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# Imbalance and Correction of the Rural Credit Cooperatives and Rural Economic Relations

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**Abstract** This article expounds the manifestations of imbalance between the rural credit cooperatives and rural economic relations: the rural credit cooperatives fail to effectively promote economic development in rural areas; the rural economy is also incapable of effectively promoting the development of the rural credit cooperatives. It analyses the reasons for imbalance between the rural credit cooperatives and rural economic relations, including the direct reason (loss of function of the rural credit cooperatives), the fundamental reason (restricted economic development of agriculture and countryside and relative pauperization of farmers), and the deep-seated reason (sluggish rural economic development). Corresponding countermeasures and proposals are put forward for promoting balanced development of the rural credit cooperatives and rural economy as follows: first, deepen reform of the rural credit cooperatives, strengthen the function of the rural credit cooperatives in serving the needs of agriculture; second, speed up economic development in rural areas, eliminate the economic constraints for the development of the rural credit cooperatives; third, transform the development pattern and the development strategies, foster the macro-institutional environment for balanced development of rural credit cooperatives and rural economy.

**Key words** The rural credit cooperatives, Rural economy, Imbalance, Coordination

Economy determines finance, and finance also has an effect on economy. However, the conclusion is not substantiated, using financial and economic relation theory to deduce the relationship between the rural credit cooperatives (main force of China's rural finance) and rural economy. The economic development in rural areas and the development of rural credit cooperatives are mired in a vicious cycle of mutual restraint. Imbalance between the rural credit cooperatives and rural economic relations has become an important factor in restricting the economic and social development in rural areas. Therefore, concluding the imbalance manifestations of the rural credit cooperatives and rural economy and exploring the reasons, is of great theoretical and practical significance to deepening the reform of rural credit cooperatives, promoting balanced development between the rural credit cooperatives and rural economy, and achieving the balanced development of urban and rural areas.

## 1 The manifestations of imbalance between the rural credit cooperatives and rural economic relations

The imbalance between the rural credit cooperatives and rural economic relations is reflected in two aspects: on the one hand, the rural credit cooperatives fail to effectively promote economic development in rural areas; on the other hand, the rural economy fails to effectively promote the development of rural credit cooperatives.

**1.1 The rural credit cooperatives fail to effectively promote economic development in rural areas** According to the classical theory of economic and financial relations, the rural credit cooperatives are viewed as the main force of rural finance, whose development should play a positive role in promoting the development of rural economy, but that is not the case in fact.

**1.1.1** The rural credit cooperatives are big "funnel" for outflow of rural capital. The shortage of funds in rural areas is a key factor restricting the economic development in rural areas. Outflow of capital is a major cause of shortage of funds in rural areas, and the rural credit cooperatives are the main channel for outflow of funds in rural areas. The outflow of astronomical sums of money in rural areas leads to "anemia" of rural funds, thereby restricting the rapid development of the rural economy and society, aggravating the issues concerning agriculture, countryside and farmers, and leading to worsening imbalance between urban and rural areas.

**1.1.2** The rural credit cooperatives fail to play a dominant role in rural finance. As the main force of rural finance, the role of rural credit cooperatives in supporting the development of agriculture and countryside is mainly realized through the input of credit funds. Although the input proportion of agro-credit funds in rural credit cooperatives is the highest in all financial institutions, the role of the rural credit cooperatives in agricultural economy and rural economy is not commensurate with the status of main force in rural finance.

**1.1.2.1** The credit funds in the rural credit cooperatives are not injected into development of agriculture, farmers and countryside. Out of consideration for financial security and profitability, the rural credit cooperatives tend to put the credit funds into township enterprises and individual business with strong profitability in rural areas, and even the rural credit cooperatives in

the central and western regions of China channel the funds into the eastern regions with developed economy, but most farmers do not get the loans of the rural credit cooperatives.

**1.1.2.2** The rural credit cooperatives have far from met the demand of agriculture, farmers and countryside for credit funds. The research conducted by Wen Tiejun on the loan situation of farmers in 24 districts of 15 provinces in China shows that in the period 1995 – 1999, the proportion of rural members' loans from the rural credit cooperatives tends to decline, and more than 70% of the rural members' demand for loans is resolved by the private financial way<sup>[1]</sup>. According to the report of Folk High-interest Loan: Myth or Nightmare? which was broadcasted in CCTV's " News 1 + 1" on September 28, 2011, 89% of households and 60% of companies in Wenzhou City are involved in private lending activities. Private lending is so prevalent.

