

Analysis of Enhancement of Consumer's Consumption by Microcredit Regulations from the Perspective of Legal Economics

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Abstract: As the Chinese economy continues its development, so develops the consumption level of its consumers. The expanding consumption demand creates a contradiction to the relatively invariable income level, increasingly leading to Chinese consumers to utilize microcredit to help pay for their short-term consumptions. Microcredit can influence the behavior of urban resident consumption, and by regulating microcredit, authorities can adjust and regulate the consumption habits and patterns. A well-regulated microcredit system that protects consumers can enhance economic growth and provide an overhaul to consumption structure through increased consumption. This Article focuses to analyze the enhancement of urban resident consumption by microcredit regulations from the perspective of legal economics, studies the impact of microcredit on urban resident consumption, the change in consumption patterns in a regulated microcredit system, and theorize the economic necessity of a regulated microcredit system. This Article utilizes Resident Consumption Function Theory to analyze the relationship between consumer's expected future income and current income, the result helps this Article understand the urban resident income status when taking microcredits. The growth of microcredit in China has increased significantly in recent years, from 12.4% a year in 2015 to 63.9% a year in 2020. With the rapid expansion of microcredit, so expands its proportion in the overall financial credit market, from 6.4% in 2015 to 16.3% in 2020, becoming increasingly an important influence of urban residence behavior and consumption pattern. By analyzing the yearly development of microcredit, this Article proposes that the microcredit market is growing in importance in the overall Chinese financial system, and a well-regulated microcredit system which protects urban residence is necessary for the future economic development of China.

Keywords: Microcredit, Consumer Consumption, Consumer Protection, Law and Economics

1. Introduction

The rapid economic development in China has recently entered a slowdown phase. As growth slows, the economic transformation and upgrade that is occurring in China also develops new features, and urban resident consumption has become the main body of demand growth in the supply-side demand reform [1-2]. A feature of the slowdown in economic growth is that the consumption level of urban residents continues to decline, the level of savings continues to rise. [3-4].

Microcredit is a credit of which commercial banks, microfinance companies, and other financial institutions provide urban residents with, mainly for the purpose of goods and services purchase and advance consumptions. The recent economic slowdown has accelerated the demand for microcredit. [5-6]. As a financial means to increase consumption and stimulate effective demand, microcredit increases the growth of consumer demand and transformation and upgrade of consumption structure by providing urban residents more opportunities for advance consumption [7-8]. Therefore, the study of the impact of microcredit on urban resident consumption and the stimulation of Chinese domestic consumption demand is of significant value in the pursuit to explore effective ways to enhance sustained and stable economic and financial development [9-10]. Research by Mia indicates that Bangladesh has made significant progress in socio-economic and economic development over the past few decades and that microfinance has made a significant contribution to this socio-economic development [11].

Many researchers across the globe have studied the impact of microcredit on urban resident consumption achieving many academic results. Raval D points out that the utilization of microcredit for advanced consumption must be based on the free-will of consumers, and for the purpose to

maximize consumer utility and proactively divide future income between current consumption and future consumption in an economic optimal way [12]. Collins J M et.al. argue that microcredit is an important supplementary tool for advanced consumption decision-making, which consumers can opt to use in their consumption decisions, to the benefit of consumption growth stimulation and transformation and upgrade of economic structure [13]. In AEM and BED's research, they show that strengthened national control of microfinance will promote consumers or small and medium-sized enterprises to improve their credit to obtain loans, which will help consumers maintain a more optimal consumption condition [14]. These studies on the increase of urban resident consumption by the microcredit and the necessity of microcredit regulation establish the theoretical basis for the research in this Article.

This Article mainly explores the impact of microcredit and the necessity of microcredit regulation on urban resident consumption from the perspective of law and economics. By correlating the relationship between microcredit and urban resident consumption, this Article intends to study the changes in urban resident consumption under a well-regulated microcredit system. The conclusion in this Article leads to proposed measures that microcredit regulations must take to increase urban resident consumption, such as regulate microcredit providers, enhance the diversification of microcredit types, improve microcredit laws and regulations, strengthen microcredit industry supervision, and improve the construction of a social credit evaluation system. This Article also studies the resident consumption theory function, and the correlation between consumers expected future income and current income, to understand the consumers income while they are utilizing microcredit.

