

Credit Generation without (External) Contract Enforcement: Property Redemption Rights in Traditional China, 1592 - 1950

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1. Questions

How did people obtain and issue credit without external contract enforcement in Late Imperial and Republican China?

What role did social organisations (e.g. kinship groups) play in this market?

2. Context and Source

A focused case study of 15 villages in Yongtai County, Fujian, in southeastern China

Source: Private contracts and account books dating from 1592 to 1950 (Zheng et al, 2022)



(Source: Zheng 2020)

Villagers have been preserving these documents in their households for 5 centuries!



Why here?

- Characteristic of southern China: mountainous, late settled but still highly commercialised and market-oriented
- Extraordinarily comprehensive and systematic survival of sources with the original archival ecosystem intact, making record-linkage easier

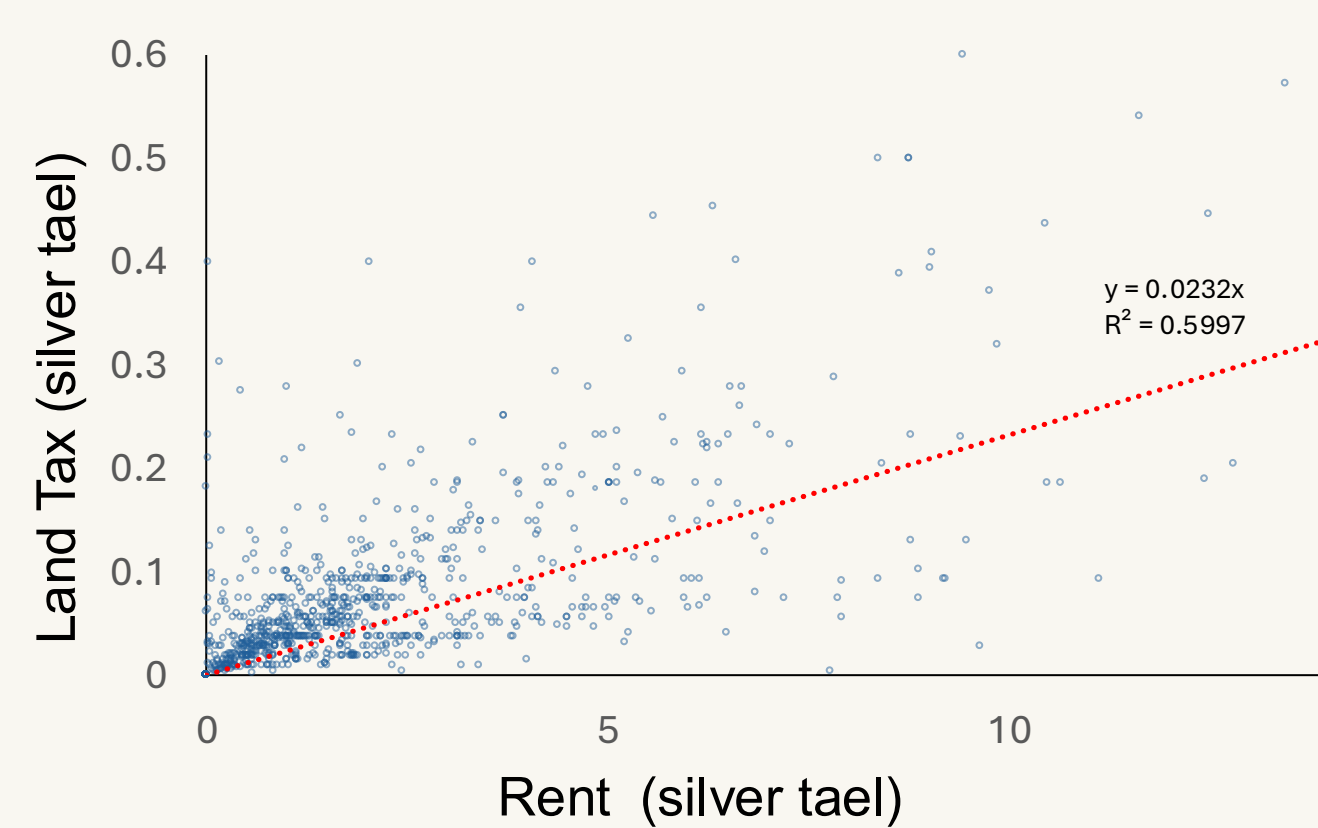
3. What was wrong with contract enforcement institutions?