### **1.2 The rural economy is incapable of effectively promoting the development of the rural credit cooperatives**

Based on the VAR model and cointegration analysis, Yao Yaojun uses Granger causality test method to conduct empirical analysis of the relationship between financial development and economic growth in China's rural areas in the period 1978 – 2002. Granger causality tests show that rural economic growth does not Granger cause rural financial development, which indicates that the rural financial development does not experience the corresponding qualitative change with the economic growth in rural areas, and rural financial development seriously lags behind economic development in rural areas<sup>[2]</sup>. The rural credit cooperatives are the main force of rural finance, so the above research conclusions can be deduced as " economic development in rural areas is not the reason of the development of the rural credit cooperatives<sup>[2]</sup>.

Xiong Deping's empirical studies have shown that in the transition period, China's rural economy fails to promote the development of finance in rural areas<sup>[3]</sup>.

**1.2.1** The economic development in rural areas fails to directly promote the development of rural finance. Xiong Deping believes that rural economic development is conducive to improvement in the level of rural savings, but improvement in the level of rural savings does not necessarily represent the development of rural finance. The growth of rural savings, which cannot translate into effective investment in rural areas, can only be the development of rural finance with mutated function, and at best, be rural financial institutions' development, rather than the rural economic development needed by economic development in rural areas. Economic development in rural areas can neither promote the growth of rural credit. Rural economic development has not played the role in inducing demand for rural financial development. The relationship between economic development in rural areas and rural finance is not in line with Patrick's " demand following" mode.

**1.2.2** The economic development in rural areas also fails to indirectly promote the development of rural finance. Xiong Deping also believes that the rural consumption has not formed the effective demand capable of inducing rural financial development. Meanwhile, the investment growth in rural areas is not

conducive to the growth of rural credit. Since the financial function of rural formal financial institutions is not sound, financial investment and self-sufficient investment ( main body of rural economy) have " crowding out" effect on financial investment.

Since the rural credit cooperatives are the main force of rural finance, Xiong Deping's findings can also be reasonably deduced as " economic development in rural areas fails to effectively promote the rural credit cooperatives".

## **2 The reasons for imbalance between the rural credit cooperatives and rural economic relations**

As to the factors responsible for imbalance of the rural credit cooperatives and rural economic relations, there are the factors concerning the rural credit cooperatives, the factors concerning agricultural economy and rural economy, and the factors concerning the external macro-institutional environment that the survival and development of the rural credit cooperatives and rural economic relations hinges on.

**2.1 The direct reason: loss of function in the rural credit cooperatives** The institutional alienation and heavy historical burden are the two major factors leading to the loss of function of the rural credit cooperatives. Loss of function is the direct cause for imbalance between the rural credit cooperatives and rural economic relations.

**2.1.1** Institutional alienation restricts the role of the rural credit cooperatives in serving agriculture, farmers and countryside. The rural credit cooperatives gradually deviate from the principles of cooperation in the process of development, evolving into " official-run" financial institutions. In addition to unclear property rights, imperfect corporate governance institutions, and formality of democratic management, it is bound to produce the phenomenon of " internal control". This will result in the rent-seeking behavior of the actual decision-makers in the rural credit cooperatives. The resource allocation capability of the rural credit cooperatives will be seriously weakened or the resource will be misallocated, and the majority of farmers and shareholders' financial needs cannot be normally met, thereby affecting the normal development of rural economy<sup>[4]</sup>.

Loss of the nature of mutual assistance and cooperation and phenomenon of " internal control", are responsible for the change in the non-profit nature of the rural credit cooperatives, " commercialization" and " non-agricultural conversion" becoming increasingly serious. As a result, first, through paying the deposit reserve, transferring deposits to the central bank, buying government bonds and financial bonds and other ways, the rural credit cooperatives cause considerable funds in rural areas to flow into cities and non-agricultural industries with high relative rate of return, resulting in outflow of rural funds and shortage of funds in rural areas; second, in recent years, the grassroots organizations of the rural credit cooperatives are continuously streamlined, so that the rural credit cooperatives tend to be away from rural areas; third, an enormous sum of difference between savings and loans in the rural credit cooperatives is mostly put into non-agricultural industries and cities; fourth,

the phenomenon of "non-agricultural conversion" of rural credit funds in the rural credit cooperatives is serious.

**2.1.2 Heavy historical burden inhibits the role of the rural credit cooperatives in serving agriculture, farmers and countryside.** Over a long time, the local government has been intervening in the rural credit cooperatives unduly. In addition to self-operating errors of the rural credit cooperatives, bad debts left by the rural credit cooperatives, inflation and other reasons, it results in heavy historical burden on the rural credit cooperatives. The data released by the CBRC by the end of 2003 show that total non-performing loans in the rural credit cooperatives reach 514.7 billion yuan, accounting for 37%; in addition, there is a loss of 131.3 billion yuan over the years; there are 19542 insolvent rural credit cooperatives, accounting for 54.98% of the institutions; the adequacy ratio of capital of the rural credit cooperatives is only 2.35%, far below the normal standard of 8%.

