



Tropentag, October 11-13, 2006, Bonn

“Prosperity and Poverty in a Globalised World—
Challenges for Agricultural Research”

Determinants of Credit Rationing: A Study of Rural Households in North China

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Abstract

Compared with the burgeoning urban economy, the situation in rural China can hardly be cheerful. Rural communities suffer from low grain prices, insecure land rights, lack of capital, and the rising costs for education and health. One of the policy instruments of the Chinese government is to address the rising inequalities between urban and rural areas by providing subsidized credit to rural households.

This paper investigates which type of rural households benefit from credit. After a brief overview of rural financial market in China from a historical perspective, we describe the method of data collection and the theoretical and econometric model. Using first-hand survey data of households from North China, a two-stage probability models will be applied to analyse the determinants of credit rationing in both formal and informal credit markets. We model a sequential decision-making process where in the first stage households decide to apply for a loan or not, and in the second stage, state-owned banks as lenders decide to fully or partially grant the requested loan amount or to reject the loan altogether. In the first stage, univariate LOGIT models are used to estimate the probability of applying for loans. In the second stage, we test hypotheses concerning household characteristics that can be observed by the lender to determine the credit rationing decision. To account for selection bias, we use —following models developed James Heckman— the Mill's ratio estimated from the first stage LOGIT models. Two sequential models are estimated: one for the informal and one for formal credit market. This allows us to identify differences in demand and supply behaviour in these two market segments.

Keywords: China, Credit rationing, Rural households