

# **Rural finance reform in China**

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## Abstract

*China's current financial structure does not give sufficient support to rural areas, leaving many farmers and rural businesses without the capital they need to develop. Rural finance is the weakest point in the country's entire financial system. Low profits for rural financial institutions, a lack of rural financial products and services and the difficulty many farmers experience in securing loans are the main problems plaguing the rural financial system. Accelerating rural financial reform and making it easier for rural people to access capital are key parts of the country's effort to reform its overall financial system, to resolve "Three Rural Issues (San Nong)<sup>1</sup>" (Agriculture, Countryside, Farmers), and to create "new socialist countryside". The main objectives of this paper are to (i) examine the current status of rural finance's demand and supply and identify existing issues and constraints; (ii) evaluate ongoing rural financial reform and explore suitable roadmaps to develop a well-functioning and sustainable rural finance system, which would address the diverse needs of "new socialist countryside" construction.*

Keywords: banks, microcredit institutions, agricultural insurance, informal finance

JEL Classification: G21, G22, Q14

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<sup>1</sup> San nong literally means three "nong". The word "nong" in Chinese is combined with other words to form phrases such as nongye (agriculture), nongcun (villages or countryside), and nongmin (farmers or peasants).

# 1. Introduction

China's rural financial market has long been underdeveloped. For quite some time, the difficulty in borrowing money has severely prevented farmers from making headway in developing their industry. According to a recent national survey for rural households, only 16% of farmers have recourse to formal or informal credit. This is partly due to their weak economic foundation, but also to a lack of collateral (the land belongs to collectives)/credit guarantee and to high transaction costs involved in obtaining formal credit. Another factor is the closing of many local branches of major state-owned commercial banks in the late 1990s because of small business volume and high costs, and the failure of new ones to appear. So the emergence of informal financial institutions can't be avoided. In the meantime, *Fu Pin* Communities (Poverty Alleviation Communities) give free economic aid for long time, so that credit culture is not well created. Difficulties to get loans for farmers and difficulties to grant loans for official financial institutions have become a contradiction.

While farmers accounted for 70% of the population, they were responsible for only 15% of the country's total bank loans and deposits (statistics at the end of October 2006). Per capita outstanding loan balance for rural residents is less than 5 000 yuans (640 US\$) at the end of 2005, only 10% of that for urban residents. By the end of 2005, "total deposits" and "total loans" in East represented 60% and 57% of national totals respectively, while those in Centre and in West were only 40% and 43% respectively. The capitals flow to the East and the cities. (China Daily, 22/01/2007) Serious shortages in credit and other types of financial services in rural areas have become a bottleneck for the development of agriculture as well as the increase of peasants' income, and thus enlarge income disparity between rural and urban populations, especially in Centre and West as well as parts of Northeast.

In the 11<sup>th</sup> five-year plan, the issues concerning agriculture, rural areas and farmers constitute a top priority of the central government. The government is seeking to promote rural development with the "new socialist countryside" program, which aims at improving agricultural production, people's living conditions and public administration in rural areas with their huge population of about 800 million. It was estimated by NBS that the country would need 15 trillion yuans (1.92 trillion US\$) to fund its new countryside construction by 2020, most of which would come from financial institutions. So the government presses ahead with rural financial reforms to establish an efficient and commercially sustainable rural finance framework and to boost rural development and narrow the growing urban-rural income gap.

The remainder of this paper is organized as follows. Section 2 provides a descriptive analysis of supply and demand of rural financial services, and discusses the predicament currently faced by rural finance and contributing factors. Section 3 examines ongoing rural financial reform under the "new socialist countryside" construction. Section 4 underlines market economy's role in the development of a dynamic rural finance sector, and puts forward some proposals.

## 2. Analysis of financial constraints in rural areas

### 2.1 Rural Financial Services: Supply

#### 2.1.1 Past rural financial situation

The institutions previously providing rural financial services in China included both official and unofficial financial organizations. The official institutions mainly included Agricultural Bank of China (ABC), Agricultural Development Bank of China (ADBC), Rural Credit Cooperatives (RCCs), and China Post Savings and Remittance Bureau (CPSRB). In addition, such state-owned commercial bank as Industrial and Commercial Bank of China (ICBC) and the life and property insurance companies in Xinjiang and Shanghai provided a few financial services to the peasants. Unofficial financial organizations are generally meant popular organizations, which mainly grant loans between private individuals and in the form of clandestine money shops (presented in 2.3).

### **Agricultural Bank of China**

As a state-owned commercial bank, the ABC is a pillar in rural finance, involved in agriculture-related loans including specialised rural loans (poverty alleviation, grain, cotton and oil businesses), conventional agricultural loans (crop cultivation, forestry, water conservancy, livestock breeding, fishery and agro-food processing), loans for township and village enterprises (TVEs), loans for rural supply and marketing cooperatives, loans for the purchase of agricultural products and for the construction of rural infrastructures. The main targets of service are rural enterprises and there are very few loans for peasants households. The support to rural areas decreased gradually. The total amount of agriculture-related loans fell from 593.7 billion yuans in 1997 to 353.6 billion yuans in 2001, and the proportion in the total loans issued by the ABC decreased from 54% to 30% in the same period.

### **Agricultural Development Bank of China**

The ADBC is a bank created for policy reasons. Its functional position has been adjusted along with the reform of the grain and cotton marketing systems. It has changed from the comprehensive functions in the early days of its establishment to its later single function. When founded in 1994, the range of its main credit business included loans for the procurement and storage of grain, cotton, oil, sugar and meat; loans for the transfer, marketing and wholesale of grain and oil; policy loans for grain, cotton and oil processing enterprises; poverty alleviation loans; loans for small-scale technological improvement involving crop cultivation, forestry, livestock breeding and aquatic products. In 1998, the range of its credit business was reduced to the sole responsibility for the supply and management of funds for the purchase of grain, cotton and oil. In 2005, ADBC granted loans of 342.37 billion yuans, of which 215.07 billion yuans were for the procurement of grain and oil and 59.12 billion yuans for the cotton procurement. The two items together accounted for 80% of the ADBC loans.

### **Rural Credit Cooperatives**

Of the official financial institutions, the RCCs are the main support force to peasants. They also provided loans to the rural collective economy organizations and agro-food processing enterprises. Between 1996 and 2001, the total loans granted to peasants by RCCs were 1 654.8 billion yuans with the average annual amount of 275.8 billion yuans. In 2001, the total loans granted to peasant households by RCCs were 365.7 billion yuans, accounting for 84% of the total agricultural loans provided and more than 95% of loans to peasant households granted by all financial institutions. The balance of agricultural loans from RCCs accounted for 77% of the balance of agricultural loans in all financial institutions at the end of 2001. Because of policy interference and non-liberalized interest rate, their returns couldn't make up

the losses and costs. At the end of 2002, the non-performing loans of RCCs stood at 514.7 billion yuans, accounting for 37% of their total outstanding loans. There were 19 542 RCCs in loss, or 55% of all RCCs.

Without agricultural insurance' protection and credit guarantee system, loans are mainly granted to the richest peasants. About 80% of loans to peasants were granted to those in high income, peasants in middle and low income have difficulty to get loans, especially in developed regions. Because the opportunist cost is high in these regions, RCCs have lots of investment channels. According to a research in one RCCU at city level in Zhejiang province, loans to peasants raised from 29 million yuans in 2003 to 34 million yuans in 2004, the growth rate was 1.47%. But total loans increased from 1 829.4 million yuans to 1921.8 million yuans, the growth rate was 6.24%, higher than the one for loans to peasants. And loans to peasants accounted only for 1.59% and 1.74% respectively.

