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

**Xiangping Jia**

**Cheng Xiang**

**Jikun Huang**

Center for Chinese Agricultural Policy, Institute of Geographical Sciences and  
Natural Resource Research, Chinese Academy of Sciences  
IGSNRR, Datun Road Jia No. 11, Anwai, Beijing, 100101  
jiexp.ccap@igsnrr.ac.cn

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

Xiangping Jia, Cheng Xiang, Jikun Huang

Center for Chinese Agricultural Policy, Chinese Academy of Sciences

## 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

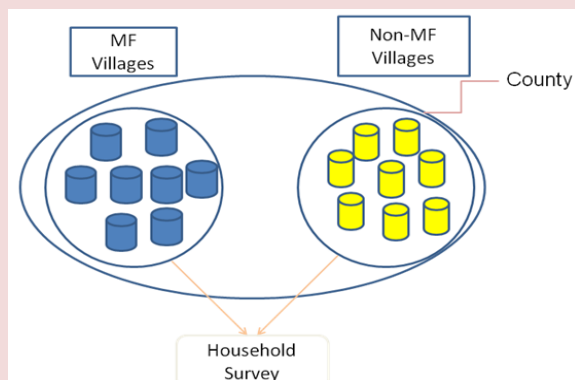
we examine China's largest NGO microfinance (CFPA microfinance)

**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.



## Results

	Microfinance villages	Non-microfinance villages
<b>Percentage of households with different credit</b>		
CFPA microfinance (%)		
2006	10	0
2009	57	0
Formal credit (%)		
2006	7	21
2009	9	18
Informal credit (%)		
2006	15	32
2009	24	47
<b>Total amount and sources of credit</b>		
Household credit access in 2006 (Yuan)	2143	4634
From CFPA microfinance	257	0
From formal credit institutions	643	1764
From informal sources	1243	2879
Household credit access in 2009 (Yuan)	8569	10870
From CFPA microfinance	3256	0
From formal credit institutions	1200	2609
From informal sources	4113	8261

- ◆ 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.

- ◆ 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

$$FF_{it} = a_0 + a_1 * MF_{it} + a_2 * IF_{it} + a_3 * YEAR + e_{it}$$

$$IF_{it} = b_0 + b_1 * MF_{it} + b_2 * FF_{it} + b_3 * YEAR + e_{it}$$

$$FF_{it} = c_0 + c_1 * MF_{it} + c_2 * IF_{it} + c_2' * Previous_{i(t-1)k} + c_3 * YEAR + e_{it}$$

$$IF_{it} = d_0 + d_1 * MF_{it} + d_2 * FF_{it} + d_2' * Previous_{i(t-1)k} + d_3 * YEAR + e_{it}$$

	Formal financial institution		Informal financial network	
	Logit model	OLS (amount)	Logit model	OLS (amount)
Microfinance (t) (Dummy or amount)	0.06 (1.10) <sup>c</sup>	0.10 (1.60)	0.02 (0.80)	0.06 (0.62)
Informal credit (t) (Dummy or amount)	0.15*** (3.57)	0.04*** (5.15)		
Formal credit (t) (Dummy or amount)			0.12*** (3.53)	0.11*** (5.15)
Microfinance (t-1) (Yes=1; No=0)	0.02 (0.38)	-0.31 (-0.77)	-0.08** (-2.34)	-0.22 (-0.34)
Formal credit (t-1) (Yes=1; No=0)	-0.01 (-0.34)	-0.38 (-0.75)	0.06* (1.66)	0.27 (0.33)
Informal credit (t-1) (Yes=1; No=0)	-0.04 (-0.77)	-0.30 (-0.76)	-0.13*** (-5.81)	-3.11*** (-4.71)

- ◆ 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

## 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.