The Coexistence and Interaction of Formal and Informal Lending in China - Discussion of the Wenzhou Case

Abstract: Interest in China's economy has typically been focused on its phenomenal growth. However, more recently there has been growing interest in emerging constraints on and vulnerabilities regarding that growth. A key focus has been concern with issues of shadow banking. This paper discusses one aspect of China's finance system, which has some crossover with shadow banking: informal lending to private enterprises (PE). This lending is characteristically unstable and exhibits a number of features that constrain private enterprises. Intrinsic to those constraints are issues of usury, bribery and rent-seeking (as an expression of power), all of which bear on the institutional context of ethics. This paper discusses the case of Wenzhou, the most prominent city for private enterprises in China. The Wenzhou case is explored using a narrative form drawing on multiple sources including academic papers, regulation, newspapers and social media. This is an increasingly recognized approach within mixed methods research and this paper provides for important qualitative insight into how and why questions regarding the Wenzhou case. The Wenzhou case is typical in terms of the coexistence and interaction of formal and informal lending in China. Finally, we highlight the limits of the recent reform process and current approach to resolving the problem of financing for PEs in China.

Keywords: Business financing, formal bank lending, informal lending, private enterprises, Wenzhou, China.

JEL: G01, G23, G28, P26, P34

Article type: Research paper

1. Introduction

The particular strategy of economic reform in China over the last few decades has created a number of tensions. In general the tendency to approach reform as an incremental process, where relatively straightforward or uncontroversial changes are made first, has meant that many of the more complex or difficult reforms have been left until later. Additional problems may then arise because of this deferment. As a result, the state is sometimes confronted by the challenge of cumulative problems in particular aspects of the economy. One key area in which problems have been experienced in China is business financing. The historical legacy of China's command economy has been a relative dominance of large state owned enterprises (SOEs) in terms of policy focus. This has extended also to a dominance of the finance system by state owned and state controlled banks within a highly centralised approach to regulation and policy. State banks have tended to focus on the financing of SOEs. Since they dominate the formal lending system this has meant that many private enterprises (PEs), the majority are micro and small in size, have found it necessary to seek alternative sources of funding. As such an informal financing system has developed. The relation between the formal and informal systems is both complex and ambiguous. The informal system does not exist entirely beyond the state's purview because some of its agents can be state actors operating in the shadow banking system (Liang 2016), and because some of its practices have been developed in specific localities designated by the state for experimental reform.

The informal system in China demonstrates a number of significant distortions in finance markets. Given that these affect PEs, then these distortions are of great significance for the stability and growth potential of the Chinese economy. An experimental approach has been another typical feature of Chinese economic reform. It involves the loosening of existing regulatory control in a particular locality, creating spaces for innovation, as well as the introduction of new opportunities for institutions, which if successful may then be rolled out across China. These localities then also acquire an additional first mover status becoming nodal points for some form of economic activity. As such the following paper sets out different aspects of the emergence and consequences of informality based on the case of Wenzhou City. Wenzhou has emerged as China's premier location for PEs, and as such has experienced a range of problems based on informal lending and these can be seen as indicative of issues likely to be experienced elsewhere. This paper adopts a narrative form based on multiple sources including academic papers, regulation, newspapers and social media. Based on these sources as a mixed methods approach the paper provides readers with a number of significant insights. These concern: (1) the main cause of huge funding gaps for PEs in China, (2) whether and how 'local power' can play a role in mitigating funding shortages for local PEs, (3) how formal and informal lending coexist and interact in China, as conceived through the lens of the Wenzhou case, and (4) why recent regulation, reforms and policy changes in 2014 are limited as means to resolve problems PEs face in business financing. The argument in this paper is broadly embedded in the debate about the concurrence of China's under-developed financial markets, weak legal and institutional context, and the interacting mechanisms of formal and informal finance in China (e.g. Alford 2000; Pei 2001; Li 2001; Clarke 2003; Tsai 2004, 2015; Allen et al. 2005; Pistor and Xu 2005; Lu and Yao 2009; Yao and Yueh 2009; Hsu 2012). We also draw attention throughout the paper to arising issues of ethical concern.

The paper proceeds in 5 sections. Section 2 provides a brief introduction to Wenzhou in the context of its prominence as a site of informal financing. Section 3 sets out the causal context of a 'funding gap' experienced by Chinese PEs. Section 4 explores the roles of Wenzhou local government and business associations. Section 5 explores the reciprocities between formal and informal financing based on some typical examples (many of which can be found elsewhere in

China). Section 6 discusses the emerging solutions to the arising problems of finance, based on the Chinese reform model: experimental local institutional change, which the state then intends to generalise; specifically, the ‘Wenzhou City Private Financing Regulation’. Here the limits of this policy change has been highlighted. Finally, the conclusion (Section 7) summarises what we have achieved in the paper.

2. Wenzhou city as a site of informal finance

Wenzhou is a prefecture-level port city located in the South East corner of the coastal province of Zhejiang with a population of approximately 9 million. Wenzhou’s annual GDP per capita is twice the national average (Qin et al. 2014). As a corollary Wenzhou has a comparatively developed informal lending market. Informal lending constitutes approximately 30% of all lending in the city, significantly higher than the national average of 8% (Guo and Liu 2002). As such, Wenzhou has long been recognized in the Chinese media as the national capital of both “informal lending” and “private enterprise” (see examples, Liu 1992; Parris 1993; Wu 2006; Qin et al. 2014).

Though strategically located in terms of some aspects of modern supply chains, in historical context Wenzhou has experienced political isolation (it is some distance from the provincial capital, Hangzhou) and is located in a mountainous region with little arable land. This has had some bearing on local culture. Local self-reliance and trade have been enduring features of that culture. During particular periods of crisis Wenzhou has also experienced significant out-migration and thus contributed to the Chinese diaspora and to the phenomenon of *huaqiao* (overseas Chinese business networks). Wenzhou migrants in South East Asia, Europe and the Middle East have retained links with the city and a strong sense of a Wenzhou identity. These migrants have over the years provided a ready source of business acumen, investment and remittances. A sense of a Wenzhou identity is thus cross-pollinated (Parris 1993; Qin et al. 2014).

Wenzhou became a major trading port in South East China as early as the tenth century (Liu 1992). Local capital shortages quickly became an issue and varieties of *hui* based funding were developed. *Hui* translates roughly as people who know each other well, and in terms of financing refers to locally pooled capital lent at interest (expressed in the bi-syllabic of the Chinese language based on different types of groupings and purposes of financing – friends, village etc., becoming *hehui, biaohui, chenghui* and so forth). The system has some of the characteristics of contemporary crowd-funding though it has traditionally been classified with rotating saving and credit associations and referred to as *minjian jiedai* (people's credit, a curb-side market, etc.; see Tsai 2004).