### **China Post Savings and Remittance Bureau**

China Post began its postal savings services in 1986 with the establishment of the China Post Savings and Remittance Bureau (CPSRB). CPSRB had a single financial service function, providing only a savings service and no loan business. The deposits taken from the public were transferred to the central bank. The difference between its interest income from the central bank and the interest paid to clients, had constituted the major source of profit even as traditional postal services declined. The interests paid by central bank in 2002 were 18 billion yuans, which was the biggest source of profit. The deposits in rural areas remain 30%-45% of total deposits. These capitals flowed out of countryside directly.

### **Agricultural insurance**

Both agriculture and farmers need insurance to be better protected from risks. And that concerns the stability of the entire economy and livelihood of the people. However, for more than twenty years of development since 1982, agricultural insurance business had shrunk gradually. Only two state-owned commercial insurance companies were engaged in agricultural insurance: the People's Insurance Company of China (PICC) and China United Property Insurance Co., Ltd. Apart from such provinces/municipality as Xinjiang, Shanghai and Yunnan where there was agricultural insurance business on a relatively high scale, the scale of agricultural insurance business in other provinces was rather small. Increasing risks of natural calamities and lack of effective demand inevitably led to narrow business scope and limited scale of agricultural insurance. And this, in turn, discouraged commercial insurance companies from providing agricultural insurance. Premiums from agricultural insurance were a meagre 460 million yuans (US\$55 million) in 2003, accounting for only 0.5% of all property insurance premiums, according to official statistics.

## **2.1.2 Supply-related constraints on rural finance and contributing factors**

Supply-related constraints on rural finance mainly reside in the insufficient network of official financial institutions and in an insufficient supply of funds by these institutions.

### **i) The structural withdrawal of state-owned commercial banks from the market and the inadequate network of rural financial institutions**

From the mid- to late 1990s, the four major state-owned commercial banks started to commercialise their businesses. The impulse to seek benefits, the implementation of international standards, preparations to enter overseas markets and increasing their competitiveness in the face of fierce foreign competition made them draw back from the front line and adopt another developmental strategy of “large banks, large markets and large industries”, with a gradual withdrawal from markets at county-level and below and a reduction in their operational structure at the basic level to focus on more profitable opportunities in the larger cities. Between 1998 and 2001, the state-owned commercial banks shut down 44 000 of their grass-roots offices with a net reduction of 240 000 staff. Relevant data from the annual reports of these banks shows that, between 1998 and 2001, Bank of China (BOC) reduced 2 722 branch offices at the local level. At the same time, it also abolished and merged 246 county branches, so that their number fell by 22% compared with the end of 1997. China Construction Bank (CCB) reduced its county branches by 3 601. From 1998 to 1999, the cumulative net reduction of their operational network was 4 000 establishments. Industrial and Commercial Bank of China (ICBC) abolished and merged 8 700 branch offices. Agricultural Bank of China’s (ABC) network fell from about 60 000 establishments to 44 000. The main task of their rural branches has become to attract rural deposits. A large quantity of deposits drawn from rural areas provided credits to profitable urban businesses. In 2002, it was estimated that capital drained from rural areas by the state-owned commercial banks through the absorption of deposits reached 300 billion yuans.

Although nominally the institutions providing financial services to the countryside included mainly the ABC, the ADBC, the RCCs, CPSRB, and the PICC, those institutions which could in fact supply funds to the countryside were very limited. The ADBC acted as a policy bank and did not provide any loans to ordinary enterprises involved in agriculture or to peasant households. Although the ABC provided loans for agriculture, this was mainly for rural infrastructures and agricultural product processing companies, with very few loans for peasant households. Moreover, after the withdrawal from the rural financial network over recent years by ICBC, CCB and BOC, the ABC has not filled the gap. Therefore, millions of peasant households and tens of thousands of rural enterprises had to apply for loans from RCCs. However, there were only about 40 000 RCCs and they failed to form a financial network. CPSRB provided only a savings service and didn’t issue loans. So there is a lack of financial institutions which can provide credit services and this is one of causes for the insufficiency in the supply of rural funding. Meanwhile, the already limited financial service suppliers usually offer far less diversified products in rural areas than in cities.

Moreover, due to losses in the agricultural insurance activities and inability to obtain policy-related subsidies, the PICC was also forced to contract the scope of its business and to reduce compensations paid to farmers. Thus, through various channels, the policy arrangements described above directly or indirectly reduced the supply of funds to the countryside.

## **ii) Greater risks, higher costs, lack of collateral**

Given the predominance of smallholdings in China’s agricultural sector, banking institutions in rural areas have a large number of business clients who are limited in their production scales and are asset-poor. Farmers are often behind schedule in making mortgage payments and their incomes are uncertain as they are reliant on local weather conditions. In addition, the amount of single loans is small, the terms of repayment are short and the cost of extending loans is high. The interest rates are lower than that for industrial and commercial loans while the opportunity cost for issuing them is higher. These characteristics result in relatively

greater risks and higher costs in providing credits to farmers than to many other businesses. Consequently, banks with a commercial outlook are generally not enthusiastic about providing rural credit services.

Furthermore, Chinese law requires fixed assets to be used as loan collateral. Farmers' "inventory"—such as livestock—is not qualified as collateral and farmers do not own the land they work so can't put it up as collateral either. This places them, as small customers with no guarantee, at the end of the queue for credit.

### **iii) Outflow of capitals**

Since the Asian financial crisis, great changes occurred in the ABC with regard to its market orientation and operational policy. Its conduct on commercial basis became more pronounced. Seeking good results, it strongly reduced operational network and curtailed grassroot level institutions. Also, in view of long capital recovery term, low earnings rate and considerable risks in agriculture, the capital put into circulation by the ABC has been moved from mainly serving agriculture to the development of commerce and industry and from the countryside to the cities. Before the mid-1980s, more than 98% of all loans from the ABC were concentrated on the countryside. Between the mid-1980s to the early 1990s, in order to resolve the "sales difficulty" of agricultural products and to support TVEs, the ABC used 60% of its credit capital every year for the purchase of agricultural products and for the development of TVEs. In the period of 2002-2004, as the business of the ABC expanded towards towns and non-agricultural industry, agricultural loans accounted for below 20% of all loans by the ABC. Therefore, as loans have been withdrawn from the grassroot level, a huge quantity of rural savings has been drained from the countryside. The range of business operations of the ABC was fundamentally no different from other state-owned commercial banks and the leading position which it held for a long time in rural finance had been greatly weakened.