After the implementation of new round of pilot reform in the rural credit cooperatives in 2003, the central government made a decision that the central bank offered the special notes of 170 billion yuan to replace non-performing assets, to help the rural credit cooperatives ease the historical burden. As of the end of March 2009, the central bank honored the special notes of 156.9 billion yuan in total for the rural credit cooperatives. Be that as it may, as of early 2009, there is still a huge bad debt of 590 billion yuan in the rural credit cooperatives to be resolved. In this case, the rural credit cooperatives are incapable of providing sufficient credit funds for economic development in rural areas, and it is difficult for the rural credit cooperatives to play a dominant role in rural finance<sup>[5]</sup>. Because of the heavy historical burden, it is a rational choice for the rural credit cooperatives to channel the limited funds into high-profit, low-risk non-agricultural industries and urban areas, thereby exacerbating "anemia" of the rural funds.

**2.2 The fundamental reason: sluggish economic development in agriculture and countryside** The fundamental reason for imbalance between the rural credit cooperatives and rural economic relations lies in sluggish economic development in agriculture and countryside.

**2.2.1 The characteristic of lag in economic development of countryside and agriculture.** Over the years, the level of development of agricultural economy and rural economy lags far behind the level of development of the industrial economy and urban economy; the gap between urban and rural areas is widening; issues concerning agriculture, countryside and farmers are becoming more serious. The low level of development of the agricultural economy and rural economy determines that the circulation amount of currency needed by the development of the agricultural economy and rural economy is not large, and the effective demand of rural economy for rural finance is not huge, thereby restricting the development of business space of the rural credit cooperatives.

**2.2.2 The relative pauperization of the farmers.** In 1978, the per capita net income of rural residents was 133.60 yuan, and the per capita disposable income of urban residents was 343.30

yuan, with absolute sum of income difference of 209.70 yuan between urban and rural areas. By 2010, the per capita net income of rural residents was 5919 yuan, and the per capita disposable income of urban residents was 19109 yuan, with absolute sum of income difference of 13190 yuan between urban and rural areas. The relative impoverishment of the farmers is growing, leading to low savings rate in rural areas and "anemia" of rural funds.

In 2003, in more than 10 trillion of the balance of savings of urban and rural residents in China, the deposits of rural residents accounting for nearly 60% of the total population, only occupy about 20%. This makes the development of the rural credit cooperatives face severe economic constraints, and thus the demand of economic development in rural areas for credit funds cannot be met, resulting in a vicious cycle of mutual restraint between economic development in rural areas and the development of the rural credit cooperatives.

In addition, since the comparative benefit of rural economy is low, it inhibits the credit funds input of the rural credit cooperatives to countryside and agriculture, thereby affecting the development of business space of the rural credit cooperatives.

**2.3 The deep-seated reason: the impact of the macro-institutional environment** From point of view at deep level, the loss of function of the rural credit cooperatives and sluggish economic development in rural areas is the product of social macro-institutional environment.

**2.3.1 The impact of the economic system and economic development strategy.** The rural credit cooperatives in New China, formed in the early 1950s, are product of highly centralized planned economic system, and also product of heavy industry and priority urban development strategies. Under the conditions of public ownership economic system and the planned economic system, the state wholly monopolizes the economic resources in society, and finance will naturally become the state-owned public ownership finance. In this case, the finance is generated within economic system. Meanwhile, under the conditions of heavy industry and priority urban development strategies, the rural credit cooperatives are the financial institutional arrangement for effectively mobilizing the rural economic resources and supporting the construction of heavy industry and urbanization. Relative to the rural economy, the rural credit cooperatives are exogenous from the beginning. This is the institutional root cause of the rural credit cooperatives changing from run by the local people to run by the official. As pointed out by Xie Ping, "China's formal cooperative finance never exists", "In the past 50 years, the conditions for survival of cooperative system did not exist in China"<sup>[6]</sup>.

**2.3.2 The impact of the dual economy and financial structure.** The result of heavy industry and priority urban development strategies is to transform China into the society with typical characteristics of "dual structure". Dual social structure will inevitably lead to dual economy and financial structure.