Wenzhou was one of the first localities to begin to develop PEs after the beginning of reform (Liu 1992). Small private firm owners did not require large capital sums, lacked any longstanding bank accounts, and often had few political connections to expedite access. They constituted both a political and economic risk (which was not offset by any formal – rather than graft based - realisable profit motive within the state lending system). As such, the *hui* system – which during previous years had persisted in a variety of concealed ways – re-emerged.[1] By 1986 an estimated 95% of Wenzhou households were engaged in *hui* based lending (Tsai 2000). There was a strong motive for this kind of behaviour on behalf of the lenders; the reform process had reinvigorated a cash economy but trust in the state bank system was low, interest rates offered in the state-owned banks were also low, and local inflation though variable was typically higher than bank interest rates. *Hui* based lending offered the opportunity of achieving

[1]See, [*Jingji ribao*] [Economic Daily] (2005). [*Wenzhou minjian jiedai diaocha*] [Survey on Wenzhou Informal Lending], 10 June, p.13.

considerably higher rates of return and based on local knowledge through which some apparent risk could be mitigated. Once locked in as a viable institutional solution to capital shortages the informal system simply continued to reproduce itself through the continued activity of participants. A 2011 survey carried out by the Wenzhou Branch of People's Bank of China estimated that 89% of Wenzhou residents and 60% of firms were continuing to participate in informal lending, in a market valued at approximately 110 billion RMB.[2]

A key point here is that a weak institutional focus on a basic problem, in this case the financing of a dynamic new area of the economy (PEs), creates a gap.[3] A solution emerges based on existing (if historical) practices. Thereafter, the basis of China's economic reform strategy – the deferment of some important structural reforms – serves to perpetuate the "solution". China has not engaged in a full liberalisation of banking services in order to incentivise a range of banks to offer funding and effective support to PEs. A key issue is that the local informal solution creates unintended and problematic consequences. Specifically, the informal financing system is inherently unstable and prone to cycles of crisis. Capital pools are formed with an expectation of beating the returns available from the banks. Those who cannot borrow from the banks access this capital. They do so whilst paying rates higher than offered by the banks. Interest rates charged in the informal system can vary from 18-40% (Wu 2011). This phenomenon proved private entrepreneurs can "develop mechanisms to get around weak institutions" (Marceline and Mathur 2014, p. 32). The initial success of lending attracts further capital to the informal system and this can broaden the availability of capital to more borrowers, potentially reducing the credit quality of accepted borrowers. At the same time, borrowers must meet payments at relatively high interest rates. This creates scope for problems of debt

[2] See, [*Jinrong shibao* - FT Chinese] (2011). [*Wenzhou minjian jiedai shichang diaocha* - Survey on Wenzhou Informal Lending market], 22 August, p.9.
[3]By the end of 2011, there were 76,400 private enterprises (*siying qiye*, employing 8 or over labours by regulation) and 332,900 family/individual businesses (*getihu*, with less than 8 employees) in Wenzhou (see Lin 2012).

servicing. Some borrowers may take out other loans to cover existing ones. So the absolute scale of debt can be increasing for different reasons and there can be a problem of greater leverage. This is a problem for all participants. A threshold may be reached creating widespread liquidity and insolvency problems. These may start a feedback loop because of multiple loans and because lenders may be participants in several schemes. Crucially, the system lacks institutional supports and so all sides can be wiped out. The specific mechanism in the Chinese case – exemplified by Wenzhou - is PE financing. Note, however, this is not just a problem of the informal sector; it bleeds also into the formal sector based on the exploitation of interstices in the formal sector (see Section 4). The point is that even though PEs are able to access financing, they are doing so based on higher rates and an uncertain service. So, the system can potentially harm investment, expansion and profitability because of instability, lack of proper institutional structure, and because of prejudicial interest rates. Business financing is, then, distorted.

Wenzhou has experienced several financing crises centred on *minjian jiedai.* The most recent serious crisis occurred in 2011-12. In early 2011 the state, aware that its fiscal and monetary expansion after the global financial crisis was creating problems of asset bubbles across China, began to tighten monetary policy. Tightening monetary policy in a system with significant amounts of informal lending is a calculated risk. Tightening monetary policy is both a mechanistic instrument of economic policy and a warning. Tightening within the formal banking system also increases the current dependence on the informal system for those who need access to financing. As such, reduced lending through the formal system and higher lending rates feed through into greater demands on the informal system, and the scope for informal lenders to charge higher rates. The additional pressure this created meant that from April to September 2011 Wenzhou experienced a widely reported credit crunch resulting in a wave of defaults in the informal system. More than 90 entrepreneurs (some are well-known) fled the city (this was reported as *paolu*) and went into hiding in order to escape their creditors and there were several reported suicides.[4] So significant was this crisis (both in scale of capital at risk and in terms of its symbolism across the nation, given Wenzhou's status) that in October 2011, then Premier Wen Jiabao visited Wenzhou in a very public show of concern and support. The main banks were ordered to direct additional lending to PEs in order to reduce the tax burden on private firms' VAT and sales tax rates were also reduced on a national basis.[5] Lending by edict, however, is not an appropriate solution to a problem of institutional weakness and clearly the state is aware of this. In March 2012, China's State Council approved a Wenzhou pilot scheme for comprehensive financial reform to support private business financing via better controlled small banking enterprises.

In November 2013 the Zhejiang Provincial People's Congress passed "The Wenzhou City Private Financing Regulation". This is widely recognised as the beginning of legislation to address the issues created by the informal financing market in China. It is, however, only the beginning. It does not yet have any clear substance (see Section 6 for discussions and analysis).

3. The problem of monopoly: Informal finance and the funding gap

Banking in China continues to be dominated by a small number of state-owned or state controlled banks. The 'Big Four' are still entirely owned by the state as are what are termed policy banks.[6] The state is also the majority shareholder in the joint stock commercial banks, and has the capacity to directly intervene in an arbitrary way in the operations of any other

[4] See e.g. [*Zhongguo zhengquan bao* - China Securities Journal] (2011). [*Bufen zhongxiao qiye shenxian gaolidai nitan* - Some SMEs in deep mire of usury] 20 Oct 2011, p.A03.
[5] See[*Xin jing bao*][Beijing News], cited by http://www.sina.com.cn, 11/6/ 2012. [accessed 5.7.14].
[6] The Big Four includes: the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC), the Bank of China (BOC) and the China Construction Bank (CCB).

bank and this includes any nominally private bank. Private banks (e.g. Minsheng Bank) operate under close restrictions.[7] Foreign banks only have access to the Chinese market as minority participants in state-owned or controlled banks (Liang 2012). The state has resisted greater liberalisation and diversification of the banking system for a variety of reasons. A direct line into the banks ensures that any aspect of fiscal or monetary policy can be translated into rapid action through edict. The state is also able to manage the development and (in principle) ultimate divestment of the large state owned industries. Both the capacity for rapid direct action and the focus on SOEs enable centralised management of economic issues that are ultimately also matters of political stability. Importantly, the state is also able to deal directly with any emerging issues of financial stability arising for the solvency of given banks, based on non-performing loans. The tension here is that it is the continued shaping of financial policy according to particular political imperatives that helps to create the potential for instability. The state is then caught between recognizing and fostering a more decentred and arm's length approach to banking – in order to conform to international standards and encourage modern financial activity – and accepting the risks this entails (the different problems of financial instability that arise in a private banking system based on issues of financialisation).