After the withdrawal of SOCBs, the burden of financing agriculture was left mainly to the RCCs. The RCCs operated in a risky sector for credit provision. During the process of several large policy adjustments, the RCCs had accumulated huge amount of bad debts, their losses were very serious and the supply of capital was extremely short. For example, a large number of loans extended to the « collective units » before 1978 had long ago become bad debts. During the development process of TVEs, rural collective organizations have applied for a large number of loans. Bad debts came into being because some TVEs were eliminated by the market or liquidated, shut down or suspended for government policy reasons. When the ABC was separated from the RCCs, it transferred a large number of bad debts to the latter. After the rural cooperative foundation (RCF) was closed down, the state transferred a large number of bad debts to the RCCs. All these debts constitute bad assets for the RCCs. In addition, RCCs were nominally cooperative peasant financial organizations but were actually the extensions of the state-owned banking system in the countryside. They became some kind of interest group independent from peasants, and their operating process was usually controlled by insiders. The "Three Meetings" (meetings of members, meetings of the board of directors and meetings of board of supervisors) were a mere formality, management was chaotic, operations poor and losses serious. By the end of 2000, the RCCs book value of bad assets throughout the country had reached 517.3 billion yuans, accounting for 49.9% of all loan balances. The accumulative losses stood at 108.3 billion yuans, accounting for approximately 10% of the total assets of the RCCs. A huge amount of policy and operational losses severely weakened the capacity of the RCCs to provide loans. In order to cover the RCCs' shortage of loan

capital, the PBC adopted a re-loan policy but the scale of the funds was far from being able to meet demand.

The RCCs couldn't adapt to the requirements of rural economic development. About a third of them were seriously indebted, another third were in precarious shape, and those reporting profits didn't, in the main, lend to farmers or small borrowers. For the RCCs which have a surplus of capital, proceeding from a consideration of self-financed sustainable development, there is a serious tendency towards commercialisation in operation. This leads to a major flow of capital to cities and non-agricultural sectors which genuinely need loans from the RCCs. At the same time, the RCCs also cause much capital to flow from the countryside every year through such means as the payment of reserves against deposits, the transfer of deposits to the Central Bank, the purchase of government and financial bonds and investment in real estate projects. Since the 1990s, the average annual transfer of funds by the RCCs has been approximately 200 billion yuans.

In addition, interest rates were liberalised for banks in 2004, but the RCCs can still only lend at up to 130% of the benchmark rate set by the PBC. This ceiling imposed because of the lingering belief that charging commercial interest rates to rural people amounts to usury, makes it hard for the RCCs to achieve financial sustainability. Most RCCs lend at 9-10% interest, and this is simply not profitable.

Large part of rural capital was channelled out of rural areas by CPSRB. After the state-owned commercial banks cut back their networks of rural deposit operations, the CPSRB network spread all over the cities and countryside, was provided with an enormous area for the absorption of savings. Rural financial resources began to be concentrated in CPSRB and the RCCs. The policy regulated that the CPSRB could only deal in savings operations, but not in loans issuing operations. Therefore, a large amount of capital was transferred out of countryside by intermediary of PBC.

**Table 1 – Rural Financial Institutions vs. Urban Finance Institutions in China**

Rural Area	Urban Area
- Rural Credit Cooperatives	- State Commercial Banks (ICBC, ABC, BOC, CCB)
- State Commercial Banks (Agricultural Bank of China)	- Joint Stock Commercial Banks
- Policy Banks (Agricultural Development Bank of China)	- City Commercial Banks
- CPSRB/Postal Savings Banks of China	- CPSRB/Postal Savings Banks of China
- Microcredit institutions	- Policy Banks
- Buyer & Supplier	- Foreign Banks
- Informal Arrangements (ROSCA)	- Informal Moneylender

**2.2 Rural Financial Services: Demand**

Currently, there is an insufficient effective demand by peasant households for services offered by official financial institutions. On the one hand, there is insufficient natural demand which is mainly determined by the low degree of rural commercialisation, high farmer self-consumption of grain, oil, meat and vegetables and a limited degree of monetisation which have reduced the commercial demand by peasant households for funds. On the other hand, stimulation of demand is insufficient.

Firstly, as the provision of consumer credit services by official institutions is lagging, demand by peasant households for such credit is weak. Currently, it is difficult to activate the rural market in this respect, partly due to low peasants' income. However, when peasant build houses, buy durable consumer goods, educate their children, or hold weddings or funerals, it is generally very difficult for them to obtain loans from official institutions. This forces peasants to transfer their demand for consumer credit to unofficial financial institutions and, as a result, the demand for funds from official financial institutions is reduced.

Secondly, risks in agriculture and the low degree of rural marketisation have reduced investment demand by peasant households. As natural disasters frequently occur in China and farm produce is perishable, the natural risks in agricultural production operations are high. But agricultural insurance is backward. At the same time, because of the low degree of market development, the risks and costs for obtaining information and technology, as well as market transaction costs, are high for peasant households. Due to such risks and a lack of policy tools to overcome them, the majority of peasant households can choose only to operate within traditional agriculture instead of entering into other businesses. This restricts their investment channels and reduces their borrowing demand to official financial institutions.

Thirdly, loans from official financial institutions are difficult to access which inhibits investment demand of peasant households. Investment loans from official financial institutions such as RCCs and ABC are difficult to access for peasant households, mainly because of a lack of collateral (e.g. land use rights can not be mortgaged)/credit guarantee and complex formalities. It's especially difficult for impoverished peasant families or peasants living in backward areas, as well as for households with middle or high incomes who want to expand their scale of production or to adjust their agricultural setup. Since ABC has been transformed into a state-owned commercial bank, fewer and fewer loans have been extended to peasant households. The RCCs, the main official financial institutions issuing loans to peasant households, find it difficult to meet the requirements of the majority of those wanting loans. This is due to the tedious formalities of loan procedures, serious problems with the "official businessman" style of working, backward ideas concerning operations and understaffing. This has resulted in the repeated recurrence of difficulties with loans. A lack of innovation and insufficient supply in the institutions has seriously constrained the demand by peasant households for funds from official financial institutions.

**Table 2 – Characteristics of financial demands in rural areas**

Financial demands in different regions	East	non agricultural sectors
	Centre	crop-cultivating and livestock-breeding
	West	consumption needs
Characteristics of demand entities	Rural households	small-scale production, dispersed housing, lack of collateral (land can't be mortgaged)
	Rural enterprises	majority in early growth, small-scale operation, non-normalised management, low transparency
Agricultural sector' characteristics		seasonal and long- cycle production, low profitability, influenced by nature

### 2.3 Informal finance

Because of functional defects of official rural financial organizations, it is difficult to meet the demand for capital by peasant households which is growing day by day. By contrast, unofficial financial organizations have advantages such as freedom of investment orientation,

flexible time limits for loans and simple procedures. This provides the unofficial financial organizations with enormous room for survival and opportunities for development in the countryside. According to a research, 72.8% of loans are obtained through informal channels, of which 93.2% are granted between peasants, while only 27.2% come from financial institutions. Presently, there are many unofficial financial institutions in China's rural financial market such as ROSCA (Rotating Savings and Credit Association), private loans, and cooperative mutual foundations. The existence of this popular finance reflects the imbalance of rural financial institutions and the financial dualism. With the difficulty in satisfying rural financial demand through official financial arrangements, unofficial arrangements play a positive role in such matters as expanding production, invigorating rural financial market, increasing financial efficiency and, in particular, encouraging private economy's development.

However, there are many problems with the functioning of popular financial organizations and with their funding activities. Firstly, interest rates on deposits and loans are generally rather high so that production and operational costs for peasant households rise while their competitiveness falls. Secondly, there are considerable financial risks. Organisational conduct is not standardised. There are good and bad among popular financial organizations. Some are run in a chaotic fashion and take huge risks, which is very disadvantageous for maintaining normal financial order and this has affected the stability of the financial market and rural society. Thirdly, popular financial organizations generally develop on a small-scale activity which is either clandestine or semi-overt and the government can't provide effective supervision on them.