Formal legal jurisdiction reserved to the county magistrate, who

- was overburdened and inaccessible: served a population of 262k in 1829 (Cao, 2001);
- focused far more on criminal than civil cases.

Dispute resolution primarily conducted by **influential local figures, neighbours and kin**:

- lack of impartiality and formal procedures;
- overemphasis on compromise and compassion from both sides.

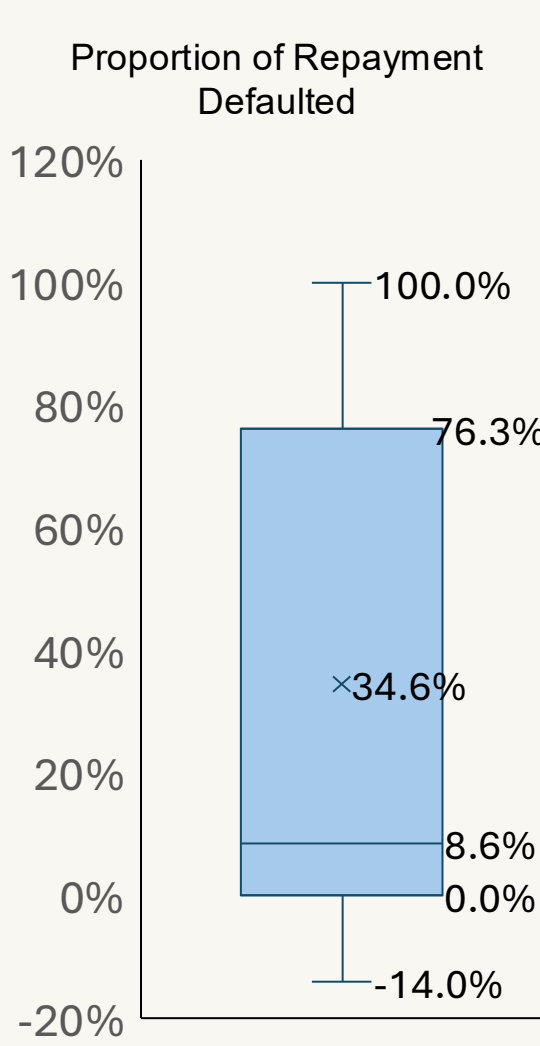
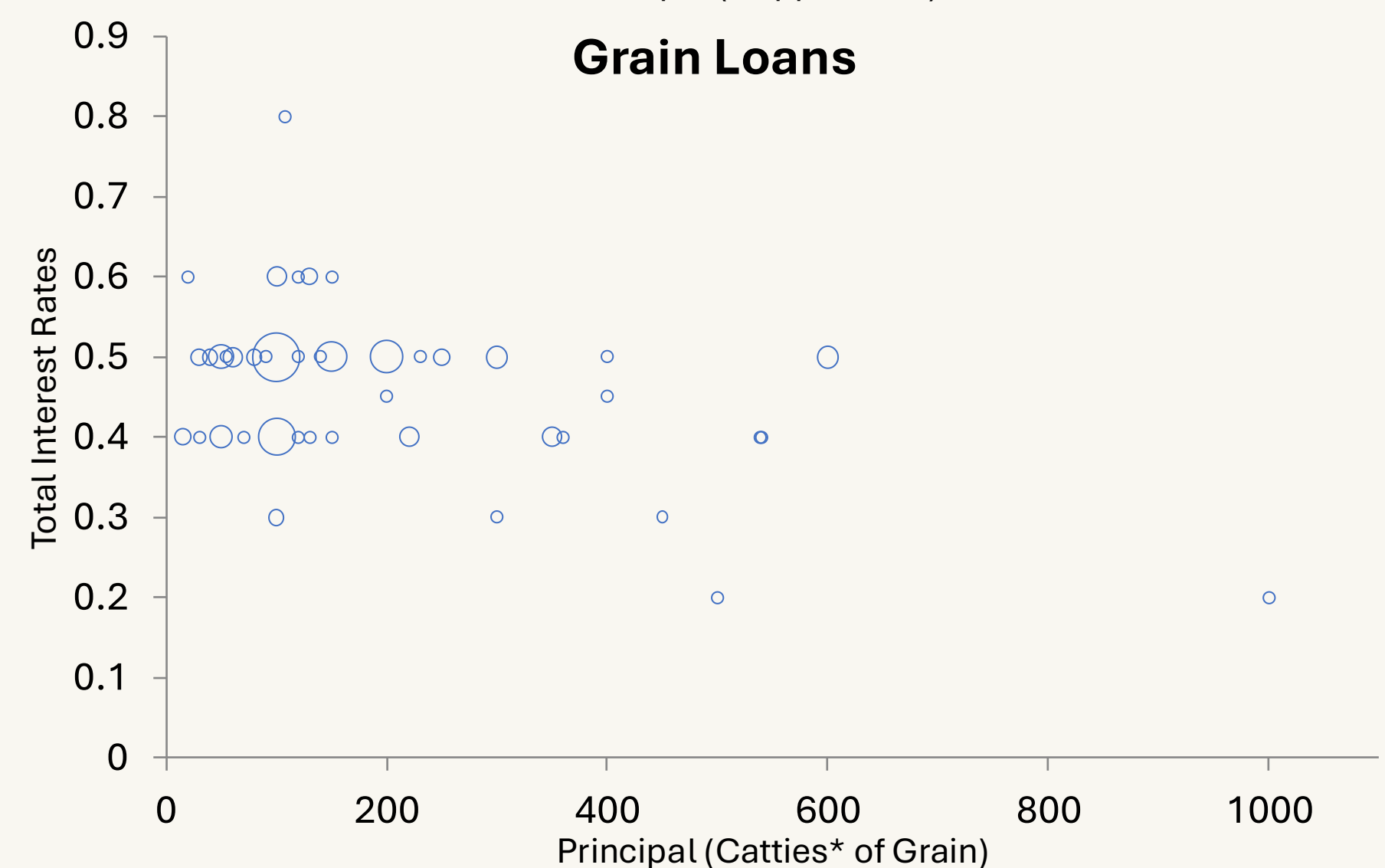
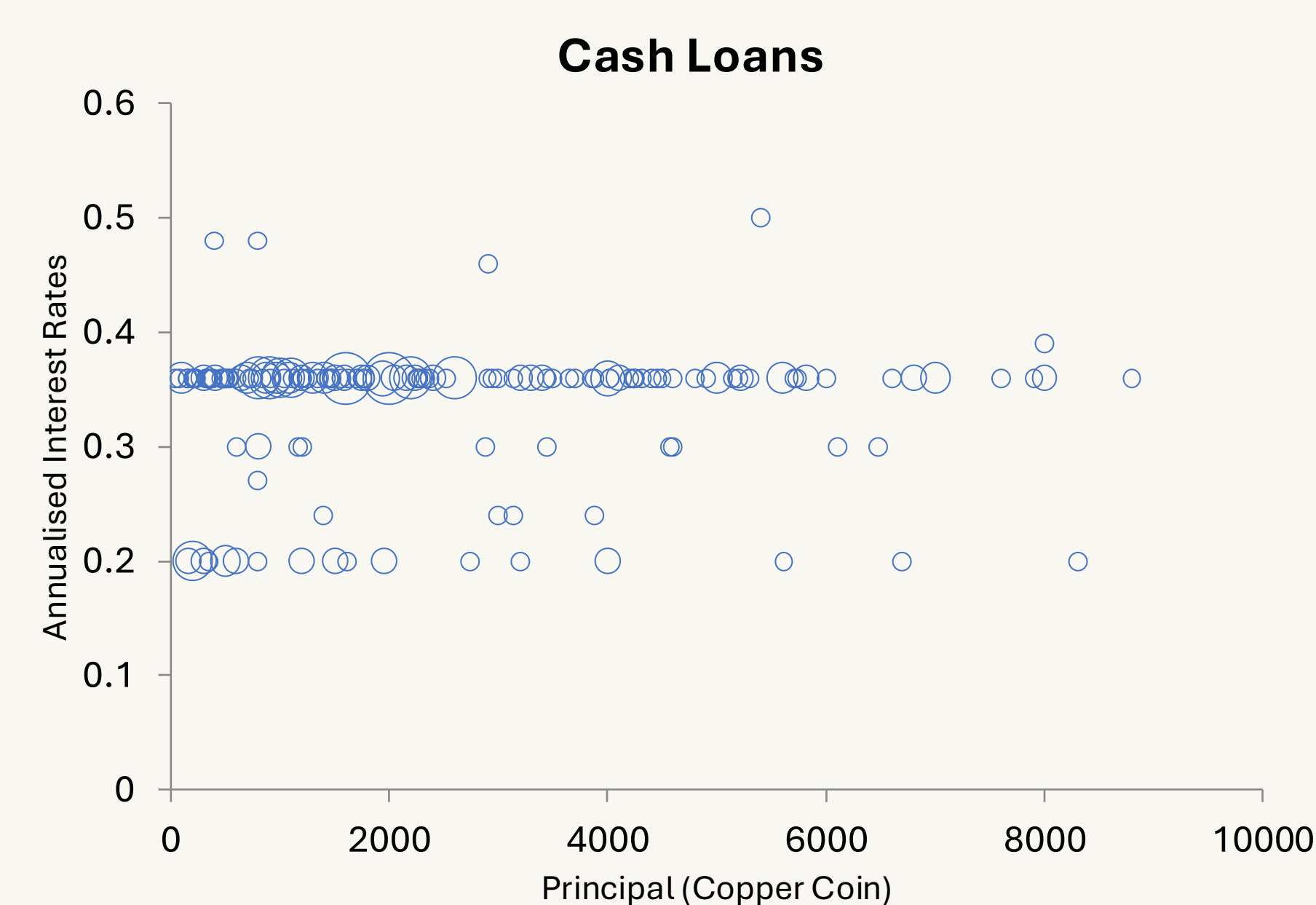