China is in many respects moving towards conformity with international standards but has not shed the characteristics of state control. In 2012, 72% of China's banking assets were controlled by the state, of which the "Big Four" constituted 48%, the joint stock commercial banks 15%, and the policy banks 9% (Clennam 2012). It can then be vulnerable to problems arising from both modern financial activity and from the arbitrary power potentials of the use and abuse of state power. Significantly, the existence of this concentration creates a further distortion. State-owned and controlled banks enjoy both a formal and informal guarantee from

[7] See, [*Zhengquan ribao* - Securities Daily] (2013). [*Fangkai minjian ziben ban yinhang zhengdang qishi* - It is the right time to start private banks] 8 July 2013, p.3.

the state and also access to financing and investment opportunities that are denied others. As such, they access capital cheaply, engage in lending on a large scale more freely, earn returns based on market privilege and are forgiven any arising problematic debts.

State-owned or controlled banks are focused primarily on servicing large SOEs. They have few incentives to extend business financing and services to PEs. This problem is longstanding (Wu et al. 2008). In 2000 the private sector received less than 1% of the total lending made available from the formal banking system (Tsai 2002). In a small World Bank survey in 2003 only 20% of respondents obtained bank loans as part of their business financing (Ayyagari et al. 2010). According to the 2013 *Survey on the Chinese Banking Industry* 'small loans' still only accounted for 14.6% of the market in 2012.[8] There is then on a national basis a continuing problem of financing for the 30 million private enterprises currently operating in China. These now contribute more than 80% of urban employment, more than 60% of GDP, and more than 50% of tax revenues.[9]

So, informal financing services a recognized need on a local basis. Not only is it called forth by the lack of access to formal lending it also has some advantages, particularly for PEs working at a local level and requiring relatively small capital sums. Local knowledge and personal connections potentially overcome distrust and asymmetric information problems. One can informally vouch for another's character and this is more than a simple metric of creditworthiness. Moreover, decisions can be quick, and this can be quite significant given the bureaucratic and sclerotic nature of the formal system for lending. For example, one might require short term financing to meet the initial margin for delivery of a product and this can be

[8] See [*2013 Zhongguo yinhang ye diaocha baogao* - Survey on the Chinese Banking Industry, 2013], KPMG.
[9] See, [Guang Ming Web]. Available from: http://politics.gmw.cn/2013-03/13/content_6993021.htm, [accessed 7.7.14].

an immediate and unexpected opportunity. Without access to standby bridging loans and a significant overdraft facility at a recognized bank a PE may miss out here.[10]

Anecdotally, it is widely known that sums of less than 100,000 RMB can be accessed within a matter of minutes in Wenzhou, and larger sums within 24 hours.[11] Credibility is extremely important in the informal system and is built up through multiple interactions and based on a system of character vouching. Research by Wenzhou's China Securities Regulatory Commission (CSRC) indicates that 87% of PE borrowers in the informal system do so without any use of collateral, and only 63% personal loans with informal form of receipts.[12] This, however, does not mean the system lacks risk assessment or rules. It may be flexible in terms of what loans may be given for, maturity dates and interest rates, but both sides have expectations and these are rooted in practices that are known to all parties. The most prevalent form of informal *hui* lending is *chenghui*. The extended family is an extremely significant set of relations in Chinese culture. *Chenghui* refers to borrowing or lending amongst the extended family. It is the typical first resort for financing since it involves the greatest degree of information and trust. Where one cannot rely on extended family *yinbei* become significant. *Yinbei* are professional intermediaries who bring together potential lending pools and borrowers. The role requires a high degree of personal credibility (though whether this is genuine integrity is a different matter), and as such there are relatively few *yinbei*, and each can be involved in many financing deals. As such, they are a potential source of concentration of risk if there should be a sudden problem within the informal lending system.[13] As already noted, problems can be cyclical, as lending increases then informal institutions that speak to

[10] Noted in [*Jinggi ribao* - Economic Daily] (2005). [*Wenzhou minjian jiedai diaocha* - Survey on Wenzhou Informal Lending], 10 June 2005, p.13.
[11] Ibid.
[12] Ibid.
[13] Ibid.

issues of credibility rather than stark creditworthiness become more difficult to maintain, credibility (vouching etc) can be insufficient to establish creditworthiness; concomitantly, borrowers may be borrowing larger sums, at higher interest rates and based on more leverage, creating debt servicing problems (see Section 4 for how feedback loops here can be compounded). This is a particular problem in Wenzhou as a major centre for private enterprise and for informal lending. What has happened within Wenzhou may well be indicative of problems elsewhere, but one may also ask why the informal lending system is not as prominent or well developed in other localities. We have already drawn attention to geographic and cultural reasons but one may also draw attention here to the role of local government and of Wenzhou's business associations.

4. Local power – The roles of local government and business association

The Chinese language has many aphorisms that are deployed in everyday conversation to convey longstanding principles and attitudes in shortened form. The two most common in the context of the use of local government power are: 'The mountains are high and the emperor is far away,' (*shan gao huang di yan)* and 'Lower ranks can always find a way round higher level policy,' (*shangyou zhengce*; *xiayou duice*). There has always been a sense that distance from Beijing creates scope for local government to both fail to strictly adhere to central state policy and to creatively apply that policy. This has become an increasing possibility as the reform period has developed. It has to some degree been encouraged by the state, since there have been many instances where local initiatives have then been adopted nationally when found to be successful. What occurs then depends to some degree on the nature of the risks particular local government officials are prepared to take, which can then over time become a form of unofficial local policy framework. It is widely recognized that Wenzhou officials have made great efforts to develop and protect private enterprises, and have recognized the use of informal financing as a means to fill a funding gap (see examples, Liu 1992; Parris 1993; Tsai 2000, 2002, 2004; Zhou 2011). This began early in the reform process. In the 1980s local government overrode ideological distrust of private enterprise by sheltering them within different registered organization categories; many were registered as partnerships and treated similarly to collectives. This also allowed them to enjoy tax exemptions and favourable income tax rates. It has long been recognized locally that Wenzhou officials could be relied upon to simply ignore local informal lending practices as long as they did not result in disputes or attract national attention because of a local crisis.

Here tacit encouragement and tolerance of informal lending has flowed from several mutually reinforcing sources. During the communist period Wenzhou has experienced chronically low state investment. Wenzhou has not been a provincial or national investment priority (Parris 1993). Wenzhou officials thus had no particularly strong vested interests embedded in existing state owned industry. Once alternatives became possible, officials were more inclined to see their merit. They provided potential employment, tax revenue, and sources of local investment, resulting in a wide variety of local material benefits. Informal lending underpinned the growth of PEs. Furthermore, local material benefits extended also to the enrichment of government officials in various quasi-legal ways. Cadres or *ganbu* are at the centre of their own wide-ranging *guanxi* networks. *Guanxi* is a culturally specific practice of client-patron relations based on gift giving and expectations of reciprocal conduct. Over the reform period business activity has been highly regulated, requiring many permissions, licences and so forth. The system has gradually loosened in current anti-corruption campaign. However, cadres are still in a position to make life difficult for a business if they so wish. Fostering and accessing *guanxi* can thus be extremely useful. In this context, cadres relatives have enjoyed a local competitive advantage in terms of registering and operating private enterprises, and it has always been seen as advantageous to develop links with family members of significant cadres or to ensure that cadres themselves have a stake (direct or indirect) in the success of a business (see Section 4).