### 2.3.1 Informal finance's role for rural finance

The research group of Central University of Finance and Economics led by Professor Mr. LI Jian Jun had investigated in rural areas<sup>2</sup> of 15 provinces<sup>3</sup>. Informal finance existing index is 32.22, i.e. there is roughly one-third existence probability of informal finance in rural areas. Informal finance existing index is 37.74 in West, 35.45 in East, and 23.35 in Centre. In Fujian, the informal finance existing index is the highest, reaching at 61.63, and the lowest in Jiangsu with only 12.5.

**Table 3 – Informal finance existing index in rural areas of 15 provinces**

(1) Are there informal financial institutions in your village/county?	Coefficient	Choice %	Total	East	Centre	West
A. Yes	100	0.2545	25.44	40.99	20.10	24.30
B. It is said yes.	66.7	0.1471	9.81	5.94	8.97	17.14
C. I don't know.	33.3	0.1781	5.93	6.55	4.94	9.12
D. No	0	0.4203	0	0	0	0
<b>Informal finance existing index 1</b>		1	41.18	53.48	34.02	50.56
(2) In which institution do you deposit?	Coefficient	Choice %	Total	East	Centre	West

<sup>2</sup> The research group send out 2 656 questionnaires, among which 2 227 were valid. They were filled by 1 597 farmers, 366 rural officers and 264 officers in rural financial institutions.

<sup>3</sup> 15 provinces in survey:

East (6) – Fujian, Guangdong, Hebei, Zhejiang, Hainan, Jiangsu;

Centre (5) – Shanxi, Hubei, Hunan, Heilongjiang, Henan;

West (4) – Yunnan, Guizhou, Shaanxi, Gansu.

A. formal financial institutions	0	0.7127	0	0	0	0
B. informal financial institutions	100	0.1777	17.77	15.05	8.35	13.25
C. lending to others	50	0.1096	5.48	2.37	4.32	11.67
<b>Informal finance existing index 2</b>		1	23.25	17.42	12.67	24.92
<b>Informal finance existing index</b>			32.22	35.45	23.35	37.74

Notes: 1) Coefficients are defined by the research group;

2) Choice %: percentage of enterprises in sample which have chosen such response;

3) Total=Coefficient\*Choice %;

4) Informal finance existing index=(Informal finance existing index 1+Informal finance existing index 2)/2

Source: China's underground finance survey (LI Jian Jun, 2006), China's underground finance size and its influence on macro-economy study (LI Jian Jun, 2005)

Informal finance size index in rural areas of 15 provinces is 56.78, i.e. less than 50% of credits for peasants come from formal financial institutions, such as banks, rural credit cooperatives, etc. Informal finance size index is the highest in East (62.43), the lowest in Centre (55.47). In less developed regions, the share of formal credits is relatively low.

**Table 4 – Informal finance size index in rural areas of 15 provinces**

Order by region		Order by province	
Province	Index	Province	Index
<b>15 provinces in country</b>	<b>56.78</b>	<b>15 provinces in country</b>	<b>56.78</b>
<b>6 provinces in East</b>	<b>56.45</b>	<b>4 provinces in West</b>	<b>62.43</b>
Fujian	66.44	<b>6 provinces in East</b>	<b>56.45</b>
Hebei	55.37	<b>5 provinces in Centre</b>	<b>55.47</b>
Jiangsu	52.08	Yunan	68.70
Guangdong	49.04	Fujian	66.44
Zhejiang	36.31	Shanxi	63.77
Hainan	29.17	Shaanxi	61.18
<b>5 provinces in Centre</b>	<b>55.47</b>	Hunan	58.92
Shanxi	63.77	Guizhou	58.71
Hunan	58.92	Hebei	55.37
Hubei	53.70	Hubei	53.70
Heilongjiang	51.82	Jiangsu	52.08
Henan	35.25	Gansu	51.92
<b>4 provinces in West</b>	<b>62.43</b>	Heilongjiang	51.82
Yunnan	68.70	Guangdong	49.04
Shaanxi	61.18	Zhejiang	36.31
Guizhou	58.71	Henan	35.25
Gansu	51.92	Hainan	29.17

Source: China's underground finance survey (LI Jian Jun, 2006), China's underground finance size and its influence on macro-economy study (LI Jian Jun, 2005)

Informal finance effect index in rural regions of 15 provinces is 21.07. Informal finance has relatively big influence in Centre and in West (with index 24.56 and 31.02 respectively), and almost no effect in East (2.85). In previous years (before 1999), informal finance institutions in Centre and in West were mainly quasi-legal ROSCAs, the interest rates were higher than official interest rates, and the assessment for debtors was less strict. It was easier for peasants

to obtain credits from ROSCAs, and these informal financial institutions helped development of rural economy.

**Table 5a – Informal finance effect index for rural areas of 15 provinces**

Informal finance's influence for development of rural economy	coefficient	Choice %	Total	East	Centre	West
A. Upsetting order of rural economy and finance, negative effect	-100	0.2841	-28.41	-38.38	-26.32	-24.10
B. Supplementing formal finance, favourable effect	100	0.4948	49.48	41.23	50.88	55.12
C. No effect	0	0.2211	0	0	0	0
Informal finance effect index		1	21.07	2.85	24.56	31.02

*Notes: 1) Coefficients are defined by the research group;*

*2) Choice %: percentage of enterprises in sample which have chosen such response;*

*3) Total=coefficient\*Choice %*

*Source: China's underground finance survey (LI Jian Jun, 2006), China's underground finance size and its influence on macro-economy study (LI Jian Jun, 2005)*

Informal finance has negative effect in 5 provinces, and favourable effect in 10 provinces. Informal finance effect index is the highest in Hunan (58.66) and the lowest in Heilongjiang (-13.54). This reflects that informal finance isn't balanced and disparate in regions.

**Table 5b – Informal finance effect index for rural areas of 15 provinces**

Province	Informal finance effect index
Heilongjiang	-13.54
Fujian	-11.68
Guangdong	-5.77
Henan	-1.00
Shanxi	-0.63
Zhejiang	4.55
Hubei	6.12
Hebei	8.56
Gansu	9.09
Shaanxi	24.42
Guizhou	32.58
Hainan	33.33
Yunnan	37.78
Jiangsu	41.67
Hunan	58.66

*Source: China's underground finance survey (LI Jian Jun, 2006), China's underground finance size and its influence on macro-economy study (LI Jian Jun, 2005)*

Informal finance has complex effect on development of rural economy. On the one hand, informal finance eases peasants' access to credits, stimulates their investments and favours agricultural production; on the other hand, agriculture sector is fragile, it is restrained by natural conditions, peasants' refunding capability can't be ensured. High interest rates in

informal financial institutions accelerate poverty of less developed regions and are harmful for peasants and rural economy. According to this survey, informal finance has relatively big positive effect in less developed regions in Centre and in West. Peasants obtain capitals through informal channels, and this helps their agricultural production. But “looking for profit” tendency is not suitable for supporting fragile rural economy.

### 2.3.2 ROSCA (*he hui*)

Rotating Savings and Credit Associations (ROSCAs) are called *hehui* in China. Different forms of ROSCAs can be found in different regions. The structure of ROSCA is always simple. In fact, with few exceptions (e.g. the members have access to the fund in turns (*lun hui*) or by chance (*yao hui*)), most are in the form of Bidding ROSCAs (*biao hui*). ROSCAs are clearly community based with most members living in the same village and rarely from elsewhere<sup>4</sup>. The sequences of the funds to be used among the registered members of the ROSCAs are determined through bidding the interest rates at certain fixed period of time. The aim of the villagers in establishing the ROSCAs, or becoming a member, is generally to finance family emergencies in their daily lives. The percentage of villagers, who try to raise funds through this means for production capital or for other types of commercial capital, is relatively low<sup>5</sup>.

