

Note to China: Rural development, not consumption is the answer

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China's hopes of an economic recovery fueled by the rural countryside may be dashed. Despite recent government subsidies and provisions to boost the consumption of the country's 700 million rural residents amid a global financial crisis, it may not be enough to address the more than two decades of exported-oriented growth which has largely benefited industries and urban cities at the expense of the rural populace. Such short-term thinking and stimulus plans ignore a larger and more fundamental problem: that while the country's growth and stability is inextricably linked to rural development, not enough has been done to promote the livelihoods of rural farmers and residents, many who continue to be mired in poverty. By focusing on consumption, the government is turning a blind eye to the reality that many Chinese have little means to consume.

Thus, the many reported and unreported incidences of rural unrest in China in recent years are awakening the government to its greatest fear - social and economic instability - and the need to address rural development issues such as land reform, job creation and reduction of inequalities between the urban and rural areas. In particular, stimulating the rural economy will be critical. As such, one of the greatest opportunities and challenges for the country is to effectively channel investment and capital to rural China to promote entrepreneurship and job opportunities – an area that is still in its infancy. As China increasingly sets its ambitions on becoming a world leader, it must appreciate that overhauling reforms at home should remain a priority.

This paper will provide a brief overview of the importance of rural development in relation to China's economic growth and the historical reasons and factors that have led to the neglect of the countryside and its subsequent impact. The paper will also highlight key reforms that are needed, particularly in the area of rural financing, which may be a factor in reshaping the direction of China's growth.

Breaking the rice bowl

Since the introduction of market-oriented reforms in the late 1980s, the shift from a previously agrarian economy to an export-oriented one has been drastic. These reforms in addition to the restructuring of state-owned enterprises in the 1990s pushed millions of Chinese from townships and villages into jobs in the urban cities and development zones such as Guangdong where labor was needed to keep the momentum of factories and new businesses running. Alongside its economic growth, China also made huge strides in reducing poverty. According to the World Bank, between 1981 and 2004, the fraction of the population consuming less than a dollar-a-day fell from 65 percent to 10 percent, and more than half a billion people were lifted out of poverty. With impressive GDP growth rates averaging from 11 to 13 percent in the past decade, China is now the world's fourth largest economy.

However, these impressive growth figures only highlight one side of the story. While growth and income in the urban cities increased dramatically in the 1990s, farmers saw falling living standards. Growth in farmer income which reached a rate of 15.2 percent a year in 1984 dropped to 2.8 percent a year in 1991. Although there was some recovery in the early 1990s, stagnation of rural incomes marked the latter part of the decade. This stagnation was caused by policies promoting rising costs of industrial inputs into agriculture, falling prices for agricultural products and increased taxes, all of which combined to transfer income from the countryside to the city. As a result, an enormous gap between urban and rural living standards has occurred. Per capita income of China's rural residents was US\$606 in 2007, less than a third of per capital urban disposable income.

Why rural development is important

Despite the government's emphasis on industry and urban-led growth, rural China will continue to play a role as the backbone of the country's economy and stability given it houses 60 percent of the country's population; the majority of whom are small-scale farmers. Aside from employing more than half the country's labor force, the survival of the agricultural sector is linked to China's survival. With China's rapidly increasing population and appetite for consumption, food security is an emerging concern. China is currently feeding its population, which makes up 22 percent of the world's population, on only 7 percent of the world's arable land. As a result, China has become a net importer of food to increase its food supply, in addition

to cultivating a reliance on buying overseas farm land. By one estimate there are now one million Chinese farmers in Africa as well as others in Philippines, Laos and Russia. .

The recent financial crisis has also highlighted China's dependence on exports and foreign investments which has subsequently dropped as global demand has decreased. The closing down of factories and businesses across the country has not only impacted economic growth but has also called into question whether China's current development model is sustainable. By relying on exports and key industries to fuel its growth, China has not only made itself much more susceptible to the external forces but it has also created distinct regional as well as urban versus rural disparities. The Central Intelligence Agency estimates that 49 percent of the country's GDP is built on industries employing 25 percent of the work force while agriculture, which makes up 11 percent of China's GDP, employs over 43 percent of the country's labor force. These figures not only show the distortion in China's labor market but also that there are great opportunities for the government to optimize its resources in the agricultural sector.

Spilling rice and more

The consequences of China's urban-oriented industrial development strategy are stark. Decades of low investment and poor quality in delivery of basic services and rural infrastructure in addition to lack of job opportunities has stifled development of the rural economy. The delivery and quality of basic infrastructure and services in the rural area is significantly poorer in comparison to their urban counterparts. For example, it is estimated that 47 percent of rural residents lack access to running water compared with 97 percent of urban residents who do. In addition, only 22.5 percent of rural households have access to medical insurance, pushing many to seek the aid of local unqualified healers. Therefore, investment in agriculture via building of better infrastructure, provision of services, farmer training and promotion of rural entrepreneurship is essential in order to develop the rural areas.

The lack of jobs in the rural sector has resulted in the exodus of young or skilled labor; this has become a familiar story across villages in the country. Yet, those seeking their fortunes in cities often have their dreams dashed. Although infrastructure and basic services in the urban areas are significantly better in comparison to the rural areas, migrant workers and their family often have limited, if any, access. China's *hukou* (residency registration) system, which was designed in 1958 to limit movement within the country, now hinders non-residents such as migrant workers and their families in cities from accessing basic services and benefits like their urban counterparts.

While the need to change regulations which would enable rural residents to move more freely and to create equal access to services is critical, the government has been slow to do so.