This extends also to the role of local business associations. Though local government has been broadly supportive of PEs and private enterprise in Wenzhou a parallel set of organizations have also developed that entrepreneurs have regularly called upon. Since the 1980s the state has fostered national and then regional and local 'non-government associations' (*minjian xiehui*). As in the case of state-sponsored trade unions in China these associations are not quite civil society organizations in the traditional sense of that term. They are quasi-corporatist entities intended to mediate between the state and a particular interest group but with the presumption that state concerns and interests form the prevailing context for eventual decision making. In Wenzhou these business associations include the Wenzhou General Chamber of Commerce, Wenzhou Private Enterprises Association and Wenzhou SME Association/Wenzhou SME Development Promotion Association. Wenzhou business associations have exerted a degree of unusual local autonomy in comparison to other local associations. As such, tacit support for informal lending from within the associations has provided another channel by which the practices have developed and grown on a local basis.

A key feature here has been a succession of charismatic and reform-minded high-ranking personnel within the associations. For example, Zhou Dewen, current chairman of the Wenzhou SME Association/Wenzhou SME Development Promotion Association is regularly cited as a key local agent. It is perhaps significant that Zhou Dewen is a member of the Democratic Progressive Party (DPP) rather than a member of the Chinese Communist Party (CCP). He also has a background in academia and private enterprise rather than state administration. As such, though required to be a representative of state policy he is also more distanced from the state's key networks. He is thus perceived as a more effective mediating figure between the state and the concerns of local businesses. This has recursive effects since a reputation for greater objectivity makes him also a candidate for policy reform posts, in turn increasing his and the association's influence. Zhou is also vice president of the China Association of Small and Medium Enterprises, deputy director of the China committee of the APEC SME union, and a vice chairman of the World Economic and Trade Joint Promotion Agency. He has written for the *Financial Times* (China edition) and is currently a member of the drafting team for the "Wenzhou City Private Financing Regulation" initiative.

So, it seems clear that Wenzhou is a site where informal lending was able to develop because of contributing and conducive factors. Those include geographical and cultural factors and also the tacit support of key local agents of the state and business associations. It is important to note these are not necessarily negatives; Wenzhou has flourished as a site of private enterprise and PE growth. The core issue is rather the instability and vulnerabilities of the informal system as it has developed. It is important also to note that lack of a *formal* focus on PEs in the formal system and institutional weakness in the formal system have combined to exacerbate problems in and through informal lending. There is then some reciprocity in terms of the vulnerabilities here, and any attempt to address informal lending practices must also take these into account.

5. Reciprocities between formal and informal financing

Given that the banks in China are not a major source of lending for PEs one might expect that one could simply observe a strict demarcation between the formal and informal lending sectors based on the profile of clients (see for example, Cull and Xu 2003; Berger and Udell 2006; Ayyagari et al. 2010; Lu et al. 2012). This, however, has not been the case, and particularly so since the implementation of the 2004 Commercial Banking Law. The Law allows for incentives to bank agents for the achievement of given targets. Bank agent's salaries and bonuses are linked to lending (Shen et al. 2009). However, in addition to the reasons simply focus on larger SOEs, the highly bureaucratic nature of the formal lending system militates against a focus on PEs. This is particularly so since agents are encouraged to seek out larger volume borrowers and are required to provide evidence of creditworthiness that many PEs simply cannot provide. However, though PEs are not a priority, they can become an additional resource through which bank agents meet targets. For this to occur, agents can find themselves seeking ways to artificially enhance the apparent creditworthiness of PE borrowers as tested through the existent bureaucratic procedures. There is then a distortion built into the way commercial logic is applied (Chen et al. 2013, p. 2533). Bank agents are motivated to misrepresent PE accounts, and so the information made available from PEs is not just limited from the bank's point of view, it is unreliable. PEs, meanwhile, find that their main interactions with banks do not conform to the strictures actually stated. The whole can then develop in pathological ways, which actually serve to exacerbate the potential for credit crisis caused by banks' lack of integrity and irresponsibility (Cowton 2002).

Qualitative research and local investigative media identify a variety of problematic practices used by bank loan officers in Wenzhou.[14] Two strategies in particular are designed to inflate the bank agent's statistics through the manipulation of lending to PEs:

(1) *Vouching*: the *hui* lending system and the role of *yinbei* has made PEs familiar with the practice of vouching for the creditworthiness of others in informal networks of lending. Bank loan officers have adapted this system. During the upward swing in a lending

[14] For example, [*Wenzhou ribao* -Wenzhou Daily] (2011). [*Wenzhou minjian jiedai guimo yue 1100 yiyuan* - Amount of Wenzhou informal lending reaches 110 billion RMB], 22 July 2011, p. 6; [*Zhongguo zhengquan bao* - China Securities Journal] (2011), [*Bufen zhongxiaofangqi shenxian gaolidai nitan* - Many small and medium sized property enterprises deeply mired in usury], 20 October 2011, p. A3.

cycle, when officers are under pressure to expand lending, officers are motivated to persuade private entrepreneurs who can actually establish a formal credit history, and so more easily comply with the formal requirements for lending, to vouch for firms that cannot. Evidence suggests that officers either offer better terms and conditions to the existing customer or use the implied threat of the withdrawal of services. The practice may well provide some PEs with formal credit access that would otherwise be unduly denied. However, it also creates the potential for non-creditworthy firms to gain access. The bank is not in a position to adequately discriminate between the two because the loan officer is motivated to distort the typical procedures of diligence. Moreover, the bank officer has constructed a web of inter-relations of liabilities and if these are sufficient in number, then an economic shock or sudden credit crisis issue can produce contagion. Significantly, this contagion spreads across both the formal and informal sectors, because PEs borrow in both, and spreads from weaker firms to apparently stronger ones, since the latter can be engaged in vouching in both sectors. The self-interested (essentially rent-seeking and sometimes criminal) activity of loan officers thus becomes a nodal point for contagion. This was widely reported, for example, during the 2011-2012 Wenzhou credit crisis. [15]

(2) *The exploitation of guanxi*: the development of *guanxi* creates readily accessible socio-economic networks that a bank loan officer can seek to exploit (Dunfee and Warren, 2001). Successful PE clients of banks do not just provide guarantees for other firms. In a curious reversal they can also become agents of the bank agent. Just as pressure can be placed for firms to engage in vouching, pressure can also be placed for firms to seek out other firms within their networks and encourage them to apply for credit. Again,

[15] Recall the previously referred to *paolu* or 'run away' business owners. Of the 90 named in the media several were prominent entrepreneurs. See, for example, [*Zhongguo zhengquan bao* - China Securities Journal] (2011), [*Bufen zhongxiaofangqi shenxian gaolidai nitan* - Many small and medium sized property enterprises deeply mired in usury], 20 October 2011, p. A3).

this is not necessarily a negative.[16] It provides both PEs with access to lower interest rate formal credit and bank services. However, actual creditworthiness is not the basis of the process and the information upon which the lending is built remains questionable. And again, it is only at some point of crisis that any vulnerability becomes manifest. The bank is not in a position to place confidence in its own accounts.