The Bidding ROSCA refers to a rural private finance cooperative which allows registered members to rotate their access to the collective fund through a bidding system. The higher the interest offered as a bid, the sooner the member gets the fund. The founder of the ROSCA is called “the head of the association” (*hui shou*), and the rest of the members are called “the feet of the association” (*hui jiao*). Only the head has the right to have first access to the fund without having to pay interest. This helps him to gain time and opportunity to solve other problems that were caused by a shortage of cash. This is his biggest benefit as the head of an association, and this is the reason why the villagers are enthusiastic about organising ROSCAs and acting as the head. It does not matter who organises the ROSCA and acts as the head, the key is that there are at least ten members who want to take part and pay up regularly and on time. The villager who wants to set up the ROSCA will need to have some basic resources—such as his/her reputation and credibility in the village, family influence, a wide enough circle of friends and family members, etc. These elements restrict the number of ROSCAs and heads.

In a Bidding ROSCA, the winning bidder at any bidding interval is the member willing to pay the highest rate of interest for the use of the funds of the ROSCA. The change of the interest rate during the running of a ROSCA is a key feature. Generally speaking, the interest is calculated on a monthly basis. The interest offered at each bidding interval varies: it is affected by interest rates set by the People’s Bank of China and by local economic conditions, and it is closely linked to how urgently the “foot” members need the capital. Amongst the factors, the last one was the most direct and important, and this is the “charm” of a Bidding ROSCA: the “foot” members who need the money urgently are normally willing to pay higher interest for the capital in order to get the money as soon as possible (*dehui*); and those

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<sup>4</sup> There are three categories of members in ROSCA: residents of the village, those related to one another (some of them are relatives of the villagers who live in the same village and some others from other villages), co-workers or friends who live nearby.

<sup>5</sup> Most of ROSCAs are set up to solve family needs when situations arise that are urgent and cannot be put off (medical treatment for a family member or tuition and other expenses for sending a child to school), and for important family matters (building a new house, paying for a marriage, and for higher education fees). Some are for business capital or setting up a factory.

who can set money aside can gain interest from their capital. Interest rates of the ROSCA are higher than those of official financial institutions. The closer the relationship, the lower the interest rate for using the capital becomes, and the stronger is the co-operative spirit. The ROSCA having the lowest interest rate is formed by relatives in the same family. This arrangement combines economic interest and social and cultural factors. Thus, it is a highly competitive financial system.

Risk is a key factor for any financial institution. For a private financial organization such as a ROSCA, risk is even more important because if any member breaches the agreement, the ROSCA can't survive. The welfare of all members will be directly affected and the aims will not be realised. For this reason, every member of the ROSCA is fully aware of the importance of risk control and management. For the head, he/she faces even more serious responsibilities. If any one of the members in ROSCA fails to make his/her payment on time, the head will pay it out of his/her own pocket in order to maintain the ROSCA. In order to prevent this from happening, the head must carefully select his/her members. Accordingly, during the running of the ROSCA (normally 2-3 years), he/she monitors the situation very closely to reduce any risk. If "foot" members do not take the initiative to pay their share, he/she will often visit them and urge them to pay up, either directly or indirectly.

The average financing of each big ROSCA (normally over a two-month period) is 14 000 yuans, compared with 1 000-6 000 yuans for small ROSCAs. The average for both big and small ROSCAs is 6 000 yuans.

The duration for most ROSCAs is longer than one year, so some people took part in two or more ROSCA at the same time.

### **3. Ongoing rural finance system reform in "New Socialist Countryside" Construction**

At the beginning of 2006, the central government issued the Central Government Number One Document for support to rural development and building a "new socialist countryside". Rural financial sector's development becomes an important concern. The government speeds up the establishment of a wide-reaching multi-level, sustainable financial system in rural areas, which have been underserved by the existing financial system.

By the end of 2006, the balance of agriculture-targeted loans issued by the RCCs across the country, the ABC and the ADBC had amounted to 4.5 trillion yuans, making up 20% of the aggregate credit offered by all financial institutions. Credit support to *Sannong* has greatly increased.

#### **3.1 Agricultural Bank of China**

The government is accelerating the shareholding reform of the ABC, following the successful listing of the other three big state-owned commercial banks. It's generally believed that the ABC will follow the restructuring steps of the other three big commercial banks: government capital investment, dealing with non-performing loans, establishing shareholding companies, introducing strategic investors and seeking opportunities for listing. The ABC's shareholding reform should be carried out in a steady manner that would serve the financial demand of rural areas.

By the end of 2005, the bank's total assets were valued at 4.77 trillion yuans. With its balance sheet at the end of 2005 showing a bad loan ratio at 26.17% and non-performing loans topping 739 billion yuans (US\$ 93 billion), due to its huge unprofitable lending in the rural sector, the bank's restructuring is rather complicated and could take a relatively longer time than the other three to complete. Up to 70 billion US\$ would be needed to clear the bank's non-performing loans before it could meet overseas listing standards, according to analysts. Although the ABC has the heaviest burden among its peers, it also has unique advantage. The ABC has 36 000 outlets scattered across the country (about 18% of the Mainland's bank branches or 60% of its outlets), mostly in villages in the inland and western provinces and even in the most far-flung areas, far more than the other three State-owned lenders. And 98% of the outlets are electronically connected. It has 180 million clients and 510 000 employees (51% in total), the largest among the "big four".

The ABC will strengthen its role as a major financial service provider for farmers and county-level businesses. Until now, the bank has completed internal and external auditing, set up an accounting supervision and control center, and started the personnel resources reform scheme to pave the way for the shareholding reform. It is expected to finish financial restructuring in 2007 in preparation for public listing in 2008.

By the end of 2006, agriculture-related loans amounted to 1.7 trillion yuans, or 55% of total loans. These loans are mainly granted to agricultural lending enterprises, urbanization construction, products' circulation system construction, rural SMEs, infrastructure construction, special resources' exploitation, peasants for production and consumption.

### **3.2 Agricultural Development Bank of China**

In 2006, ADBC provided loans of 316.1 billion yuans for purchase, marketing and reserve of grain, cotton and edible oil, with an increase of 41.5 billion yuans more than the same period of the previous year; the balance of various loans at the end of year was 884.4 billion yuans, with 97.3 billion yuans more over the beginning of year, increasing 29.2 billion yuan over the same period of the previous year.

In July 2006, approved by CBRC, the credit business of ADBC for the leading enterprises in agricultural industrialization has been extended to cover agriculture, forestry, animal husbandry, sideline production, fishery, processing, technology, and the credit business of the bank has gone beyond the areas of grains, cotton and edible oil, creating favourable conditions for ADBC to support the building of new countryside in a wider scope.

