

# Literature Review on the Impact of Financial Credit on Rural Farmers' Consumption

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**Abstract:** China's rural consumption market has great potential, and the expansion of domestic demand cannot be separated from the continuous development of the rural consumption market. As an important core of expanding domestic demand, the economic driving effect of rural consumption plays a decisive role in opening up the whole economic chain. This study sorts out the impact of rural financial credit on farmers' consumption expenditure in china, and concludes that rural financial credit has a positive effect on farmers' consumption. Therefore, we should fully activate the driving effects of rural finance, vigorously develop the advantages of rural finance in supporting agricultural consumption, and promote the better and faster development of the rural economy. This is not only a solution to the problem of agriculture, rural areas and farmers, but also an important measure to implement the rural revitalization strategy.

## 1. Introduction

Consumption, investment, and net exports are also known as the “troika” driving china's economic growth. Consumption originates from people's demand for a certain commodity, which is an important part of market operation. As the final purpose and foothold of production, effective consumption supply is an important means to promote economic growth in the context of constantly depressed investment and net export. As a largely agricultural country, the consumption of rural residents in china plays a major role in the improvement of residents' living quality and happiness, as well as the stable operation of the macro-economy and the supply-side structural reform of agriculture<sup>[1]</sup>. The continuous and steady progress of china's economy requires the continuous improvement of farmers' consumption level, which is not optimistic in recent years due to the lack of capital inflow. As the main force of the rural economy, the growth of consumption requires strong support from the capital. The lack of effective capital flow mechanism leads to a large gap between rural residents' consumption desire and the actual supply, which harms the improvement of the rural economy in the long run.

The shortage of farmers' funds will severely restrict the development of the rural economy and the improvement of farmers' family welfare levels<sup>[2]</sup>. As the core of the optimal allocation of monetary resources, finance plays a vital role in the financing of rural consumption. Therefore, financial credit is regarded as a beneficial exploration and effective way to ease the constraints on farmers' financing. From the successful experience of developed western countries, it can be seen that financial credit has a significant role in accelerating the realization of residents' effective consumption willingness and increasing the actual consumption scale of society. Therefore, while stimulating the development of the rural consumer industry, we should make full use of credit instruments to accelerate the realization of farmers' effective consumption intention, to increase the actual consumption scale of rural society and promote economic growth. Existing literature holds that financial credit can improve consumers' consumption demand by increasing their current income and alleviating liquidity constraints. However, in recent years, the farmers' consumption rate has not increased correspondingly with the development of financial credit, which deviates from the original intention of developing rural financial credit. Therefore, it becomes important to study the

relationship between financial credit and farmers' consumption, which can not only test the effectiveness of china's policies supporting rural financial credit in the past, but also provide data support and relevant suggestions for current and future strategies to promote consumption.

This paper starts from the consumption behavior of rural residents in the consumption field with a higher degree of marketization, sorts out the literature, and expounds the influence of financial credit on the consumption of farmers and the effect of different credit methods on the consumption of rural households. The second part is the impact of financial credit on consumption. The third part is the effect of formal and informal credit. The fourth part is the conclusion and enlightenment.

## **2. The Impact of Financial Credit on Consumption**

Many scholars believe that most farmers' consumption is significantly positively related to their wealth level, among which income is one of the fundamental factors determining consumption. However, due to the weak nature of agriculture and the rapid growth of the rural population, the effect of increasing consumption by increasing the income of farmers is not very significant. With the continuous development of the economy and society and the continuous improvement of the rural financial system, the role of financial development in rural consumption cannot be ignored<sup>[3]</sup>. Financial credit has become another important factor affecting consumption. In the short term, loan behavior increases wealth by borrowing funds; in the long term, loan funds are used to expand reproduction, which is conducive to the long-term improvement of wealth levels<sup>[1]</sup>, and thus positively promotes consumption growth. The experience of developed countries shows that consumption growth depends to some extent on financial support.

The research on the relationship between financial development and farmers' consumption can be traced back to the financial deepening theory proposed by mckinnon, which holds that financial development can ease the credit constraints faced by farmers, thus stimulating farmers' consumption. Considering the credit constraints, some researches have shown that credit constraints hindered farmers' consumption and make the actual consumption of households lower than the theoretical optimal consumption<sup>[4]</sup>. Therefore, consumers without credit constraints have a higher willingness to spend. Consumers who are subject to credit constraints can ease their credit constraints by credit, and then stimulate their consumption. Under credit constraints, credit levels have a significant positive impact on consumption. Therefore, the development of financial credit can be considered as an important factor to solve the dilemma of china's low consumption rate.