So, there are clear motivations for bank agents (loan officers) to exploit institutional weaknesses within the formal a sector in ways that exacerbate problems in the informal lending system. In Section 3 we noted that local state officials have looked the other way as informal lending practices have developed because it has paid to do so, both for the local economy and for themselves. However, there is an additional issue here that is also significant. As already noted, interest rates in the informal lending system are considerably higher than they are in the formal system. Rates in the formal sector vary around 6-8%, whilst those in the informal system can be as high as 18-40% (Wu 2011). There are then significant credit transformation potentials between the formal and informal lending systems and this creates a powerful motivation for rent-seeking behaviours from any strategically positioned agent. Cadres (*ganbu*), local non-government/business association agents, and bank agents have privileged access to credit from the formal system and so can take out loans, mediate with *yinbei*, and become a primary source of funding in *hui* in the informal sector. Cadres and business association agents, of course, also have significant networks and *guanxi* to expedite this process; bank agents, meanwhile, also have significant contact with business associations and well-connected PE entrepreneurs. Significantly, none of these agents can actually state on a loan application that the purpose of credit is to transfer lending from the formal to the informal system. As such, rent-seeking promotes misrepresentation within bank information systems (whilst the interest rate gap

[16] (See for example, [*Jinji ribao* - Economic Daily] (2011), [*Danbao gongsi yihua cheng dixia qianzhuang* - Guarantee companies' alienation into underground Banks], 10 October 2011, p. 4).

encourages agents to leverage themselves to increasingly dangerous levels – providing another way in which expanding debt arises).

Again, the whole creates vulnerability should a default or shock occur. According to local media and sources, there are many strategies used to undertake unofficial credit transformation. For example, cadres may take out additional debt on property (up to 70% of the value creating additional mortgage liabilities). Since cadres are able to demonstrate a good credit history (job security, stable income etc) they are able to access credit based on their rank (recently this has been 300,000 RMB for manager level cadres (*keji*) and 500,000 RMB for senior managers (*juji*).[17] These strategies are ostensibly lacking in deceit, in so far as the borrower is not necessarily required to state the purpose of the loan (though good practice would require a bank officer to inquire and to make the borrower aware of the potential for problems). However, one must consider the effect of motive and mutual self-interest between different agents here. It can be simply understood that the purpose is to engage in transformations and so the bank officer will be tacitly in collusion; moreover the process can transition to one of simple manipulation. Officers may receive inducements to massage the figures in order to maximise lending and minimise scrutiny. Once these behaviours and relationships are embedded they can then move beyond the constraints of smaller scale property secured borrowing or relatively easily manageable unsecured loans related to legitimate declarations of income. All sides, particularly as the informal sector grows and returns on lending seem to be a one-way bet, have motives to seek any and all ways to shift capital from the formal to the informal sector. Again, the problems here are unintended consequences of the potentials of the system that has arisen.

---

[17] [*Zhongguo xinwen zhoukan* - China Newsweek], cited by http://finance.sina.com.cn/china/20130926/154116860578.shtml. [accessed 22/07/14].

Since the processes involved are focused on misrepresentation, and agents have strong reputational incentives to cover up any emergent problems then evidence here is of varying quality (Beck et al. 2006). State agencies provide highly approximate estimations and the media are minded to publish investigative accounts during manifest crisis or in particularly egregious cases. During the events of 2011-2012, local media in Wenzhou and, as the crisis escalated, regional and national media, reported numerous cases of impropriety by cadres and business association agents (in one specific case 80% of participants in an informal lending scandal were officials).[18] Given their role in credit transformations officials were accused of usury, and of simply perpetuating the problems of the formal system that require an informal system to exist (and in which there was always the potential for greed to escalate inherent weaknesses).[19] Concomitantly, in one case a bank loan officer repeatedly used a false property certificate to obtain a total of 16.52 million RMB that was then directed into the informal lending system.[20] It is also worthy of note that the state is acutely aware of the debilitating effects on public confidence in and perception of cadres and of the banking system (Pei 2008; Scott 1972; Rocca 1992).

If considering the Wenzhou credit crisis of 2011-2012 in terms of a longer timeline for context, one might note that the seeds of this particular cycle were sown by central government's response to the global financial crisis. The crisis resulted in disruption to China's role as a key exporter in global supply chains and many export-oriented firms were forced to close, creating sudden widespread unemployment, uncertainty and fear. The state responded rapidly with a significant fiscal expansion and a loosening of monetary policy (Hou and Wang 2013; and for context regarding back activity, see Berger and Udell 1998, 2006; Bernanke and

[18]See [*Nanfang ribao* - Nanfang Daily] (2011): [*Wo bang ni banshi, ni bang wo fang gaolidai* - I help you to return you help me for usury], 29 Sept 2011, p. A8.
[19] Ibid.
[20] http://finance.sina.com.cn/china/20130926/154116860578.shtml [accessed 21/07/14].

Gertler 1995; Kakes 2000; Önder and Özyıldırım 2013). Over 4 trillion RMB was injected into the economy, and this involved also a directive to the state controlled banks to rapidly expand credit availability to support output and demand. As observed by Nguyen and Boateng (2015), there is a close relationship between the government's monetary policy changes and risk-taking behaviour by Chinese banks. The rapid change in policy in a system used to top-down hierarchical lines of authority lead rapidly to pressure on bank loan officers to meet expanded loan quotas. This pressure was to persist as China continued to respond to slowing global demand (particularly as recession spread across Europe and growth remained slow in the US).

However, the scale of lending within the context of motives we have already identified, quickly translated into opportunities for capital to be concentrated in forms of investment behaviour that create bubbles, and also for capital to be diverted to the informal sector. If there is pressure for lending to rapidly increase in a situation of uncertainty for production then there is a tendency for capital to be focused on forms of investment that offer rentier varieties of return – so investment in property tends to increase. This is not irrational in a developing state such as China. There is a long term aspiration to refocus the economy or balance it with a greater proportion of GDP deriving from consumption – commercial property, including for retail, can readily appear to be a warranted form of investment focus; similarly, as China's educated and urban middle class expands, the demand for higher quality residential property developments is also expected to rise, and so there seems a credible narrative for this kind of investment too.[21] However, a sudden and rapid increase in investment in land and property based on readily available credit can quickly create a situation where prices are rising because of perceived scarcity, creating then a bubble effect, where investment becomes speculative i.e. participants are investing in order to benefit from the rapidly rising prices, and this is a highly

[21] http://www.euromoney.com/Article/2942944/Real-estate-Property-throws-a-shadow-over-China.html [accessed 05/07/14].

unstable situation. The tendency for prices to rise attracts more participants but the whole is only sustained by the availability of credit and as the market heats up more credit is necessarily required to maintain the expanding bubble. According to the People's Bank of China, in the second quarter of 2011, new bank loans issued to property developers increased to 169 billion RMB from 42 billion RMB in the first quarter.[22] In so far as a febrile atmosphere can quickly arise in which many seem to be getting rich quickly (albeit much of the wealth is essentially notional based on values of properties and balanced by the debt each is carrying that anchors ownership of any asset) others are attracted to the activity and so any agent able to offer access to credit can find themselves positioned to make personal gains.