ADBC was active to explore the appropriate approaches to support the flagship agricultural industrialization enterprises not involved in grains, cotton and edible oil. It formulated the policies and approaches of business development and created new models of business management according to the characteristics of new business. In management of loans, it advocated the idea of fostering clients and established a project base for leading enterprises not involved in grains, cotton and edible oil. It established a business cooperation relationship with related government departments, strengthened the analysis of related industries, organized professional training sessions, and selected a number of projects which had a strong representation of the industry, a good economic benefit and a big social influence, hence a good beginning of the business. By the end of 2006, the aggregate loans supplied for 61 leading industrialization enterprises not involved in grains, cotton and edible oil had

amounted to 1.78 billion yuans. Of the total loan, 160 million yuans was invested in horticulture, 430 million yuans in fruits, 140 million yuans in tea, 140 million yuans in traditional Chinese medical herbs, and 910 million yuans in forestry.

In 2006, ADBC launched experiment of credit business for small-size agricultural enterprises in the four provinces (municipalities) of Shandong, Chongqing, Jiangxi and Fujian. This is an important attempt made by ADBC to provide more support for building new countryside, broaden the scope of business and alleviate the financing difficulties of small agricultural enterprises. Thanks to the efforts made by the headquarter and the pilot branches, the business piloting of loans for small agricultural enterprises achieved a complete success, a set of business management models that suited with small agricultural enterprises and ADBC were developed, and a professional team of loan management for small agricultural enterprises was established. By the end of 2006, the four pilot branch banks in Shandong, Chongqing, Jiangxi and Fujian had supplied a total of 1.01 billion yuans to 160 small agricultural enterprises, involving more than a dozen industries such as fruits, vegetables, flowers, tea leaves, livestock and poultry, aquatic products, timbers, forest products, silkworms and traditional Chinese medical herbs. These undertakings involved activated more than 1.6 million *mu* of land used for growing crops and raising animals, and more than half a million farming households, with each household increasing income of about 4,000 yuans, creating jobs for 28,000 people, and realizing an economic benefit worth 2.5 billion yuans.

### **3.3 China Development Bank**

China Development Bank enters “new socialist countryside” construction according to Central Government Number One Document (2006).

The uneven development across China during the past 30 years has left the rural farmers, the vast majority of the Chinese population, with little of the economic success. Many of these farmers have become migrant workers in the cities across China. The government has undertaken a number of initiatives to improve the living standards of the farmers. One of the initiatives is to promote urbanization at county level. The improvement of living standards for farmers is partially dependant on the success of urbanization. Leveraging its experience in financing city infrastructures, CDB inject funds into pilot urbanization regions to support the construction of rural infrastructures and public facilities. In addition, it targeted local business players to assist them with funding for the purchase of new equipment and technical know-how, and to create more job opportunities. In 2006, loans to support the “new socialist countryside” construction amounted to RMB 32.2 billion, and the outstanding balance at year end was RMB 77.2 billion.

### **3.4 Rural Credit Cooperatives**

#### **3.4.1 RCCs’ reform**

In 2003, the State Council initiated pilot reforms of the RCCs, allowing them to reform their property right schemes according to regional conditions. Originally covering eight provinces<sup>6</sup>, the program was quickly expanded to most other provinces during 2004<sup>7</sup> and 2005<sup>8</sup>. The overall goal of the program is to improve corporate governance and operations through

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<sup>6</sup> Jilin, Shandong, Jiangxi, Zhejiang, Jiangsu, Shaanxi, Guizhou, Chongqing.

<sup>7</sup> 21 provinces/municipalities, Hainan and Tibet excluded.

<sup>8</sup> Hainan. There is no RCC in Tibet.

“ownership transformation”, and to shift more responsibility for RCC governance and financial liabilities to provincial and county governments. The program also involves the consolidation of individual township level RCCs under the guidance of the provincial government.

Due to the imbalanced development in regional economy and the co-existing of different economic structures and ownership patterns, there are great differentials among RCCs, which determine that their future development destined to diversity. Generally, in the most economically advanced regions, where sufficient economic strength exists and the ability of industry to give support to agriculture is more powerful, the RCCs are merged into single legal entities (rural commercial banks or rural cooperative banks); in central and western areas, where the conditions for economic and social development are rather poor and the provision of more government support is needed so that the credit co-operative system can be gradually developed and perfected, the RCCs are merged into county level RCC Unions (RCCUs). In addition, provincial level RCC Unions are being established in most provinces, in part to ensure oversight of all individual RCCs, but also to offer services to RCCs that would enable, for example, achievement of economies of scale. In general, reform of RCCs should be adapted to the demands of diversified economic development through the diversification of their organisational structure, thereby giving more effective guidance to rural economic development and agricultural structural adjustment and realising the effective allocation of rural credit resources (Annex 3). By the end of March 2007, there have been 89 rural cooperative banks, 14 rural commercial banks, and 1 453 city/county-level institutions as the unique legal entity.

The PBC issued special credits or special bills to replace the non-performing loans of RCCs. The pilot RCCs can choose themselves. In case of special credits, the PBC granted credits to provincial governments. The amount is 50% of difference between their liabilities and assets at the end of 2002. The interest rate is 50% of reserve rate in PBC. The duration is 3, 5, 8-year term. In case of special bills, the amount is 50% of difference between their liabilities and assets at the end of 2002. The duration is 2-year term. These special PBC bills pay interest but cannot be sold or borrowed against, but can be repaid before maturity. Beneficiary RCCs are then to raise additional capital and take steps to improve governance. If, after two years, the RCC has met certain criteria<sup>9</sup>, the PBC will redeem the bills. Going forward, beneficiary RCCs are to comply with the same regulatory standards as do commercial banks. Being the result of in-depth reform on RCCs with better assets superiority in developed regions, rural commercial banks have developed well. At present, the non-performing loan ratio and capital adequacy ratio can basically meet the supervisory standard. Up to the end of March 2007, PBC and CBRC had put 166.1 billion yuans into RCCs through special bills and special loans. And the PBC has repaid 18.8 billion yuans to the first pilot RCCs in 285 counties/cities of eight provinces. NPL ratio is 10.6%<sup>10</sup> (calculated by four-level classification method), decreasing 26.3 points compared to 2002. Capital adequacy ratio is 8.2%, 8.0% and 10.6% respectively for RCCs, rural commercial banks and rural cooperative banks.

The first pilot RCCs in eight provinces and the second pilot RCCs in West and in Centre are exempted from income tax for three years (for 2003-2005 and 2004-2006 respectively). In June 2006, Ministry of Finance and State Administration of Taxation decided to prolong tax

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<sup>9</sup> Capital adequacy ratio should reach 2% for RCCs and Rural Credit Cooperative Union at county/city level, 4% for RCCs with a unique legal entity, 8% for rural commercial bank and rural cooperative bank. In addition, NPL ratio (calculated by old method) should decrease 50%, compared to the one at the end of 2002.

<sup>10</sup> NPL ratio is 27.7% (calculated by five-level classification method), and NPL amount to more than 730 billion yuans.

cut period for these pilot RCCs (until 2008 and 2009 respectively). The rural commercial banks can't enjoy this tax advantage. But they can always have a business tax rate of 3%, 2 percent lower than the one for other commercial banks (policy effective from 2004). The money economized from this tax advantage should be used in writing off bad assets and in increasing provision, but not in distributing dividends.

The pilot RCCs introduce market principles in their interest rates so that interest on deposits could go up by 30% of benchmark rate (at most 50%) while interest on loans could go up by 70% (at most 100%).

The RCCs' earning abilities enhanced. Since 2004, the RCCs have turned around from loss making to profit making, with sustained growth (Table 5).