2. Research and Analysis

2.1 Research Object

This Article mainly studies the path of the microcredit regulations to enhance Chinese urban resident consumption from the perspective of law and economics. To form a basis for further analysis, this Article will make the recent development of institutional microcredit in China as research object, identify the year-on-year growth rate of microcredit from 2015 to 2020 and its market share in the overall financial credit market, as well as study the proportion of microcredit in Chinese GDP development to further analyze the impact of the development of microcredit on urban resident consumption. Other credit that could be classified as microcredit but doesn't involve institutional parties in its transaction process, such as private loans, falls out of the scope of this Article.

2.2 The Function Theory of Resident Consumption

According to Kim, Resident consumption level is not only related to current income, but also affected by expectations of future income, savings assets, microcredits and other aspects. In general, consumer consumption behavior is primarily determined by their current income level. When faced with unexpected expenditures or large expenditures that exceed the income level however, the availability and expenditure of microcredit also plays an important role in consumer consumption decisions. In circumstances without unexpected large expenditure and available credits, residents are tended towards saving instead of consumption. In circumstances with emergence of unexpectedly large expenditures and available credits, the otherwise relatively stable resident consumption level will change, and resident tendency towards consumption through microcredit will exceed their tendency to saving [15]. This is illustrated by the Total Consumption Function:

$$c_t = b_1 * Y_t + b_2 * Y^* + b_3 * A_t \quad (1)$$

Whereas, c_t, Y_t, Y^*, A_t represent the current consumption, current income, expected future income, and current assets of consumers respectively, and b_1, b_2, b_3 represent current income, expected future income, and the marginal tendency to consume current savings assets. The relationship between consumer's expected future income and current income is expressed as:

$$Y^* = \beta * Y_t \quad (2)$$

Then the total consumption function is:

$$c_t = (b_1 + b_2 * \beta) * Y_t + b_3 * A_t \quad (3)$$

2.3 Current Market Situation of Microcredit

The emergence of microcredit in China is a relatively late innovation compared to other forms of credit. Since the first regulation of microcredit in Security Law of the People's Republic of China [16], as Chinese economic development enters slow-down, and the government focused on diverting from an export-focused economy to a consumption-focused economy, the importance of consumer consumption enhancement has gained more significance in recent years. As Chinese consumption grows, so too grow the scale of microcredit. The development of microcredit in China in recent years is shown in Table 1(China Statistical Yearbook -2020 18-3).

Table 1: Development of Microcredit

	2015	2016	2017	2018	2019	2020
Year on Year Growth	12.4	13.7	26.4	47.5	52.6	63.9
Ratio to Total Loans	6.4	8.9	11.6	12.9	14.1	16.3