Ultimately, the system increases in vulnerability as debt levels rise, because the interest rate sensitivity of borrowers also rises, and their dependence on credit is increased. At some point the whole can then be subject to a collapse and these become a positive feedback loop through contagion effects. In the 2012 case the collapse was set in motion relatively slowly as the central bank, the People's Bank of China, began to ratchet up interest rates. The People's Bank raised interest rates five times between October 2010 and August 2012. It also increased the mandatory reserve requirement ratio (RRR) of the banks (reducing their capacity to lend) 12 times during the same period.[23] Formal credit thus became both more expensive and scarcer. Since loans were often given for a 3 month period in the formal system, many borrowers quickly found themselves needing to renew their lending (which was then denied, forcing them further into the informal sector, which itself was also then under pressure). Illiquidity and insolvency necessarily followed and this quickly spread through formal and informal

[22] Ibid.
[23] Ibid.

connections that had been constructed in ways we have already referred to. At the height of the crisis in 2012 the number of commercial lawsuits increased by 61% from 2011 (to 19,446).[24]

The key points to take forward here are that the real lending system in China, as illustrated by Wenzhou, is complex, exhibits various institutional weaknesses based on emergent opportunities, is clearly unstable in so far as it is prone to its own variants of financial cycle, *and* is one that profoundly affects the scope of activity of PEs. As this section also illustrates, a system that maintains PEs access to credit for ordinary everyday business activity and for investment can be hijacked during a cycle of credit expansion, and so PEs are at best constrained and worst materially damaged by the real context of credit availability that exists in China. This leads us to consider issues of reform of the system.

6. **Policy changes and implications: Reform from 2013 and its limits**

It is noted at the beginning of this paper that reform in China tends to be undertaken incrementally and gradually, often with an initial local experimental basis that is then generalised across the state if found to be effective. Since Wenzhou in particular, and the province of Zhejiang in general, have emerged as a notable site for entrepreneurship and the promotion and development of PEs, and this itself has then resulted in heightened forms of problems that exist to lesser degrees elsewhere, it is unsurprising that Wenzhou and Zhejiang should also be notable as locations for reform of those arising problems and that the state should be particularly interested in this. The state, the province and the city all have vested interests in preventing debilitating credit crises.[25] As such, considerable publicity has surrounded

[24][*Nanfang ribao* - Nanfang Daily] (2011): [*Wo bang ni banshi, ni bang wo fang gaolidai* - I help you to return you help me for usury], 29 Sept 2011, p. A8.

[25] For a general discussion of regulatory decentralisation see Du and Xu (2009).

Wenzhou's response to the events of 2012. In November 2013, the Standing Committee of the 12th People's Congress of Zhejiang Province approved an appointed Wenzhou working committee's 'Wenzhou City Private Financing Regulation' and this was then implemented from March 2014.[26] The regulation was heralded as ground-breaking for two reasons. First, it formally recognizes the existence of the informal lending sector and second, it provides a set of rules for dispute resolution in the informal sector. As such, it potentially provides a set of hitherto lacking legal protections at a municipal and provincial level.

Three specific components of the regulation are worth noting here. First, the regulation allows informal lending to be formalised through the establishment of private finance management companies. These effectively become a recognized tier in the finance system and so informal lending potentially gains from greater transparency, and the state is able to more effectively monitor such activity. Second, in so far as the potential for informal lending is now formally recognized, any informal lending activity involving a single transaction above 3 million RMB or more than 30 participants in a lending scheme, is now subject to registration with a relevant authority designated by the city. As such, the state is potentially able to monitor and track the volume and scale of significant informal lending activity. Third, since the informal sector has arisen in response to a need for financing from private PEs, the regulation also empowers PEs to issue bonds and equity to directly finance themselves.

The three stated components are all positive steps forward, but let us consider what they are and what they are not. The first two components are attempts to improve the adequacy of information regarding informal lending and to increase the state's capacity to control that lending. However, neither of these two components can prevent informal lending continuing

[26] The working committee was focused around "The Overall Programme of Comprehensive Financial Reform for Pilot Area in Wenzhou, Zhejiang Province" set by the State Council in March 2012, known as the "12 targets"

to occur in the ways that it did before. Whether that activity transfers to private finance management companies and whether those liable to undertake informal lending are minded to register their activity will depend on whether the new system is enforceable and deemed also to be effective and desirable by those currently liable to engage in informal finance practices. This is something of an open issue and involves issues of trust and finance (see Colledge et al. 2014; Morgan and Sheehan 2015). One can at least note here though that if the intent is to increase information and control for the state then there may be occasions where the interest and motivations of other agents conflict with those of the state. As such, the new system may simply be bypassed, particularly if it is experienced as bureaucratic and slow, precisely because it requires more information, checks and balances than the prior informal system. The current *hui* system is already embedded and so may not simply disappear under such circumstances, and if and when opportunities for expansionary credit cycles (and also asset bubbles) arise, informal lending may again simply exceed or exploit the gaps in the existent system. However this does not make regulatory reform irrelevant or pointless, it is a major step forward for legal protections and recognitions to exist, these may ultimately motivate a transition into more formalised aspects of informal lending. But, consider here also the third component. This is essentially recognition that entrepreneurs and PEs are often starved of capital. It creates an opportunity for firms to raise capital more effectively than in the past. But not all PEs are in a position to do this, which is precisely why banks and *hui* exist as source of financing. Moreover, the third component is only necessary because of continued failings in the formal lending system, where the state banks continue to dominate and continue to focus their financing activity on larger SOEs. The regulation is then not a fundamental solution to the adverse focus of the banking system. This is an issue that needs further consideration, and cannot be resolved at a municipal or provincial level. It requires a continued evolution of the banking system and this can only be led by the state. In the meantime, PEs still face difficult conditions in accessing finance. To some degree this is also encoded in the new regulation. The regulation does not directly specify an interest rate threshold, and so does not prevent PEs becoming dependent on sources of finance subject to significantly higher interest rates.[27]

7. Conclusion

In this paper we provide an in-depth discussion focused on why formal and informal lending have coexisted in China, and how they have interacted. This is illustrated using a primary yet a typical case –Wenzhou (the national capital of both "informal lending" and "private enterprise"). To the best of our knowledge, this is the first paper to address the ambiguities and complexities of the case in context. Our findings and contributions to the literature can be summarised from three perspectives. Firstly, although significant literature has examined the origin, scope and impact of informal lending to private enterprises, our paper explores this issue with reference to the complexity and reciprocity of relations that bear on the formal lending sector. Notably highlighting institutional weaknesses and vulnerabilities, and so bringing to the fore otherwise obscure causal connections via which PEs can be discriminated against by state-owned and controlled banks. Discrimination extends to prejudicial interest rates and substandard service. We also bring to the fore additional matters of context, notably the role of tightening monetary policy within the formal banking system, which tends to increase the current dependence on the informal system for those who need access to financing. One can consider this as a push factor within the informal lending crisis 2011-2012. Others include the arbitrary power potentials abused and exploited by bank loan officers, which caused instability and vulnerabilities within the informal system, and also the contagion effects or economic shock arising from credit crisis. Secondly, our paper highlights the role of specific informal