**Table 6 – Profits of the RCCs**

Year	2003	2004	2005	2006
Pre-tax Book Profits (RMB 100 million)	-5.5	96.6	120.3	186.2

Source: CBRC

### 3.4.2 RCCs' support to rural economy

The reserve against deposits rate in RCCs is lower than that for other commercial banks<sup>11</sup>, which economizes 80 billion yuans of capitals that can be used to *Sannong*.

Up to the end of 2006, the balance of loans to peasants reached 919.6 billion yuans. 70.72 million rural households have benefited from them, accounting for 31.2% of all rural households, or 57.6% of whom have demanded and satisfied lending conditions.

RCCs play a leading role in offering financial services for rural economy. By the end of March 2007, the RCCs held 4.2 trillion yuans in deposits and 2.9 trillion yuans in loans, of which agricultural loans are 1.4 trillion, accounting for 47% of total loans granted by them and 93% of total agricultural loans granted in the financial system (PBC monetary policy report, Quarter 1, 2007).

## 3.5 Postal Savings Bank of China

In August 2003, the CPSRB was granted authority to place its deposits at its discretion (subject to certain investment restrictions), and simultaneously the PBC reduced substantially the interest rate paid on new CPSRB deposits. The balance of CPSRB's funds at the PBC are to be run-off in five years by August 2008<sup>12</sup>. CPSRB now invests its funds in government and financial bonds (the latter issued by the CDB and some state-owned commercial banks) and in the interbank market, and lends some to RCCs and UCCs.

To encourage the postal savings funds to flow back to the countryside, CBRC initiated a pilot program in March 2006 in three provinces—Hubei, Fujian and Shaanxi, which involves granting small loans fully secured by deposits held by CPSRB. In September 2006, second round of pilot units were chosen in ten provinces/municipalities—Beijing, Tianjin, Shandong,

<sup>11</sup> 7.5% for RCCs, 8.5% for other banks (effective from August 15, 2006).

<sup>12</sup> 10% for the 1st year, 15% for the 2<sup>nd</sup> year, 20% for the 3rd year, 25% for the 4th year, and 30% for the 5th year.

Anhui, Zhejiang, Guangdong, Guangxi, Henan, Chongqing and Sichuan. This is the first step in building the lending capacity of CPSRB, and a precursor to the establishment of a Postal Savings Bank.

Efforts to set up the postal savings bank have never ceased since 1997, when it was first proposed by the PBC. The State Council finally approved the establishment of the postal savings bank in July 2005, when it decided that China Post will be split into three parts: a post regulatory body, a postal service company and a postal savings bank. In June 2006, CBRC gave green light for the establishment of China Postal Savings Bank. This marks the beginning of a concrete implementation phase for the establishment of new bank.

Approval from CBRC to start its lending business was still pending<sup>13</sup>, the Bureau has started preparatory work because of its lack of experience in the area. To avoid being saddled with bad assets, and to strengthen its resistance to risks and corporate governance, it is seeking to cooperate with other financial institutions. In mid-June 2006, the Bureau signed a full-scale cooperation agreement with the CDB, a policy bank that provides long-term financing for key projects in the infrastructure and other pillar industries. Cooperation covers asset management, capital utilization, professional counsel, personnel and financial settlements. If approved, they will offer a variety of loans including syndicated, joint and commission loans and jointly manage trust assets. The Bureau will also actively undertake the sale and issuance of the CDB's bonds and asset-backed securities. The agreement is viewed as a win-win situation; the Bureau gains valuable experience from working with CDB, which in turn has the opportunity to break into the rural market. Rural areas would also benefit from the flow of deposits that could be used for development. The agreement also provides for the possible training of Bureau personnel at CDB. With this and other similar cooperation agreements and partnerships, the Bureau (Postal Savings Bank of China later), will be able to gradually move towards operating its own lending business.

Since it was kicked off in 1986, the postal savings service has developed into an important financial force in China. By the end of 2006, it had notched up savings deposits of 1.6 trillion yuans, only below that of "big four". Postal savings have accumulated almost 900 billion yuans of savings deposits under its independent use. Post offices boasted 37 000 outlets nationwide, with two-thirds of them located in counties and areas below county level (in some remote areas, postal savings even become the only financial service people have access to), and 270 million account holders. Individual postal savings bank books numbered 140 million.

The Postal Savings Bank of China (PSBC) completed registration on March 6, 2007 with total registered capital of 20 billion yuans (2.56 billion US\$). It formally opened on March 20, 2007. With its distribution network, lack of legacy lending problems (no "historical burden"), and sizeable core deposit base, the new bank has a natural advantage over its competitors in basic financial services like granting microcredit, especially for rural households and companies and to become a significant positive factor in rural financial sector development. In the future, the postal savings bank will take full use of its network advantage to improve its financial service functions in urban and rural areas. It will focus on retail customers and intermediary businesses and provide basic financial services to all residents. It will also form sound, complementary relations with other commercial banks to support the construction of a "new socialist countryside" and the balanced development of urban and rural economies.

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<sup>13</sup> CBRC give its approval in February 2007 for all CPSRB nationwide.

### 3.6 Microcredit institutions (village banks, lending companies, rural mutual funds, etc)

A Nobel Peace Prize winning concept of lending small, unsecured amounts to the poor has renewed interest in the establishment of a micro-credit bank in China. Grameen Bank<sup>14</sup> created by Muhammad Yunus in Bangladesh, has offered tiny loans of more than 5.7 billion US\$ to 6.6 millions of poor Bangladeshis to help them get out of poverty and become self-employed in the past 30 years, 97% of whom are women. Nearly 60% of debtors and their families have got out of poverty level. “It’s not charity. It’s business that can earn money and also help lift the poor out of penury”, according to him. In 1993, this model has been introduced into domestic credit markets and operated as FPC (*Fu Pin* Community-Poverty Alleviation Community). About 300 pioneering institutions, mostly domestic or overseas non-government organizations, have experimented with microcredit for more than 10 years. But China should only borrow from Grameen Bank’s model instead of importing its practice as a whole unquestioningly, as there are major differences in two countries’ specific circumstances.

A pilot commercialized micro-credit organization program was launched in five provinces<sup>15</sup> in November 2005 under the guidance of the PBC, aimed at creating competition for the RCCs and formalizing heretofore informal lending business. Like the RCC reform program, this pilot envisions a substantial role for local authorities and private investors. These companies are not allowed to take savings deposits, but only to lend from their own equity, raised from private investors. The shareholders of the micro-credit company and the institutions that provide funds should bear relevant risks from funds operation. The minimum equity threshold was set at around CNY 100 million—much less than China’s regulations require for establishing commercial banks or cooperative financial institutions (CNY 1 billion and CNY 150-200 million respectively). The first two private microcredit companies were established in January 2006 in Pingyao, Shanxi Province. Now there are seven companies in business and ten are expected to be operating by the end of 2007. They may charge as much as four times the benchmark rate, which means that it is easier for them to sustain their business and stay afloat.

In response to such problems as low financial institution network coverage, insufficient capital supply and inadequate competition among financial institutions in rural areas, CBRC issued “Proposals on Adjusting and Relaxing Market-Entry Policies for Banking Institutions in Rural Areas<sup>16</sup> to Support the Construction of the New Socialist Countryside” on December 22, 2006, which lowered the entry requirements of new rural financial institutions to increase farmers’ access to microfinance. These measures encourage private investments in rural banks and set low registered capital thresholds: CNY 3 million for establishing county/city level banks, and CNY 1 million for establishing banks at township/town level. The proposals also allow credit cooperatives to be set up at township/town level with registered capital of CNY 300 000, and at administrative village level with registered capital of CNY 100 000. The lending subsidiaries wholly invested by commercial banks and rural cooperative banks should have CNY 500 000 of registered capital. Concerning for risk management, CBRC requires that established banks must hold at least a 20% of stake in the new village banks, and each

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<sup>14</sup> This bank demand no collateral or guarantor, but mutual guarantee by five-persons group, or to purchase bank’s shares, and a percentage of credit amount as risk provision in order to prevent credit risk. The credit refunding ratio attains 99.02%.