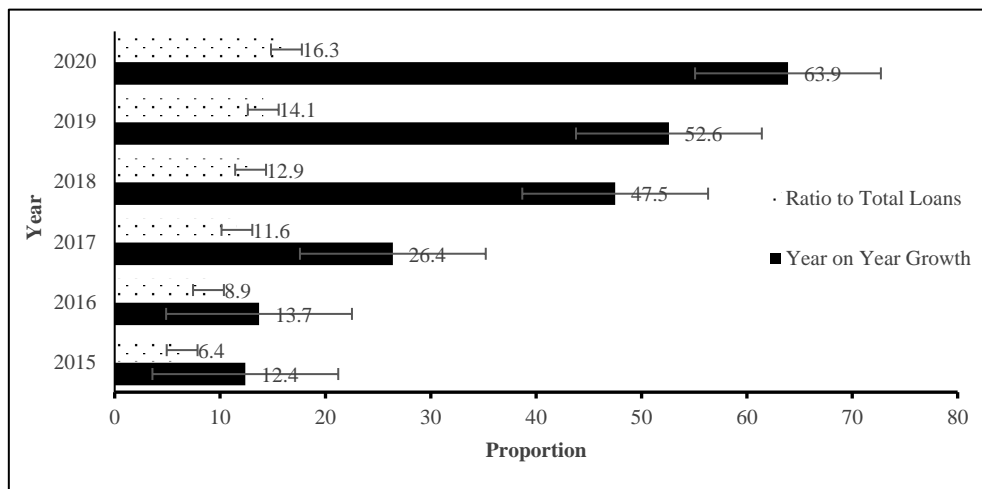


Figure 1: Development of Microcredit

Data from Figure 1 shows the year-on-year growth of microcredit has been continually rising. The growth rate of 12.4% in 2015 has reached 63.9% in 2020. The proportion of microcredit in overall financial credit market has also steadily increased from 6.4% in 2015 to 16.3% in 2020. Within five years the microcredit market transformed from a marginal form of credit in financial credit market to become a significant credit form in Chinese financial credit market.

2.4 Microcredit and Urban Resident Consumption

The inter-annual change rate of microcredit and urban resident consumption derived from the data by China National Bureau of Statistics from 2015 to 2020 is illustrated in Table 2¹(China Statistical Yearbook 2015-2020 18-3). A comparison between the growth of microcredit and the slowdown of urban resident consumption, as shown in Figure 2 clearly demonstrates that, in contrast to microcredit's rapid growth in scale and proportion to the overall GDP, tendency of urban resident consumption is moving towards a downward trend.

Table 2: Microcredit and consumption of urban residents

	2015	2016	2017	2018	2019	2020
Microcredit / GDP	1.63%	3.14%	6.81%	9.22%	13.37%	16.38%
Microcredit/ Full Loan	1.57%	2.94%	7.78%	10.30%	12.65%	13.80%
Average Propensity to Consume	16.35%	16.92%	12.68%	12.13%	13.96%	14.15%

¹ The data comes from the 2015-2020 yearbook of China National Bureau of Statistics

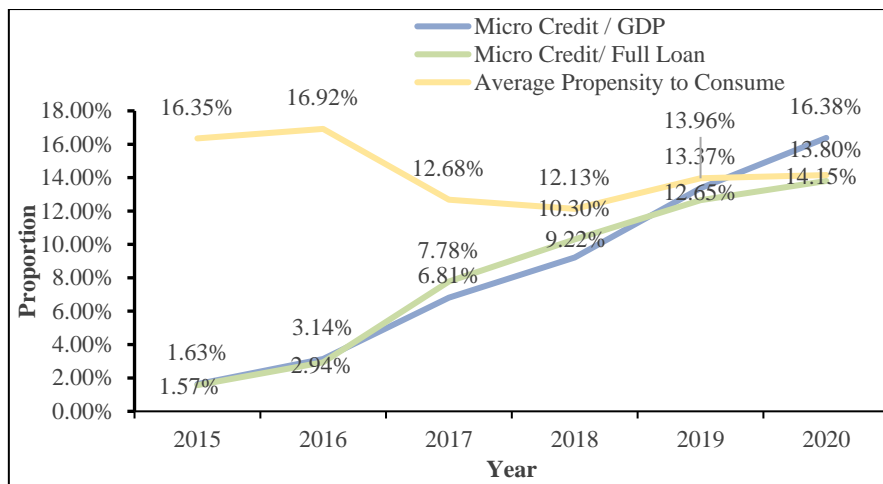


Figure 2: Microcredit and consumption of urban residents

Figure 2 demonstrates that in the circumstance of microcredit and urban resident consumption, the ratio of microcredit to overall GDP and the proportion of total loans have increased significantly. On the other hand, consumption tendency of urban residents went through a downward trend from 16.35% in 2015 to 12.13% in 2018. A major factor in its decline is due to slowdown in economic growth and urban residents restraining their consumption for future considerations, without the wide availability of an optimal microcredit system. The consumption tendency of urban residents rises after 2019 in spite of continuing economic slowdown; this rise could partly be explained by the better availability of optimal microcredit system which has undergone significant reforms and regulatory interventions by the Chinese authorities through 2018 and 2019.

