Loan*

Credit constraints of formal financial institutions make interest-free loans and interest-bearing loans happen more often.<sup>22</sup> The author considers it should loosen the restriction of policy appropriately for farmer's personal loan, with subsidization, meeting the demands of farmers' normal living expenses, reducing the loan for farmer's life consumption. On the other hand, how close the debtor and lender are has the most significant impact on the trust between them.<sup>23</sup> The law does not adjust these relationships directly. However, born of rural acquaintances structure, rotating savings become powerful restriction role for farmers, which is based on geographical and kinship advantage to obtain information and rely on some kind of social capital or social mechanism to ensure the execution of the contract, making the borrower comply with the corresponding specifications. Therefore, the government can be based on the context of rural development, promoting development by innovation, recognizing the legal status of non-formal financial institution and providing them relatively loose platform, which makes formal finance and informal finance to coordinate with each other. Reducing the cost happened during the time when non-formal financial institution avoid regulatory. Try to avoid and reduce the damage that caused by non-

formal finance when it takes unfair means to destroy legal system and moral environment.<sup>24</sup>

The relationship between the informal and formal financial institutions is not a shift, competing and alternative relationship. Due to each advantages of them, it also can be a complementary relationship.<sup>25</sup> Garmaise and Moskowitz's(2002) study showed that even such a country like U.S.A has a perfect capital market, informal financial institutions are widespread as well, playing a very important role.<sup>26</sup> In view of the above research conclusions, combining the reality of life, there will be a very long time that informal financial markets are subsisting. While farmer's personal loan and informal financial institutions occupy the front row in the informal financial markets. Farmer's personal loan rely on rural acquaintance social structure. Interest-free loan has been accepted by the majority of farmers. While informal financial institutions rely on the closeness of farmer's real life, possessing the information advantage, with convenient procedures. The two kinds of loans above are both based on blood relationship and geographical relationship, guaranteed by credit and morality of rural relatives, acquaintances, and friends. So it can be maintained ever since. The author thinks that the government can recognize the legitimacy of rotating savings (similar to third-party organizations such as "Alipay" between the sellers in electronic commerce), making use of their information resources and acquaintances relations to improve economic development in part of rural areas. At the same time, reducing lending disputes by limit rotating savings become monopolies through legislation.

##### b) *Regulate the Behavior of Farmer's Personal Loan*

###### i. *Gradually Realize the Writing Form of Personal Loan*

Since the foundation of farmer's personal loan behavior is "two-love" relationship, so there is almost no IOU.<sup>27</sup> No matter where it is, there are conditions like just oral agreement, without any written form. Because of the acquaintance of social structure, for fear of hurting other's feeling and lack of legal consciousness, generally there is no written evidence at all, which becomes potential problems of future disputes.

<sup>19</sup> See Xijun Zhao, "Strengthen Supervision of Personal Loan and Dispose Responsible Party Legally", October 12, 2011, last access date: October 19, 2013, <http://finance.eastmoney.com/news/72002,20111012168426465.html>.

<sup>20</sup> See Guangwen He, "research on rural financial control and financial deepening from aspect of the behavior of rural residents' loan", *Chinese Rural Economy*, 10<sup>th</sup>, 1999.

<sup>21</sup> See Rui Li, Ningjun L., "Analysis of Farmer's Lending Behavior and Welfare Effects", *Economic Research*, 12<sup>th</sup>, 2004.

<sup>22</sup> See Yongqiang Ma, "Analysis of Chinese Farmer's Financing Situation and Preference-According to the National Farmers' Loan Questionnaire", *The Economist*, 6<sup>th</sup>, 2011.

<sup>23</sup> See Weihua Yang, Rong Kong, "Affecting Factors of Trust of Farmer's Personal Loan", *Northern Economy*, 4<sup>th</sup>, 2011.

<sup>24</sup> See Shuitu Qian, Hui Lu, "The study of development of rural informal finance and farmer's financing behavior-based on investigation and analysis of rural areas in Wenzhou", *Financial Research*, 10<sup>th</sup>, 2008.

<sup>25</sup> See Junhua Yin, "The Financial Gap, Non-formal Finance and Reform of Rural Financial System- Research on Personal Loan in Rural Areas in Shenyang", *Financial Research*, 8<sup>th</sup>, 2006.

<sup>26</sup> See Garmaise Mark J. and Moskowitz, Tobias J., "Informal Financial Networks: Theory and Evidence", NBER working paper 8874, 2002.

<sup>27</sup> See Dongsheng Li, Qinghua Shi, "An Empirical Analysis of Farmer's Household Savings and Lending Behavior in Jianli County in Hubei", *Hubei Agricultural College*, 3<sup>rd</sup>, 2003.

