Does NGO Microfinance Crowd Out Other Credits:
Micro Evidence from Rural China

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Introduction

The rural credit market is much less developed in developing countries.

Internationally, microfinance run by non-governmental organizations (NGOs) is often considered an important approach to meeting the credit demand of rural households, particularly among the poor.

However, the perceived competitions with formal financial institutions and concerns about financial risks in the rural economy have impeded the development of microfinance by NGOs in China.

Surprisingly, little empirical evidence has been brought to prove the above concerns. Does farmers’ access to NGO microfinance undermine lending by other financial institutions (and thus poses direct competition)? How does NGO microfinance affect informal credit (a source of credit that is often considered risky)?

Objective

◆ To provide empirical evidence of potential competition that NGO microfinance may have posed for formal financial institutions

◆ To measure the likely effects of NGO microfinance on informal credit in rural China.

Sampling and Data Collection

we examine China’s largest NGO microfinance (CFPA microfinance)

Period: 2006-2009

Counties: HA and XB both are group lending and national designated poverty counties

Villages: Two categories (Microfinance villages and Non-Microfinance villages)

Households: 749 in MF and 1246 in Non MF, separately.

During 2006-2009, the percentage of households in non-microfinance villages with formal credit decreased slightly, while the rate of formal credit in microfinance villages did not drop

Econometric Estimation: Fixed effect model

\[ FF_{it} = \alpha_0 + \alpha_1 MF_{it} + \alpha_2 IF_{it} + \alpha_3 YEAR_{it} + \epsilon_{it} \]
\[ IF_{it} = \beta_0 + \beta_1 MF_{it} + \beta_2 FF_{it} + \beta_3 YEAR_{it} + \epsilon_{it} \]
\[ MF_{it} = \gamma_0 + \gamma_1 IF_{it} + \gamma_2 Previous(\text{it}) + \gamma_3 \text{Previous(\text{it})}_{it} + \gamma_4 \text{Year}_{it} + \epsilon_{it} \]

<table>
<thead>
<tr>
<th>Period</th>
<th>Microfinance (t)</th>
<th>Non-microfinance (t)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>0.06 (1.10)</td>
<td>0.02 (0.60)</td>
</tr>
<tr>
<td>2009</td>
<td>0.15 (3.57)</td>
<td>0.11 (5.15)</td>
</tr>
</tbody>
</table>

The demand for credit is immense and rising.

CFPA microfinance expanded quickly and became the primary source of credit in microfinance villages.

In non-microfinance villages, farmers relied mainly on informal financial networks, but the rate of receipt of formal credit was higher than that in microfinance villages.

Microfinance does not crowd out individual households’ access to formal financial institutions in the sampled villages.

Ceteris paribus, once a household received loans from CFPA microfinance, the probability of borrowing money in the next year from an informal financial network was reduced

Informal networks do not appear to be costless. Where NGO microfinance can substitute for them, it can mitigate the financial stresses related to the informal credit market.

Conclusions

☆ since the development of NGO microfinance poses no direct competition to the formal credit institutions in China, the intellectual bias against NGO microfinance is unwarranted.

☆ Informal networks do not appear to be costless. Where NGO microfinance can substitute for them, it can mitigate the financial stresses related to the informal credit market.