The rapid growth in scale and proportion of microcredit could to some extent correlate with the increased regulatory measures placed on microcredit. Any financial market without regulation is vulnerable to market failure [17], an unregulated microcredit market will incur substantial risk to all transactional parties. The increasing in the scope and scale of microcredit requires regulations to meet in scope and scale. Due to the inherent difference of microcredit compared to other forms of financial credits, pre-existing regulations are not ideal in regulating microcredit market. The significance of regulations on microcredit cannot be underestimated and therefore worth to study from a law and economics perspective.

3. Analysis on the Increase of Urban Resident Consumption by Microcredit From the Perspective of Law and Economics

3.1 Analysis on the Increase of Urban Resident Consumption by Microcredit

Microcredit provides urban residents with additional solutions to their budget restrains and limited liquidity dilemmas. By having added leeway to meet their current and future expenditure need, Urban residents are incentivized to make additional consumption which contribute to economic development [18]. The extra funds that the financial institution provides to urban residents through microcredit allows payment for various expenditure and consumption that are otherwise inaccessible to them. With more money to spend, consumption pattern of urban resident change. Such change in pattern also occurs in short-term and long-term savings. These changes clearly depict microcredit's stimulative effect on the consumption of consumer goods.

Although future debt repayment burden increases for urban residents who opt to utilize microcredit, the savings pressure on the other hand eases simultaneously. Present urban resident consumption will increase while long-term savings decrease. In optimal circumstances with well-established and well-regulated microcredit system, urban residents when facing foreseeable or unforeseeable expenditure can make the necessary payment through use of microcredit. As such, microcredit reduces to a certain extent the incentive for savings by functioning as a sort of consumer insurance, and incentivize urban residents to diverge their savings into consumption. Microcredit will in a sense alter urban resident consumption structure from savings-focused to consumption-focused [19].

Giving the current state of economic and social development in China, many necessary conditions

for an optimal microcredit system are not fully met. China is still undergoing vast economic and societal transformation; social welfare system is yet to provide sufficient security for urban residents; lacking a well-established judicial practice, microcredit regulations hasn't proved its effectiveness. Such insufficiencies result in the practical consequence of microcredit on urban resident consumption to deviate from theoretical expectations. In a non-optimal microcredit system, uncertainties and potential risk in urban resident lending and consumption behavior increase, as less measures are available to alleviate the information advantage, the advantage in expertise and bargaining power of microcredit providers. In the spirit of consumer protection, without effective regulatory intervention, consumers could be enticed into making impulsive and irrational decisions against their own interest, become victim of predatory schemes, experience heavy economic shortfall such as over-indebtedness, and without sufficient remedy opportunity. Therefore, although microcredit could theoretically increase consumption through many of its effects and impacts, the actual effects of microcredit on Chinese urban resident consumption must go through the lens of contemporary data, with empirical analysis performed with empirical model. To establish an optimal microcredit system, the judicial and regulatory institutions that ensure transparent and fair transaction, place the microcredit lender and borrower on standing that enhance increase of consumption while alleviate against its shortcomings and safeguard the rights of consumers is essential [20].

3.2 Measures to Enhance Urban Resident Consumption by the Microcredit Regulations

Microcredit is a relatively new form of financial credit that has gained importance in correlation with the economic slow-down in China. The traditional principal credit providers in microcredit market and in financial credit market in general has always been commercial banks. Commercial banks in China falls under a myriad of existing financial regulations that place heavy responsibility and liability on the banks themselves and their management. The market-entry requirement for commercial banks is strict with heavy requirement in capital, financial expertise.

Other formal financial institutions are similarly well-regulated, albeit on a different scale. In recent years, P2P companies, specific microcredit companies, internet companies and other informal institutions that provide microcredit have gained significant growth in their market share. From 2013 to 2019, the scale of consumer credit in China has been steadily increasing. In the past 6 years, the balance of consumer credit in China has increased by 10 trillion RMB, with rapid growth in 2017 and 2018 and a slight slowdown in 2019. Compared to formal financial institution, these new informal microcredit providers are much less regulated. In correlation to the rise of informal microcredit provider's market share, increasing cases of predatory microcredit lending to the disadvantage of consumers have been noticed. Huang R has found a causable connection between the increase in bad loans and predatory lending case in microcredit [21]. A regulation that are comprehensive in its width and depth, that are based on the specific features of microcredit transaction, and applicable to all microcredit providers are much needed in order to establish an optimal microcredit system in China. This Article proposes some of the measures that could enhance a strong urban resident consumption and develop an optimal microcredit system.