Extremely low state capacity: land taxes equalled only 2.3% of rents on average for farm plots in my database.

4. How did the conventional credit market (not) work?

Without impartial third-party contract enforcement, the market for straight and collateralised loans was handicapped:

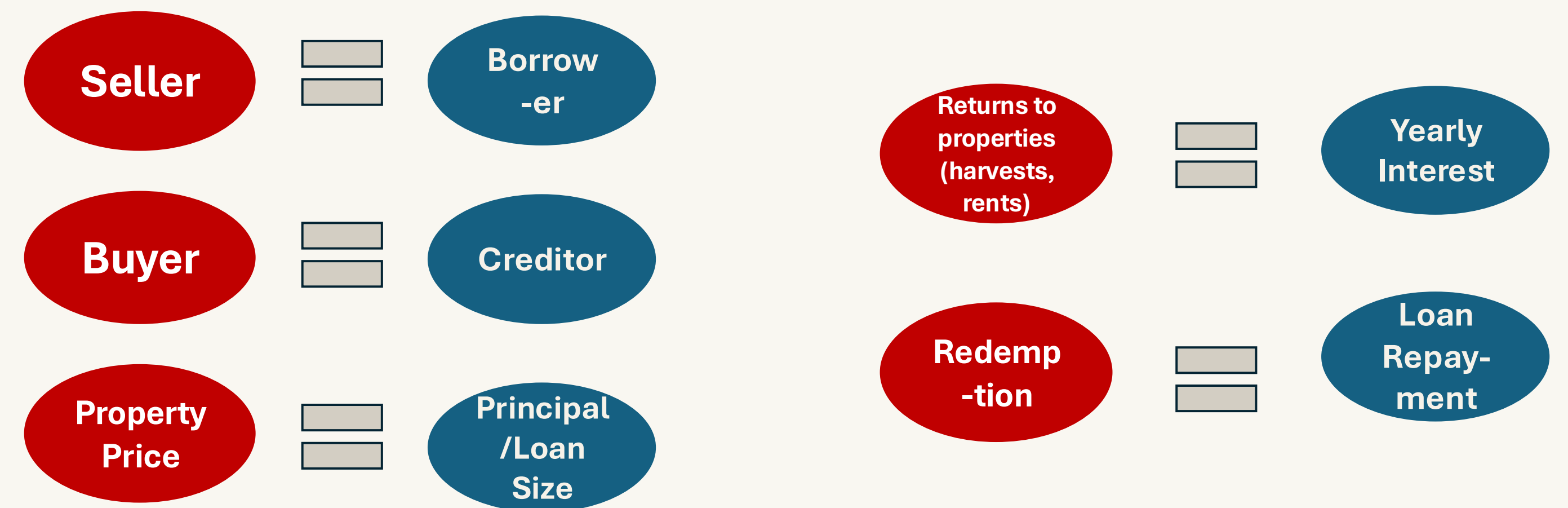
- Regulated interest-rates: customs largely stipulated 36% p.a. for cash and 40%/50% in total for grain (with certain minor exceptions)---interest rates couldn't be used to price risk!
- Short duration: most loans had to be repaid within a year.
- Small capital raised: average about 4000 copper coins, less than the yearly wage of an unskilled labourer.



Actual repayment processes in account books (N=135): while the median borrower honoured most of his debt (only 8.6% unpaid), severe defaults lowered expected returns by 34.6%: i.e. the creditor just about recouped the principal!

