

Research on the Performance of Rural Informal Finance

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Abstract: *In recent years, informal finance has played an active role in stabilizing agricultural production, increasing farmers' income, expanding farmers' consumption expenditure, alleviating farmers' liquidity constraints, and promoting rural economic growth. It has become a part of the rural financial system that cannot be ignored. Based on the economic analysis of the performance of rural informal finance in my country, this paper proposes policy recommendations to improve the efficiency of rural informal finance in order to correctly guide, supervise and standardize the development of informal finance and promote the reform of the rural financial system.*

Keywords: rural informal finance; rural financial system reform; performance research

1. Introduction

As the core of rural economic development, rural finance is the main force of the new rural construction and rural revitalization strategy. However, the development of my country's rural formal financial market is lagging behind. First, rural formal finance has insufficient breadth and depth. The number of financial institutions is extremely limited, and products and services are relatively single, which makes it difficult for farmers to raise funds through formal financial institutions. Second, rural areas are immature in terms of asset assessment, credit reporting, and guarantees. Formal financial system arrangements are not designed to incorporate the unique cultural background of rural areas. They have harsh conditions and complicated procedures, and are not suitable for rural lending to a certain extent. Thirdly, the farmer engaged in crop cultivation determines the characteristics of the funds used for one-time investment and gradual recovery. The capital demand is often short and the amount is large. It is difficult to achieve financing through formal financial institutions.

Rural informal finance refers to indirect financing provided by illegal financial organizations in rural areas and direct financing of repayment-based borrowing between farmers or between farmers and rural business owners, with obvious "underground economy" characteristics. It is not subject to the government's requirements on capital, reserves and liquidity, deposit and loan interest rate restrictions, mandatory credit targets, and audit reports. It is a "marginalized" financial activity that lacks legal basis and policy support. Compared with formal finance, informal financial lending has the advantages of flexible conditions, simple transaction procedures, low transaction costs, high capital allocation efficiency, and convenient access. At present, in China's rural financial market, contractual credit based on formal financial contracts does not dominate, but relational credit based on blood, kinship, geography, and human factors is the main way for farmers to borrow.

2. Economic analysis of Rural Informal Finance

2.1 Analysis of capital allocation efficiency

The main function of the financial system is resource allocation. Whether or not funds can be allocated reasonably is an important criterion for measuring the efficiency of rural informal financial financing. As shown in Figure 1, D is the capital demand curve of the formal financial market, D_1 is the informal financial market capital demand curve, S is the capital supply curve, the horizontal axis represents the credit scale, and the vertical axis represents the interest rate.

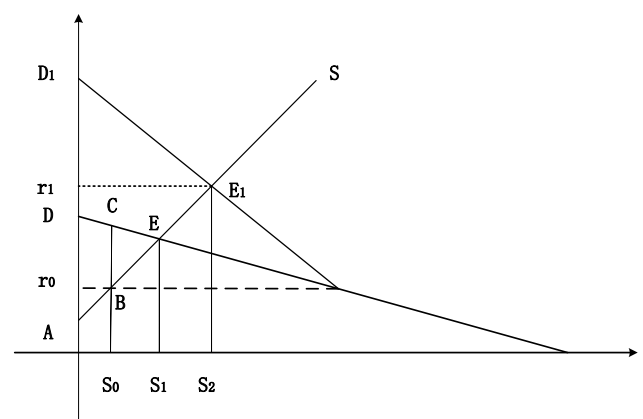


Figure 1: Funds supply and demand in formal and informal financial markets

Interest rate is the embodiment of market price and the most direct and effective tool for financial institutions to make credit decisions. Formal finance is subject to national policy to implement interest rate control (r_0), and the interest rate elasticity of the demand curve is relatively high, which is relatively flat. In the equilibrium state, the credit scale (S_0) of formal finance is small, forming a funding gap of S_1-S_0 , so it is regarded as a "constrained Pareto efficiency". The interest rate of informal finance is formed independently by the market (r_1), and it is flexible to set up and follow the market, so the interest rate elasticity of the demand curve is

lower and steeper than D. Under the same supply curve (S), the credit scale of informal finance (S_2) is larger, which effectively makes up for the funding gap of formal finance. Moreover, due to the high level of interest rates in the informal financial market ($r_1 > r_0$), the conversion of farmers' funds from savings to investment has been promoted, and the efficiency of fund allocation has been improved to a certain extent.

2.2 Analysis of welfare level

As shown in the above figure, the producer surplus of formal finance is the triangle $r_0 AB$, and the consumer surplus is the quadrilateral $r_0 BCD$. The producer surplus of the informal finance is the triangle $AE_1 r_1$, which is greater than the triangle $r_0 AB$, and the consumer surplus is the quadrilateral $r_1 E_1 D_1$, Greater than the quadrilateral $r_0 BCD$. That is, the producer surplus and consumer surplus of informal finance are greater than that of formal finance. From the sum of the surpluses of both borrowers and lenders, the total surplus of informal finance (quadrilateral ABCD) is also greater than that of formal finance (triangle $AE_1 D_1$), that is, the overall well-being of informal finance transactions is greater. It can be seen that from the perspective of welfare level, informal finance can increase the overall well-being of rural areas and is more efficient.

3. Policy Recommendations

Due to the lack of effective supervision and guidance, informal finance has gradually exposed its risks and hidden dangers. For example, high interest rates have increased borrowers' production costs and made the development of rural economic entities insufficient. A large amount of capital "extracorporeal circulation" has weakened the intermediary effect of formal financial institutions, interfered with the central bank's effective regulation of total social credit, and increased the risk of the financial system. Some informal financial financing defaults lead to deterioration of credit relationships and even legal disputes, causing serious social consequences. Therefore, informal finance needs to be included in the scope of supervision, increase the necessary norms and protection, and cultivate and guide the healthy development of rural informal finance.

3.1 Strengthen the supervision of rural informal financial organizations

The government has put informal finance on the track of the legal system, promulgated laws to allow, protect, and encourage the development of rural informal finance. Under the premise of controllable risks, the legal status of informal finance and formal finance should be accorded equal status. Establish and improve the risk control and compensation mechanism of rural informal finance, and guide and force its formal development by formulating the necessary rules, such as setting the maximum interest rate, necessary economic guarantees, and reasonable default penalties, etc., to reduce moral hazard.

3.2 Establish a mechanism for the integration of formal and informal finance

On the one hand, improve the rural formal financial system, expand the scope of business, improve service levels, reduce the financial exclusion of farmers, and allow more farmers to enjoy the policy dividends of inclusive finance. On the other hand, give informal finance a broader development space, guide its orderly growth, strengthen the competitiveness of rural financial markets, and form a complementary and complementary, reasonably distributed, and well-defined financial service system for formal and informal finance. Complement each other's strengths and learn from each other, in order to build a smoother financing channel in China's rural areas and promote the reform of rural financial system.

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Author Profile



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