(1) Diversification of microcredit types

It is observed in historical data that the traditional main component of consumer credit in China is related to housing and automobile purchase, such in scale that according to statistics published by The People's Bank of China, in August 2019 alone, The consumption loan in Beijing increased by 16.99 billion RMB, that is 10.34 billion RMB more than the same period last year. Among them, Beijing mortgage and Beijing car loans occupy the largest proportion. These two credit types form the most common types of consumer credit. The market share of microcredit in these two credit types is substantially small. RMBRMBRMBRMBRMBRMBThe credit limit for a typical microcredit is also significantly lesser than that of other credit types provided by formal financial institutions. Furthermore, the credit types in current microcredit market are mostly similar in nature, making them less capable to meet the growing diversified needs of consumers [22]. This Article proposes that, by allowing consumer to gain access to additional and diversified credit possibilities that are well-regulated and well-functioning, consumers would have more options at hand to meet their expenses, thus contribute towards an optimal microcredit system.

(2) Continued improvement of laws and regulations on microcredit

An optimal microcredit system requires a comprehensive regulation in accordance with market realities, it needs to ensure transparent and fair transaction that complies to the free-will of each

transactional party; it needs to protect consumers against institutional entities who misuse their position of strength; and it needs to establish easily accessible mechanism towards remedy. Chinese authorities have recently publicly announced a strengthened regulatory policy such as *Notice on Strengthening Supervision and Administration of Small Loan Companies*, (issued as No. 86 [2020] of the General Office of the China Banking and Insurance Regulatory Commission)towards microcredit and ramped up its legislative work, with numerous regulations targeting microcredit been issued. These recent regulations on microcredit still have room for improvement, especially in areas of consumer protection.

(3) Strengthened supervision of the microcredit providers

One of the major regulatory issues in Chinese microcredit market is that, since many microcredit providers are informal companies like internet lending platforms² and thus out of the supervision by many established supervision institutions such as China Banking Regulatory Commission, they are in a regulatory state of limbo. An inclusive institution that emphasis on supervision of different consumer credit business varieties and include the supervision of institutional microcredit partakers such as internet lending platforms can ensure a well-drafted regulation to function effectively, deny regulatory loopholes caused by lack of institutional supervision, and minimize financial risk.

(4) Establishment of credit information system

To further protect the rights of all credit related transactional parties and microcredit in particular, a publicly available credit information system that integrates all credit relevant conditions and credit ratings of both borrower and lender, and which allows each transactional party to review under authorized circumstances before the completion of the transaction ensures the integrity of the transaction, and is an invaluable asset to create a transparent microcredit transaction. Such system can provide all microcredit transactional party with informational that are essential to their decision-making in choosing whether to engage, whom to engage, when to engage, and how to engage the transaction. This system can further establish a corresponding mechanism with regulations and other systems to integrate market credit investigations data into one comprehensive information and regulatory network. If fully realized, it can provide regulatory bodies with necessary information to act upon, it will increase the cost of dishonest measures in transaction, and improve credit awareness of urban residents thereby achieving better consumer protection.

4. Conclusion

From the perspective of law and economics, this paper has studied how microcredit could enhance consumer consumptions; what are the relationship between residential consumption and microcredit, and clarified the measures needed in order to accomplish an optimal microcredit system that could protect the rights and interests of consumers and safeguard against predatory lending schemes. In the pursuit of an optimal microcredit system, faced with relatively insufficient credit information system, misuse of information advantage and other moral hazards related to microcredit, the Chinese authorities should continue to improve the protection of consumer through regulatory and informal measures. Only through efficient consumer protection can microcredit truly enhance Chinese urban resident consumption while mitigating the inherent risks involved with microcredit.

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² I.e. Huabei by Ant Finance, Jingdong Baitiao by Jingdong

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