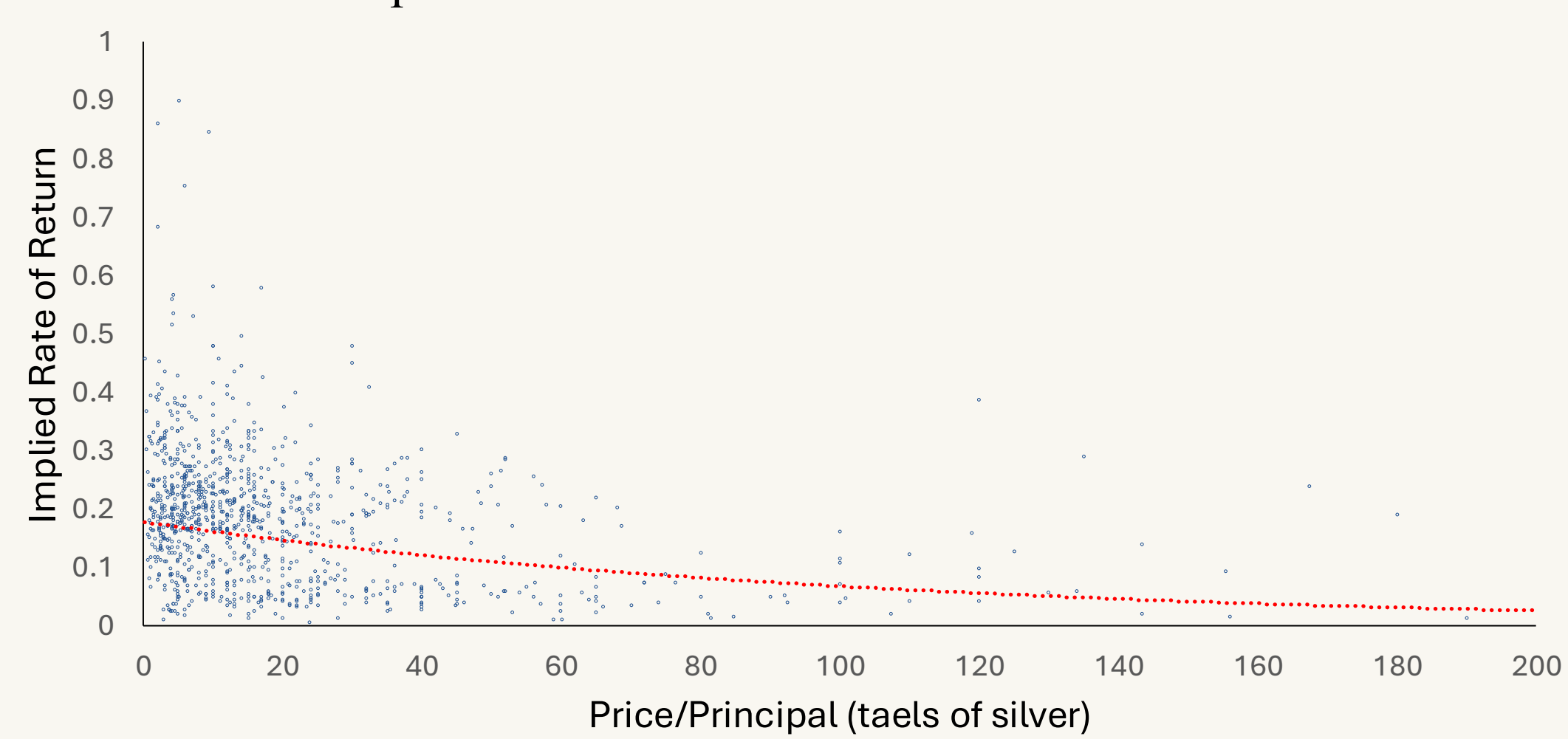
5. How did redemption rights solve this problem?

- Redemption rights were a peculiarly prevalent feature of the real estate market in this period. In what are known as **conditional sales**, sellers could stipulate a buy-back clause at the original price in their contracts.
- These deals can essentially be viewed as **self-enforcing credit contracts**: as cash and property both changed hands at the point of transaction, it (almost) solved the time-inconsistent commitment problem inherent in interest payments! Conditional sales were thus used as **substitutes for conventional credit**.



I choose two scenarios to calculate the implied rate of return (=rent/price) *

- Agent A sells the rent-collecting right on a plot to agent B with a redemption clause;
- Agent A sells the rent-collecting right on a plot he self-cultivates to agent B with a redemption clause, and leases the plot back.