In recent years, the development of finance in developing countries has accelerated, and financial credit has gradually become an important part of farmers' financial behavior. In theory, farmers have desire to continuously improve consumption level, when funds are faced with liquidity constraints, they often choose external financing to smooth consumption expenditures. In an increasingly developed rural financial market, it is relatively easy for farmers to obtain money through credit activities to change their initial endowment to alleviate their credit constraints. That is, farmers can get productive and living funds through a loan to optimize the allocation of production materials or to expand production scale, and increase household utility through consumption expenditure, to achieve stable consumption and enhance the welfare<sup>[5]</sup>. However, scholars have not reached an agreement on the effect of financial credit on consumption.

### **2.1 The Positive Impact of Financial Credit on Consumption**

As for the economic effect of farmers' financial credit behavior, many scholars have started from developed countries such as the united states and japan, and developing countries such as china, india, and turkey<sup>[6]</sup>, from the perspective of both theoretical and empirical perspectives, the basic viewpoints have reached consensus. Most scholars hold a positive attitude towards the impact of credit behaviors on the economic effect of farmers, believing that credit behaviors have a positive promoting effect on farmers' economic: financial credit through direct or intermediary effects<sup>[7]</sup> can not only increase farmers' income, savings, improve their living standards and family conditions, and enhance welfare level, which also can reduce the poverty of farmers to a certain extent.

Although scholars cannot agree on the role of different credit categories in promoting

consumption, such as some scholars believes that the production and business credit has a significant promoting effect on consumer spending growth, and found that in both short and long term, consumption credit can improve rural consumption more than production and operation credit. However, in general, farmers' financial credit can promote the growth of total annual household consumption expenditure, per capita consumption expenditure, food consumption expenditure, and non-food consumption expenditure. The increase of consumption can effectively improve the living standards and welfare of farmers, to further improve the quality of economic development and realize the goal of domestic demand to drive domestic economic growth<sup>[8]</sup>. Specifically from different countries, especially developing countries such as Pakistan, Bangladesh, Ethiopia, Philippines, south Africa, India, china, and other researches also can see that the credit can positively promote farmers' consumption, which has a positive spillover effect on rural economic development.

## **2.2 the negative impact of financial credit on consumption**

Some scholars do not agree that financial credit can have a positive impact on the economic effect of farmers. They found that the influence of financial credit on the per capita income of farmers was not significant, and the income effects on both high-income and low-income farmers were not significant. So they concluded that financial support for farmers' income is weak, and the increase in agricultural loans is not conducive to farmers' income growth.

In terms of the promoting effect of financial credit on consumption, morduch<sup>[9]</sup> and attanasio pointed out that due to the uncertainty of expectation, the gap between the rich and the poor of farmers and other reasons, the increase of financial credit has not brought growth in consumption, thus questioning the role of financial credit in boosting consumption. At the same time, it is difficult for low-income groups to obtain formal loans, which fails to have a strong influence on consumption, so fan and dai<sup>[10]</sup> argue that the relaxation of credit conditions cannot significantly promote farmers' consumption.

## **3. Impact of Different Credit Methods on Consumption**

Chinese household borrowing funds mainly come from two sources: formal finance and informal finance. Formal financial credit is primarily through the banking system and subject to the regulatory constraints of relevant state departments. Informal financial credit is free from the current regulatory system, including non-financial institution credit, relatives and friends to borrow and usury. Farmers have gradually differentiated along with the development of economy, farmers who with different resource endowments have significantly different choices in borrowing channels<sup>[11]</sup>. Different farmers have different preferences when choose loan methods, therefore, the choice of farmer's borrowing channels will vary with the type of farmer. In today's dual structure where both formal financial credit and informal financial credit coexist, farmers are choosing a credit path that maximizes utility while considering their resource endowments.

There are multiple sources of borrowing for farmers, such as self-accumulation, formal finance, and informal finance. However, when some farmers' funds are difficult to maintain and meet the needs of living consumption and production expenditures, they often resort to exogenous financings such as formal finance and informal finance to solve the problem of insufficient funds. Studies have shown that if the regions with more restrictions on formal financial credit, informal financial lending will more frequent, that is, there is a substitution relationship between them<sup>[12]</sup>. Although both formal and informal financial institutions provide productive loans and consumer loans<sup>[13]</sup>, thereby significantly improve the productivity and income level of farmers, but farmers with different characteristics have different tendencies in selecting the channel in terms of borrowing money<sup>[14]</sup>. For example, the personal characteristics of farmers will affect their credit behavior, and some households find that the cost of informal financial credit will be lower than that of formal financial credit<sup>[15]</sup>. At the same time, some researches show that the proportion of farmers who can obtain loans from formal financial institutions is small and the objects of loans are mainly concentrated in the hands of a small number of wealthy people, so farmers often turn to the informal

financial market to meet their needs. This series of analyses shows that different factors will have an impact on farmers' choice of credit channels from different perspectives. Therefore, the research on the choice of credit channel in credit behavior of farmers will help guide more financial resources to meet the needs of farmers and further optimize the rural finance structure.