[27] Though if one contextualises this with criminal codes in relation to usury one can expect a limit of four times the formal bank rate.

lending practices in localities such as Wenzhou. We note that geographical, cultural and political factors are relevant for real causal processes. For example, regarding tacit support of key local agents of the state, business associations and other influential figures. These explain why Wenzhou in particular, became a site where informal lending was able to develop (constituting contributing and conducive factors). However, it remains the case that Wenzhou's experience is relevant to differing degrees elsewhere in China. Thirdly, and concomitantly, Wenzhou was designated by the state as a site for reform of the informal lending system. This followed the Chinese model of experimental, incremental and gradual reform. Our paper provides a detailed analysis, including policy implications, of the three components of the ground-breaking new regulation - 'the Wenzhou City Private Financing Regulation'. We conclude that despite positive potential, limitations are apparent, which requires fundamental changes in institutional structure and legislation. Ultimately, then one is left wondering how the system will evolve. Key questions remain: will the regulation prevent crises, and will the state build on the regulation to promote a better system of financing for PEs?[28] Finally, we can conclude that the Wenzhou case could prove, as argued by Pagliari and Young (2014) that leveraged power can be used by financial regulatory policymakers in a specific location of the economy.

References

(1) Archival in Chinese

Regulations

Wenzhou City Private Financing Regulation	22 November 2013, Zhejiang Provincial People's Congress
Rules for the Implementation of Wenzhou City Private Financing Regulation	28 February 2014, Wenzhou City Government
Some opinions on encouraging and guiding a healthy development of private investment	13 May 2010, The State Council of China,

[28] For related discussions see Allen et al. (2005). Other issues also include: implementation (see, Pistor et al. 2000; Berkowitz et al. 2003), extension and generalisation of any effective form of the regulations and then how does one measure that effectiveness (see Levine 1997).

The Overall Programme of Comprehensive Financial Reform for Pilot Area in Wenzhou, Zhejiang Province.	28 March 2012, The State Council of China
The Implementation of Comprehensive Financial Reform for Pilot Area in Wenzhou, Zhejiang Province	20 November 2012, Zhejiang Provincial Government
SME Promotion Law of People's Republic of China	29 June 2002, National People's Congress of China
Commercial Bank Law of the People's Republic of China	10 May 1995, National People's Congress of China, revised December 2003.

Newspapers

Wenzhou Ribao
Zhejiang Daily
Guang Ming Daily
China Business News
FT Chinese
Shanghai Securities News
Securities Daily
Renmin Zhengxie Bao
China Economic Times
Nanfang Daily
West Times
21st Century Business Herald
China Business Herald
Renmin Ribao
China Times
China Business Times
Entrepreneur Daily
Economic Daily
China Business Journal
China Securities Journal
Wen Hui News
Xinhua Daily Telegraph
China High-Tech Industry Herald
Economic Information Daily

(2) Books and journals

Alford, W. 2000. 'The more law, the more. . .? Measuring legal reform in the People's Republic of China'. Stanford Center for International Development Working Paper No. 59, Stanford University.

Allen, F., Qian M., and Qian, J. 2005. "Law, finance, and economic growth in China". *Journal of Financial Economics* 77: 57–116.

Ayyagari, M., Demirgüç-Kunt, A. and Maksimovic, V. 2010. "Formal versus informal finance: Evidence from China". *The Review of Financial Studies* 23, no.8: 3048-3097.

Beck, T., Demirgüç-Kunt., A. and Maksimovic, V. 2005. "Financial and legal constraints to firm growth: Does firm size matter?" *Journal of Finance* 60:137–177.

Beck, T., Klapperd, L. F. and Mendozae, J. C. 2010. "The typology of partial credit guarantee funds around the world". *Journal of Financial Stability* 6: 10–25.

Berger, A.N. and Udell, G.F. 1998. "The economics of small business finance: The role of private equity and debt markets in the finance growth cycle". *Journal of Banking and Finance* 22, no. 6–8, 613–673.

Berger, A. and Udell, G. 2006. “A more complete conceptual framework for SME finance”. *Journal of Banking & Finance* 30: 2945-2966.

Berkowitz, D., Pistor, K. and Richard, J.F. 2003. “Economic development, legality, and the transplant effect”. *European Economic Review* 47, no.1: 165–195.

Bernanke, B. S. and Gertler, M. 1995. “Inside the Black Box: The credit channel of monetary policy transmission”. *Journal of Economic Perspective* 9, no. 4: 27-48.

Clarke, D. C. 2003. “Economic development and the rights hypothesis: The China problem”. *American Journal of Comparative Law* 51: 89–111.

Chen, J. and Dickson, B. J. 2008. “Allies of the state: Democratic support and regime support among China's private entrepreneurs”. *The China Quarterly* 196: 780-804.

Chen, Y., Liu, M. and Su, J. 2013. “Greasing the wheels of bank lending: Evidence from private firms in China”. *Journal of Banking & Finance* 37: 2533–2545.

Clennam, A. 2012. “Yielding state control”. *Global Finance* June: 48-50.

Colledge, B., Morgan, J. and Tench, R. 2014. “The concept(s) of trust in late modernity, the relevance of realist social theory”. *Journal for the Theory of Social Behaviour* 48, no. 4: 481-503.

Cowton, C.J. 2002. “Integrity, responsibility and affinity: three aspects of ethics in banking”. *Business Ethics: A European Review* 11, no. 4: 393-400.

Cull, R. and Xu, L.C. 2003. “Who gets credit? The behavior of bureaucrats and state banks in allocating credit to Chinese state-owned enterprises”. *Journal of Development Economics* 71: 533–559.

Dickson, B. J. 2007. “Integrating wealth and power in China: The Communist Party's embrace of the private sector”. *The China Quarterly* 192: 827-854.

Dittmer, L. 2003. “Leadership change and Chinese political development”. *The China Quarterly* 176: 903-925.

Du, J. and Xu, C. 2009. “Which firms went public in China? A study of financial market regulation”. *World Development* 37, no. 4: 812–824.

Dunfee, T.W. 2001. “Is Guanxi ethical? A normative analysis of doing business in China.” *Journal of Business Ethics* 32: 191–204.

Epstein, R.A. 2014. “Assets or liabilities? The politics of bank ownership”. *Review of International Political Economy* 21, no. 4: 765-789.

Ghate, P. B. (1992). **“**Interaction between the formal and informal financial sectors: The Asian experience”. *World Development* 20, no. 6: 859-872.

Guo, B. and Liu, M. 2002. “Private finance and Small & Medium Sized Enterprises development: Empirical evidence from Wenzhou Region”. *Economics Research (in Chinese)* 10: 44-46.

Hou, X. and Wang, Q. 2013. “Implications of banking marketization for the lending channel of monetary policy transmission: Evidence from China”. *Journal of Macroeconomics* 38: 442–451.