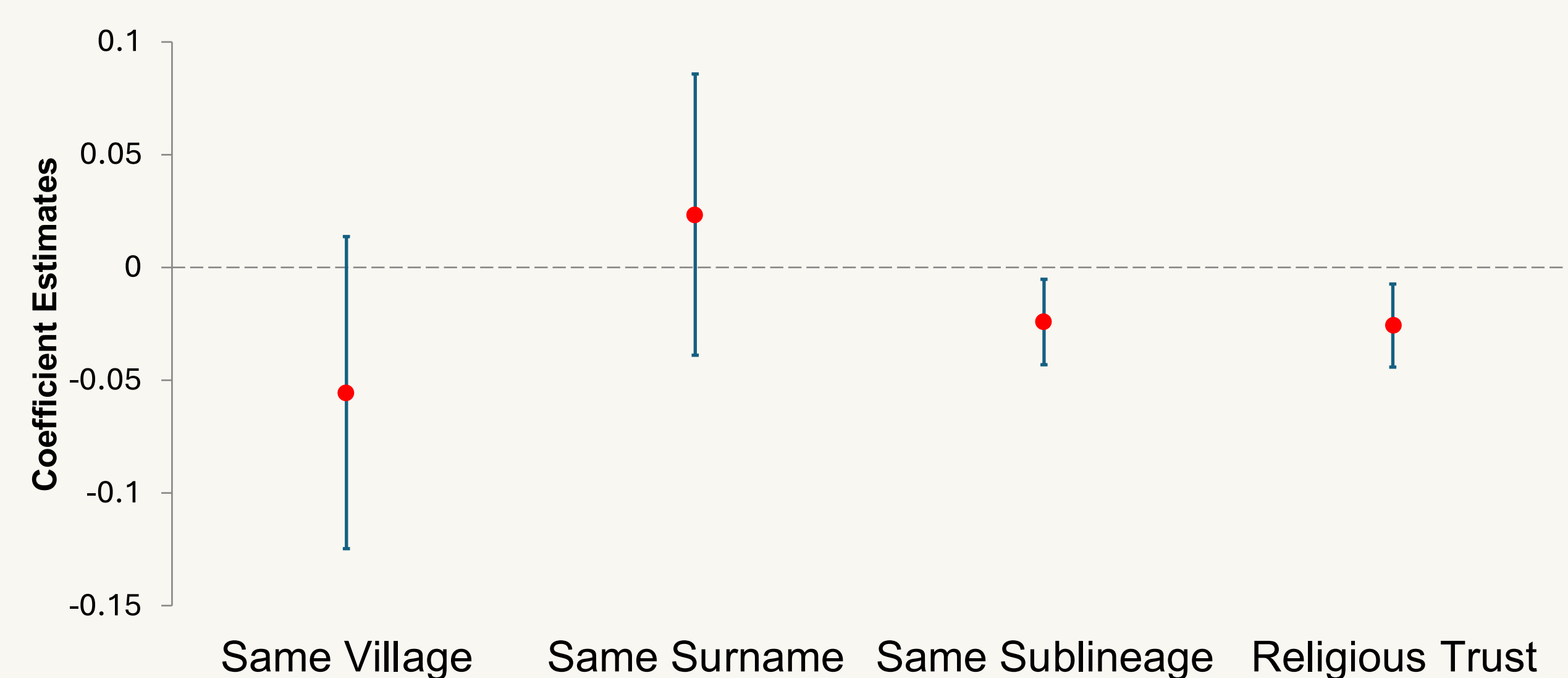


Inverse and convex relationship between principal and rate of return, as you would expect from a normal credit relationship!

Average rate of return (1592-1937) = 18.67% (N=1013)

6. How did people price these 'loans'?

Now I estimate if and how social relationships mattered between the buyer-creditor and seller-borrower using a two-way fixed effect model (rate of return = dependent variable; SE clustered at the village level):



- Contrary to what has been suggested (Mokyr et al. 2025), kinship ties (same surname) did not automatically guarantee trust and correlate with lower interest rates, but geographic proximity (living in the same village) did have a large and significant effect (5.56 p.p. / 0.43SD).
- That being said, membership in the same sub-lineage branch (closer biological ties AND/OR more economic cooperation) did matter in obtaining cheaper credit in conditional sales, although the coefficient size is smaller than living in the same village (2.42 p.p. / 0.19 SD).
- Religious trusts (e.g. ancestral halls) offered lower interest rates, but further analysis shows this was not due to capital-pooling, as they discriminated between kin and non-kin.

7. Conclusions and References

Property transactions with redemption rights served as substitutes for conventional credit in the absence of external contract enforcement.

Ordinary kinship links were less effective than neighbourly ties in establishing trust and reducing risk in market transactions.

Even using property rent/price, traditional China had much higher cost of capital (18.67%) than Colonial India (<5% post-1870, Nagar 2026) or 19th C. England (~3%, Clark 1998), although direct comparison is subject to some caveats

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*Observations after 1938 excluded due to hyperinflation in the Sino-Japanese War; grain-to-cash conversion using Fuzhou trend from CSSA 2009.

* 1 catty = 0.598 kilogram