### **3.1 The Impact of Formal Financial Credit on Consumption**

Some scholars believe that formal credit has a greater promoting effect on production and income than informal credit. After obtaining a formal loan, farmers mainly invest funds in agricultural production<sup>[16]</sup>. Formal financial credit significantly increases the income of residents in rural areas by reducing the liquidity constraints faced by them, thereby promote consumption, especially the consumption of durable goods<sup>[17]</sup>.

However, some studies have shown that although formal credit behaviors can increase farmers' investment in agricultural production, only when the financial market is efficient will the farmers' net income and consumption expenditure increase; In addition, as the proportion of farmers receiving loans from formal financial institutions is relatively small, and it is difficult for ordinary farmers to obtain loans. So, formal credit not only fails to promote the consumption of farmers and the development of the rural economy, but also inhibited it.

### **3.2 The Impact of Informal Financial Credit on Consumption**

The coexistence of formal credit market and informal credit market is a feature of the rural credit market in developing countries. It is biased to ignore the role of informal credit and only focus on formal financial credit<sup>[18]</sup>. Due to the insufficient supply of loans from formal financial institutions and the flexible form of loans in the informal financial sector, farmers are more willing to choose to obtain loans from the informal financial sector<sup>[19]</sup>. The incidence of informal financial credit by farmers is high, and the proportion of farmers who borrowed from formal finance has fallen. Informal financial credit is the main source of borrowing money for farmers, which meets the increasing demand for loans from rural households.

Regardless of the actual composition of credit channels or the subjective preference of farmers, the main choice for farmers' credit funds is an informal channel<sup>[20]</sup>. From the perspective of farmers' subjective tendencies, farmers show a more positive attitude when participating in informal financing<sup>[21]</sup>. The satisfaction of credit from informal financial channels is higher than that from formal financial channels<sup>[22]</sup>. From the perspective of the composition of financial channels, it is difficult for farmers to obtain loans from formal financial institutions due to the lack of effective collateral. Therefore, informal financial credit has become the primary choice for farmers when they are short of funds, and the proportion of credit has increased year by year<sup>[23]</sup>.

Some scholars examined the economic and institutional performance of rural informal finance, and considered that informal financial lending funds have a positive role in alleviating credit constraints and increasing farmers' income, which has the effect of improving the efficiency of financial resource allocation, improving the multi-dimensional poverty status of farmers, and improving the welfare level of both parties in the transaction, which is more suitable for rural structural adjustment. Since the loans obtained by farmers from informal financial channels are mostly used to smooth household consumption, informal finance plays a more important role than formal finance in improving living consumption.

## **4. Conclusions and Implications**

Through reviewing domestic and foreign literature, this paper draws the following conclusions: financial credit has a positive impact on farmers' consumption. In terms of the choice of financial credit channels, farmers prefer to choose informal finance for borrowing money, and informal financing has a more obvious promoting effect on farmers' consumption than formal financing.

Based on the above analysis, the following enlightenment can be obtained:

Firstly, it is essential to establish a mechanism for the return of rural credit funds to ensure that rural funds serve agriculture, rural areas, and farmers, and design effective supporting mechanisms

for new rural financial institutions such as small loan companies, village and town banks, rural capital cooperatives, and allocate funds to farmers through the efficient allocation of new rural financial institutions. At the same time, it is necessary to continuously expand the scale of credit funds for supporting agriculture, improve the conversion of rural deposits to rural loans, meet the credit needs of farmers, and enhance their consumption capacity.

The second is to intensify innovation in rural financial products and drive the upgrading of rural residents' consumption structure. It is vital to improve the mortgage mechanism for rural property rights, actively explore the establishment of an effective mortgage guarantee system for farmland property rights, steadily promote the innovation of Internet rural financial products, vigorously expand rural financial credit business, increase the types of rural consumer loans, and promote the transformation of rural households' consumption structure from material consumption to service-oriented consumption.

The third is to improve the competitive rural financial market system and relax the barriers to enter the rural financial markets. By establishing a clear, diversified, and risk-dispersed rural financial system arrangement, eliminating inertia of the rigid rural financial system, and creating a good competitive rural financial ecological environment. Government should give rural informal financial organization and formal rural financial organization of equal treatment for two types of financial organizations together to play a role of agriculture, to reduce the entry barriers for new and micro rural financial organizations, and induce rural credit funds to meet farmers' credit needs and maximize the utilization rate of rural funds, break the burden of credit rationing on farmers' consumption.

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