Hsu, S. 2012. “Role of informal finance in China’s continuing economic development”. *The Chinese Economy* 45, no.1: 28–45.

Kakes, J. 2000. *Monetary transmission in Europe. The role of financial markets and credit*, Edward Elgar, Cheltenham.

Levine, R. 1997. “Financial development and economic growth: Views and agenda”. *Journal of Economic Literature*, XXXV(June): 688–726.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R. 1998. “Law and finance”. *Journal of Political Economy* 106, no. 6:1113–1155.

Li, D. 2001. “Beating the trap of financial repression in China”. *Cato Journal*,21, no.1: 77–90.

Liang, Y. 2012. “Development finance – China’s banking system in light of the global financial crisis”. *The Chinese Economy* 45, no.1:8–27.

Liang, Y. 2016. “Shadow banking in China: Implications for financial stability and macroeconomic rebalancing”. *The Chinese Economy* 49:148–160.

Lin Z. 1991. “An examination of commodity economy in Wenzhou”. *International Journal of Social Economics* 18, no. 8/9/10: 29-37.

Liu, Y. L. 1992. “Reform from Below: The private economy and local politics in the rural industrialization of Wenzhou”. *The China Quarterly* 130: 293-316.

Lu, S. F. and Yao, Y. 2009. “The effectiveness of law, financial development, and economic growth in an economy of financial repression: Evidence from China” *World Development* 37, no. 4: 763–777.

Lu, Z., Zhu, J. and Zhang, W. 2012. “Bank discrimination, holding bank ownership, and economic consequences: Evidence from China”. *Journal of Banking & Finance* 36, no. 2: 341-354.

Madestam, A. 2014. “Informal finance: A theory of moneylenders”. *Journal of Development Economics* 107: 157–174.

Marcelin, I. and Mathur, I. 2014. “Financial development, institutions and banks”. *International Review of Financial Analysis* 31: 25–33.

Morgan, J. and Sheehan, B. 2015. “The concept of trust and the political economy of John Maynard Keynes, illustrated using central bank Forward Guidance and the democratic dilemma in Europe”. *Review of Social Economy* 73, no. 1: 113-137.

Önder, Z. and Özyıldırım, S. 2013. “Role of bank credit on local growth: Do politics and crisis matter?” *Journal of Financial Stability* 9: 13– 25.

Parris, K. 1993. “Local initiative and national reform: The Wenzhou Model of development”. *The China Quarterly* 134: 242-263.

Passas, N., Hsu, S. and Li, J. 2012. “Development and legitimacy of Chinese informal finance”. *The Pacific Review* 25, no. 4: 495–511.

Pei, M. 2001. “Does legal reform protect economic transactions? Commercial disputes in China”, in M.Peter (Ed.), *Assessing the value of law in transition countries* (pp. 180–210). Ann Arbor: University of Michigan Press.

Pei, M. 2008. “Fighting corruption: a difficult challenge for Chinese leaders”, in: Cheng Li (Ed.). *China’s Changing Political Landscape*, Brookings Institute: 229–250.

Pistor, K., Raiser, M. and Gelfer, S. 2000. “Law and finance in transition economies”. *Economics of Transition* 8, no. 2: 325–368.

Pistor, K. and Xu, C. 2005. “Governing stock markets in transition economies: Lessons from China”. *American Law and Economics Review* 7, no.1: 1–27.

Pagliaria, S. and Young, K. L. 2014. “Leveraged interests: Financial industry power and the role of private sector coalitions”. *Review of International Political Economy* 21, no.3: 575-610.

Nguyen, V. H. T. and Boateng, A. 2015. “An analysis of involuntary excess reserves, monetary policy and risk-taking behaviour of Chinese Banks”. *International Review of Financial Analysis* 37: 63–72.

Qin, D., Xu, Z. and Zhang, X. 2014. “How much informal credit lending responded to monetary policy in China? The case of Wenzhou”. *Journal of Asian Economics* 31/32: 22–31.

Rocca, J. L. 1992. “Corruption and its shadow: An anthropological view of corruption in China”. *The China Quarterly* 130: 402-416.

Saich, T. 2000. ‘Negotiating the state: The development of social organizations in China’. *The China Quarterly* 161: 124-141.

Scott, J.C. 1972. *Comparative Political Corruption*. Prentice-Hall.

Shaw, E. 1973. *Financial deepening in economic development*. New York: Oxford University Press.

Shen, Y., Shen, M., Xu, Z. and Bai, Y. 2009. "Bank size and small and medium-sized enterprise (SME) lending: Evidence from China". *World Development* 37, no.4: 800–811.

Xu, J. 2013. "Shadow bank development with Chinese characteristics and its impact on small and medium-sized business' financing". *Finance & Economics* (in Chinese) 299, 2: 11-20.

Tam, O. K. 1992. "A private bank in China: Hui Tong Urban Co-operative Bank". *The China Quarterly* 131: 766-777.

Tsai, K. S. 2000. "Banquet banking: Gender and rotating savings and credit associations in South China". *The China Quarterly* 161: 142-170.

Tsai, K. S. 2002. *Back-Alley Banking: Private Entrepreneurs in China*. Ithaca, NY: Cornell University Press.

Tsai, K. S. 2004. "Imperfect substitutes: The local political economy of informal finance and microfinance in rural China and India". *World Development* 32, 9:1487–1507.

Tsai, K. S. 2015. "The political economy of state capitalism and shadow banking in China". HKUST IEMS Working Paper No. 2015-25.

Unger, J. 1996. "Bridges: Private business, the Chinese government and the rise of new associations". *The China Quarterly* 147: 795-819.

Wu, G.L. 2006. *On Wenzhou's financial ecology* (in Chinese). Shanghai: Sanlian Book Publisher.

Wu, G. L. 2011. "Survey on current Wenzhou informal lending market". *Financial Industry* (in Chinese) August: 25-27.

Wu, J., Song, J. and Zeng, C. 2008. "An empirical evidence of small business financing in China". *Management Research News* 31, no.12: 959-975.

Yao, Y. and Yueh, L. 2009. "Law, finance, and economic growth in China: An introduction". *World Development* 37, 4: 753–762.

Zhang, G. 2008. "The choice of formal or informal finance: Evidence from Chengdu, China". *China Economic Review* 19: 659–678.

Zhou, L. and Takeuchi, H. 2010. "Informal lenders and rural finance in China: A report from the field". *Modern China* 36: 302.

Zhou, W. 2011. "Regional deregulation and entrepreneurial growth in China's transition economy". *Entrepreneurship & Regional Development* 23, no. 9–10: 853–876.

The Coexistence and Interaction of Formal and Informal Lending in China - Discussion of the Wenzhou Case

Junjie Wu[1]

Faculty of Business and Law, Leeds Beckett University, UK

Postal address:
Dr Junjie Wu
The Rose Bowl
Portland Crescent
Leeds, LS1 3HB
UK
Tel: 0044 113 8124792
Email: J.Wu@leedsbeckett.ac.uk

[1] Corresponding email: J.Wu@leedsbeckett.ac.uk