On the one hand, the state uses the scissors gap between the prices of industrial and agricultural products to transfer the surplus in agriculture and rural areas into industry and urban ar-

eas. The research group of agricultural inputs in State Council Development Research Center, Policy Research Office of CPC Central Committee once estimated: in the period 1979 – 1994, through the scissors gap between the prices of industrial and agricultural products, the government got revenue of about 1.5 trillion yuan; over the same period, the agricultural tax revenue was 175.5 billion yuan, and financial expenditure for supporting agriculture reached 376.9 billion yuan; the net agricultural surplus extracted by the government was 1.298 6 trillion yuan, and the average annual net capital flowing out from the agricultural sector amounted to 81.1 billion yuan<sup>[7]</sup>. Under system of "dual structure", agricultural and rural economy becomes a factor of the state in accumulating capital and seeking the goal of the development strategies. This is the institutional cause responsible for sluggish economic development in rural areas and fast-growing gap between urban and rural areas.

On the other hand, the dual economic structure and the dual financial structure lead to serious imbalance in distribution of economic and financial resources between urban and rural areas, to achieve the goal of urban financial expansion at the expense of inhibition in rural finance. And driven by the comparative benefit, it exacerbates the phenomenon of the financial resources in rural areas flowing into industry and urban areas, leading to "non-agricultural conversion" of the rural credit cooperatives.

**2.3.3 The impact of GDP complex and appraisal system of officeholder's performance.** All along, the government at all levels and officials harbor strong GDP complex. GDP becomes a core indicator for assessing officials' performance. Thus, maximizing the satisfaction of the government at higher levels, maximizing the satisfaction of micro-economic subjects, and maximizing monopoly rent of the local government, becomes a rational choice of the local government. Therefore, among the factors influencing the behavior of the local government, in addition to the incentive and constraint of the central government and satisfaction of the government at higher levels, in terms of the micro-economic entities in the area, the first is urban economic subject; the second is the rural non-farm enterprises and large-scale industrialized agricultural organizations; the last one is the rural small enterprises. The impact of the farmers is negligible. Therefore, the order of the local government fulfilling functions in economic development must be "the urban economy, followed by rural non-farm economy, and finally the agricultural economy"; in the rural economy must be "large-scale rural non-farm enterprises, followed by industrialized agricultural organizations, small rural privately-run enterprises, and rural household economy based on agriculture"<sup>[8]</sup>. Clearly, the rural household economy and agricultural economy are once again marginalized by the local governments and officials.

### 3 Countermeasures and proposals for promoting balanced development of the rural credit cooperatives and rural economy

**3.1 Deepen reform of the rural credit cooperatives and strengthen the function of the rural credit cooperatives in serving the needs of agriculture** We should take serving

agriculture, countryside and farmers as the fundamental purpose, eliminating financial exclusion of the rural credit cooperatives as the main content, and achieving the goal of balanced development of the rural credit cooperatives and rural economy, to propel reform of the rural credit cooperatives.

**3.1.1 Eliminate the institutional alienation of the rural credit cooperatives.** "Internal control", "commercialization", "non-agricultural conversion" and other issues, arising from institutional alienation of the rural credit cooperatives, make the rural credit cooperatives further deviate from the track of serving agriculture, countryside and farmers. Therefore, the rural credit cooperatives are not fit to take the road of commercialized operation. We should learn from foreign experience of the rural cooperative finance, turn the rural credit cooperatives into real the rural cooperative financial organizations, and make the rural credit cooperatives return to the track of serving agriculture, countryside and farmers.

**3.1.2 Advance the strategy of generalized preferential treatment in rural finance.** The rural credit cooperatives' trend to deviate from agriculture, fuels the financial exclusion of the rural credit cooperatives. An effective means to change this situation is to advance the strategy of generalized preferential treatment in rural finance. First, increase the operating outlets, form complete coverage of the rural credit cooperatives in rural areas, and eliminate rural financial barriers. Second, vigorously develop the small loan business, and to a certain extent, meet the capital needs of farmers. Third, implement the strategy of collateral substitution and innovation, and crack the inaccessibility obstacles to farmers' loans. The lack of collateral is a major obstacle to farmers' loans. We should innovate upon the substitution mechanism of collateral, for example, we can capitalize the social resources and organizational resources in rural areas as collateral for loans, to ease difficulty in farmers' borrowing money for the lack of collateral in rural areas.

**3.1.3 Ease the historical burden of the rural credit cooperatives.** The heavy historical burden has seriously hampered the role of the rural credit cooperatives in serving agriculture, countryside and farmers. To resolve the historical burden of the rural credit cooperatives, it not only needs the support of the state, but also needs the efforts of local government. The tax department should speed up the work of checking debts and cancelling the bad debts from account of the rural credit cooperatives. The local government must also take more active and effective measures to help the rural credit cooperatives to resolve the problem of historical baggage. Once the historical burden of the rural credit cooperatives is solved, there will be plentiful capital and the strength will be strengthened, thus naturally, the rural credit cooperatives can better provide services for agriculture, countryside and farmers.