The impact of neglecting the rural economy is also more clearly demonstrated from reports of growing tension among the 20 million recently laid-off migrant workers who are returning home to their villages to find that job opportunities there still remain scarce. Compounding the problem of increasing unemployment in the country is the reality that about 40 percent of the average net income of rural Chinese comes from migrant wages. This loss of income has significant ramifications for rural stability and economic growth as well as social implications for poor households. In absence of formal safety nets, many households often rely on the income of migrant workers as their main source of income. Thus recent attempts from the government to stimulate rural consumption, in the form of providing subsidies for purchases of televisions, cars and other non-essential goods, do not seem to be aligned with the reality of the average purchasing power of rural households.

One of the most pressing political and economic problems in China is the issue of land reform. Much of the social unrest and protests taking place across rural villages concern land. With the acceleration of urbanization and industrialization in China, an increasing number of farmers are losing their farm land; in 2005, the estimate was between 40 and 50 million. Studies from Chinese researchers conservatively estimate that there have been more than 40 million illegal land confiscations by local officials in the past decade. Corrupt local officials often strike bargains with land developers to identify and seize the best land while farmers receive woefully inadequate compensation in return.

For small-scale farmers who rely on land as their main source of income, the forfeiture of this land often means disaster. Due to a competitive job market and their limited education, these farmers find it hard to secure a job. According to a study conducted by the National Bureau of Statistics, only about 7 percent of surveyed households that had lost farmland received direct assistance from the government to find new jobs. A quarter of these households subsequently migrated to seek opportunities elsewhere while over half looked for local jobs in industries and farming and the remainder remained unemployed. This is despite the new policy introduced by the central government in 2008 to ensure that farmers receive fair compensation for land lost to development by allowing farmers to directly transfer their land, still technically owned by the

state, to developers or other businesses. But without proper enforcement and institutions to carry out these new laws and policies, corruption is still likely to persist.

The issue of land reforms goes beyond user rights and extends to the fine balance of increasing agricultural production to feed the country's growing population whilst promoting conservation and environmental protection. Decades of low investment, degradation of land from poor farming practices and encroachment from industrial development has resulted in heavy pollution and destruction of natural resources. It is estimated that nearly 20 percent of China's land area, some 1.74 million square kilometres, is now classified as desert affecting the lives of 400 million people. While the government is stepping up efforts to increase farmers' income through elimination of an established agricultural tax and subsidies for inputs and farmer training, it has yet to address environmental problems that damage health, particularly amongst the poor. As a result of pollution from factories and plants amongst other factors, an estimated 90 million rural residents do not have access to safe water. To address this, the State Council has declared it will focus on ensuring safe water in rural areas and further promoting the building of sewage treatment facilities.

An alternative model

As farming and agriculture continue to make up the bulk of labor and opportunities in the rural economy, the government should prioritize its efforts in stimulating growth in this sector. However, despite various attempts from the different levels of government to promote rural development through provision of vocational and non-agricultural training in addition to the abolition of agricultural taxes on farmers and use of subsidies, opportunities in the rural sector remain barren. A list of factors including insufficient resources, poor implementation, bad planning and small scale of projects could explain why different initiatives have failed.

A starting point of generating jobs and promoting rural entrepreneurship is to improve rural financing by creating access to capital and investment. While the government has encouraged laid-off workers to become entrepreneurs, without access to funds, many find it difficult, if not impossible to start a business. China's countryside has had chronic shortages since an industry reshuffle in the late 1990s forced most state banks to withdraw from rural areas, leaving behind only the Agricultural Bank of China, rural credit cooperatives and postal savings banks. As returns from rural lending are low and risks are high, these institutions limit lending for fear of bad debt and low profits. For those who receive capital, the interest rate was often 3 to 12 times higher than the benchmark rate which stood at around 5 percent in early 2009. About only 60 percent of the 120 million rural households that need bank loans are able to access them through

the current system. This is a particularly a problem for cash-strapped farmers who need capital for agricultural inputs.

As a result, the underground lending market is flourishing with an estimated worth of US\$292 billion a year to meet the needs of credit in rural areas. This is equivalent to about 10 percent of China's total personal savings deposit. While the government has indicated that it would take steps to formulate regulations on private lenders and to develop the sector, it has not said when such regulations will be enacted.

Thus there are opportunities for private investors to tap into the rural economy with its 700 million potential consumers and producers. Increasingly, farmers are joining agricultural cooperatives which enable farmers to not only have greater access to markets and increased incomes but they have access to capital which is vital to buying inputs needed for farming. Although still in its infancy, the popularity and influence of farmer associations in China are gaining momentum as the associations may represent many cooperatives thus enabling farmers to apply leverage on local government officials and other key stakeholders. Some smarter cooperatives and associations are starting to operate using a commercial approach to not only market their goods but to attract potential investors. As the global price for food has continued to increase, many investors are finding it increasingly attractive to funnel their investments into the agricultural sector thus providing an alternative and viable route for large groups of farmers to obtain much needed capital.

Conclusion

Recognition of the important role that the rural economy plays in China's economic growth is only the first step. China's top policymakers must address the major barriers which continue to hold the 700 million Chinese in rural areas from optimizing their potential. By developing a model which promotes rural development while taking into account environmental and social concerns, the Chinese government can address the disparities that two decades of urban-industrial have created. Despite these challenges, opportunities in the rural area, particularly for rural enterprises are emerging. As access to capital is critical, private and non-traditional investors will have a unique role to play in shaping China's future.