ii. *Establish Registration System of Farmer's Personal Loan*

As can be seen from the data ahead, there are quite a lot of farmers have no IOU on account of various reasons, which set many obstacles to solve the disputes, such as the difficulties of proof, authenticity of IOU. It makes the problem hardly fairly solved. Also, farmers in eastern regions may have some surplus funds. If they are in idle at home, it will be a waste of resources. For this reason, the author believes that to solve such problem effectively, a compulsory loan grading system should be established. Registration authority as mentioned here refers to organizations and institutions established or recognized by the state, registering farmer's personal loans one by one. Similar to the general property registration agency, the registration authority only confirm and register the loan contract. And it is not responsible for specific lending practices. Once the two sides have trouble with the loan, the registered records can be seen as a legal basis, which as a proof and protection within the law for lending practices.<sup>28</sup>

iii. *Implement the Guidance System of Interest Rate*

In 1991, *Civil Law of China* define usury as interest rate is more than bank lending rate four times. However, the People's Bank of China decided to release loan interest rate cap of financial institution in 2004, which made the standard above lose the original significance of restriction due to lack of reference. At present, the judicial practice personnel refers to "simultaneous and congeneric loan benchmark rate", which is published by the People's Bank of China, as a frame of reference to define usury behavior. According to this standard, usury is quite common in urban.<sup>29</sup> While in rural, usury is rare. According to the survey, it found that the rate of farmer's personal loan has no fixed value. In Wenzhou, annual interest rate is range from 0 % to 20 %.<sup>30</sup> Most of farmer's personal loans are interest-free loans. With the regional economy development, the interest-free loan gradually turns into the interest-bearing loan. It is worth mentioning that the legal consciousness of farmers also increased. When lending rate is certain, farmer would consider not only the earnings but also the security. In Fujian Province, the monthly interest rate of farmer's personal loan is 1 cent, which account for 26%, 1-2 cents account for 70 %. The proportion of which is more than the bank interest rates four times over the same period is very small. The truth

is there is usury, but not obvious.<sup>31</sup> China's financial industry is relatively mature. With the development of rural urbanization and economy, the high interest rate of farmer's personal loan will affect China's economic development.<sup>32</sup> Usury disturbs the market order seriously, causing economic bubble seriously, heavy burden on borrowers, even lead to ruin and death. The author believes that the identification of usury should adopt different standards to different subjects, distinguishing productive lending and life lending. Adding moral adjustments when necessary to crack down the interest that is not being recognized by the community and too harsh.

iv. *Unify Interest Calculation Methods*

There are two personal loan interest calculation methods, namely simple interest and compound interest. Compound interest is known as interest on interest. Compound interest formula: principal and interest = principal \* [(1 + interest) the power of n]. There is a view that compound interest calculation is usury and is illegal, which should not be protected by law. Compound interest calculation gets more than simple interest calculation. But just because of that, to define compound interest calculation is illegal, that is contrary to the principle of autonomy. According to "Several Opinions of the Supreme People's Court on Lending Cases" in article 6: "rate of personal loan could be higher than the interest rates of banks appropriately. Local court may be based on the actual situation in the region, but it could not exceed bank lending rate four times (including the interest rate of the number ). Beyond this limit, the exceeding part will not be protected." Next article: "lender shall not seek usury by joining interest in principal. In the trial, if the court found the creditor compute compound interest by joining interest in principal and the interest rate exceeds the limits specified in Article 6, the exceeding part will not be protected." Therefore, the author thinks that, interest should go through a specific calculation. If the final interest is four times more than bank lending rate, the exceeding part shall not be protected, but the rest of it should be valid.

v. *Turn Borrowing Problems*

The information of farmer's personal loan is asymmetric, which gets worse in rural areas. As a result, turn borrowing happens occasionally. For example, one villager want to borrow money from his friend, who has no extra money. So his friend turn to someone else for help. The someone earning price scissors (similar to VAT). With the lending rate increasing, the lender's

<sup>28</sup> See Haiying Liu, Zhoujun Pu, Hanxiao Wang, "Analysis of Sun Path of Personal Loan Based on Registration System", *Shanghai Finance*, 6<sup>th</sup>,2012.

<sup>29</sup> See Huilian Zheng, Xuming Zhao, "Legislative Rules of Personal Loan", *Nanjing Social Sciences*, 8<sup>th</sup>,2012.

<sup>30</sup> See Shuitu Qian, Hui Lu, "The study of development of rural informal finance and farmer's financing behavior-based on investigation and analysis of rural areas in Wenzhou", *Financial Research*, 10<sup>th</sup>,2008.

<sup>31</sup> See Birong You , "Investigation and Analysis of Farmer's Lending Needs in Fujian Province", *Fujian Agriculture and Forestry University ( Philosophy and Social Sciences )* 3<sup>rd</sup>, 2009.

<sup>32</sup> See Yuting Guan, Xiaolan Kang, Bin Liu, "The Impact on Economic and Social Development from the High Interest Rate of Rural Personal Loan", *Business Research*, 10<sup>th</sup>,2011.



repayment pressure increases, along with a corresponding increase in moral hazard. The best solution is build the appropriate lending platform (informal), so that we can obtain unified information, reduce intermediate links, and reduce financing costs.<sup>33</sup>

c) *Establish a Government Guidance Mechanism for Farmer's Personal Loan*

i. *Establish verification system of farmer's personal loan*

The witness agency set up by the government, which is similar to notary office, guarantees the contract of farmer's personal loan is valid as a eyewitness on the scene. Under such system, it will provide security for farmer's personal loan.

ii. *Establish Legal Consulting System of Farmer's Personal Loan*

Setting up the simple and delicate legal consultancy in rural areas, improving farmers' legal consciousness. Fundamentally solving the problem of irregular behavior of farmer's personal loan.

iii. *Establish Dispute Mediation Mechanism of Farmer's Personal Loan*

Intervening by the government or delegating prestigious and credible old man is in charge of coordinating the dispute caused by the farmer's personal loan. This system aims to relieve the contradictions of rural society. It is based on rural acquaintances environment so that it can implement smoothly.

<sup>33</sup> See Li Fang, "The Relationships of Register Service Center and Lending Rates of Personal Loan", *Economic Vision*, 13<sup>th</sup>, 2013.