**3.1.4 Propel the comprehensive reform in the rural credit cooperatives.** In terms of management mode, business model, and service mode, the rural credit cooperatives are still incompatible with economic development in rural areas. And there are still factors concerning management system, the system of property rights, risk prevention and other aspects, restricting

economic development in rural areas, which is not conducive to exertion of role of the rural credit cooperatives in serving agriculture, countryside and farmers. Therefore, we need to deepen reform, solve these problems, and strengthen the function of the rural credit cooperatives in serving agriculture, countryside and farmers.

**3.2 Speed up economic development in rural areas and eliminate the economic constraints for the development of the rural credit cooperatives** Fundamentally, in order to solve the problem of imbalance between the rural credit cooperatives and rural economic relations, we must depend on rural economic development. The development of rural economy relies on policy, input, and technology.

**3.2.1** Offer preferential policies to benefit farmers. We should implement the principle of "giving more, taking less", consolidate, improve and strengthen the policy of supporting agriculture and benefiting farmers. First, we must continue to reduce farmers' tax burden. Second, it is necessary to increase direct subsidies, seed subsidies, subsidies for agricultural machinery purchase and subsidies for means of agricultural production. Third, we must continue to implement the policy of minimum purchase price of grain. Fourth, we must further intensify efforts to support poverty-stricken areas. Fifth, we must establish and improve the social security system in rural areas.

**3.2.2** Increase input to agriculture and countryside. Long-term dual structure results in a serious shortage of supply of public goods in rural areas and weak foundation of rural economic development, thereby making rural financial transaction conditions inadequate, transaction risk big, and the development of rural credit cooperatives sluggish. Therefore, we should increase inputs to agriculture and rural areas, effectively shift the focus of national infrastructure construction and social undertaking development to rural areas, and provide financial support for the supply of public goods in rural areas, in order to lay a solid basis for economic development in rural areas.

**3.2.3** Promote agriculture by applying scientific and technological advances. We should accelerate the progress of agricultural science and technology, and walk the path of development of agriculture through science and technology. First, we must strengthen the capacity building of agricultural science and technology innovation. Second, it is necessary to support agricultural science and technology projects. Third, we must accelerate the conversion of achievements of agricultural science and technology. Fourth, we should improve the grass-roots agricultural technology promotion and service system. Fifth, we should vigorously promote the construction of the industrialization of agriculture, increase agricultural production efficiency.

In addition, we should take effective measures to properly solve the problem of employment of rural surplus labor force, increasing farmers' income.

**3.3 Transform the development pattern and the development strategies and foster the macro-institutional environment for balanced development of rural credit cooperatives and rural economy** We should completely break the dual structure, and balance urban and rural development, to provide

institutional guarantee for balanced development between the rural credit cooperatives and rural economy.

**3.3.1** Break the dual structure and balance urban and rural development. Dual structure leads to a huge difference in input of the basic public goods and services between urban and rural areas, resulting in sluggish development of agriculture, countryside and farmers. The coordination of urban and rural development should take achieving the equalization of basic public goods and services as breakthrough point. First, we should increase inputs to basic rural public goods and services, to lay a solid foundation for agricultural and rural economic development. Second, we should implement the strategy of generalized preferential treatment in rural finance, and increase effective supply of rural finance, to provide capital guarantee for the development of agriculture, countryside and farmers. Third, we should establish integrated urban and rural social security system as soon as possible, and return national treatment to farmers.

**3.3.2** Implement the strategy of developing rural industry to subsidize agriculture and using the prosperity in urban areas to drive the development of rural areas. The implementation of the strategy of developing rural industry to subsidize agriculture and using the prosperity in urban areas to drive the development of rural areas, requires industry and cities to come up with more money to help the agricultural and rural development. More importantly, through the "radiation" by industry and cities to rural areas, it will promote the construction of rural industrialization and urbanization. The industry and cities should offer fair treatment to rural migrant workers.

**3.3.3** Innovate upon the system of rural land property rights to make the farmers share value-added benefits of the land. Due to the problems in rural land property rights system and land acquisition compensation system, it makes farmers enjoy no gains from increase of land value, therefore, we must innovate upon rural land property rights system and land requisition compensation system, so that farmers can share the fruits of industrialization and urbanization development, to protect the interests of farmers.

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