<sup>15</sup> Shanxi, Guizhou, Sichuan, Shaanxi, Nei Mongol.

<sup>16</sup> Rural areas at county/city level or below in Centre, in West and in Hainan Province, and poverty-stricken counties defined by the central government or by provincial government in other provinces.

private investor is limited to a maximum stake of 10%. Moreover, village banks have to maintain an above eight percent capital adequacy ratio and above 100 percent bad loan coverage ratio. The new rules encourage rural banks to do all types of banking services, and sell policy-financial products through commercial network. Especially in the old, remote and poverty-stricken regions, policy banks may cooperate with commercial banks to develop financial businesses. What is missing in the new rules is the loan pricing ceiling of village banks. The government liberalised risk-based pricing in 2004 by removing the lending rate upper-limit that commercial banks can charge, but has kept the lending rate ceiling of credit cooperatives at 2.3 times of benchmark rate. Since the new village banks are much smaller than credit cooperatives, so at least the credit cooperatives' lending rate ceiling will be applicable for village banks. Given the current 5.85 percent benchmark rate in China, village banks should not be able to charge more than 13.5 percent interest: this is even lower than what commercial banks normally charge on the credit card revolving balances.

CBRC publicized the Provisional Rules of Management for Village Banks, lending companies and rural mutual funds respectively on January 22, 2007 to facilitate banks' entry to the rural market and improve their financial services. In February 2007, CBRC announced that the new rules would be piloted in 33 counties of six pilot provinces (Sichuan, Jilin, Gansu, Qinghai, Hubei and Inner Mongolia Autonomous Region).

The first three village banks were inaugurated on March 1, 2007: Huimin village bank in Yilong county of Sichuan province, Chengxin village bank in Dongfeng county and Rongfeng village bank in Panshi city of Jilin province. There are the smallest banks in China. No guarantee or mortgage is required for the farmers to get a loan. The lenders simply consult village officials and peasants-turned-businessmen concerning the applicants' credit standing and repayment capacity. In Huimin village bank, farmers can get loans of up to 20,000 yuans without guarantee, while small enterprises or farmers engaged in special areas can obtain loans of up to 100,000 yuans with a collateral/guarantee. The interest rate for loans is between 8 and 10 percent, slightly higher by two to four percent than the current interest rate in urban markets because of higher costs and more risks. But the rate is much lower than the average 12 to 15 percent charged by unlicensed lenders—well-off farmers and local businessmen who are often the only creditors when impoverished villagers can't prove their creditworthiness with rural cooperative banks. The interest rates for deposits are the same as the official rate set by the PBC, which is 0.72 percent for on-call deposits and 2.52 percent for 12-month time deposit. In Rongfeng village bank, loans need be guaranteed by five rural households, and these five rural households can guarantee for each other. Or this bank can ask the grain-procurement enterprises in upper reaches and the seed & fertilizer-supply enterprises in lower reaches to grant guarantee for rural households. These two forms of guarantee need not collateral.

The Huimin Lending Company also opened in Ma'an Town, in Yilong County of Sichuan Province on March 1, 2007. A lender wholly owned by Nanchong Commercial Bank, it has 500,000 yuans of registered capital. The company provides only a loans service.

The first rural mutual fund "Baixin" in Yanjia Village of Jilin Province was established on March 9, 2007 with registered capitals of 101 800 yuans. The members pay at least 100 yuans as organization fee, they can obtain loans of ten times organization fee paid at most.

The establishment of these microcredit organizations meets a huge demand for banking services from individuals and small businesses in the countryside. They will mushroom to help fill up the gap.

**Table 7 – Resources and uses of capitals in different banks**

Bank	Resources of capitals	Uses of capitals (lending clients)
Agricultural Bank of China	deposits	Geography : Yangtze River delta , Pearl River Delta , Baohai Rim and capitals in other provinces Industries: telecommunication, energy, petrochemical, transport, etc. Agricultural loans (55% in total loans) Lending to small enterprises Consumer loans (77% of which are housing loans)
Agricultural Development Bank of China	PBC relending (43%) Financial bonds (35%) Deposits (22%)	Traditional business: The procurement and storage of grain and oil, others (sugar, meat, chemical fertilizer, etc.) In the future: farming, forestry, animal husbandry, fishery, processing, city/town construction Technology, etc.
China Development Bank	Financial bonds in RMB and US\$	State infrastructures' construction and pillar industries Industry restructuring and promoting harmonious development of different regions Rural infrastructures' construction and agricultural resources' exploitation SMEs
Rural Commercial Banks	deposits	Loans to agriculture (leading enterprises, economic institutions, professional cooperatives), rural areas (infrastructure construction and industrial zone development), rural households and peasants (consumer and production loans)
Rural Cooperative Banks	deposits	Loans to farmers and rural households (production, consumer, education, alleviation loans), sole industrial & commercial proprietorships ( <i>getihu</i> enterprises), private enterprises
Rural Credit Cooperatives	deposits	Loans to farmers and rural households
Postal Savings Bank of China	deposits	Microcredit to urban and rural households
Village Banks	deposits	Farmers and small enterprises
Lending companies	Deposits of parent companies	Farmers and small enterprises
Rural Mutual Funds	deposits	Farmers and small enterprises members
Microcredit companies	Capitals of shareholders	Farmers and sole industrial & commercial proprietorships ( <i>getihu</i> enterprises)

Source: Annual Reports of banks (2006), CBRC.

### 3.7 Agricultural insurance

Agricultural insurance has been long underdeveloped, as insurers are often reluctant to underwrite such policies because of risks and small chance of profitability, though the rural population of 800 million underlines market potential. Agricultural insurance as a “rock” of the rural economy can stabilize the rural economy and help farmers through natural disasters. The government is making more efforts to promote the coverage of agricultural insurance and make it available for the overall agriculture sector and rural households.

Under the guidance of the Central Government Number One Document of 2004, three specialised agricultural insurance companies were established, that is regarded as a ground-breaking move to revive the business and an important milestone in the development of China’s burgeoning insurance industry: Shanghai Anxin Agricultural Insurance Co Ltd, Jilin

Anhua Agricultural Insurance Co. Ltd<sup>17</sup>, and Yangguang Agricultural mutual assistance insurance company (in Heilongjiang province)<sup>18</sup>.

French property insurer Groupama, among the first foreign companies to show an interest in agricultural insurance in the Chinese market, opened a branch in Chengdu, capital of Sichuan Province on October 26, 2004.

Aon Re China Limited (ARE) signed the first agricultural reinsurance contract with Shanghai Anxin Agricultural Insurance Co. Ltd (AAIC) in May 2005. Under the agreement, Aon Re China, supported by its global network spanning more than 40 countries around the world, will provide AAIC with advisory services such as catastrophe information forecasting and financial analysis to protect its crop insurance portfolio. Reinsurance arrangements will also maximize the economic benefit of its risk transfer program. This historic deal opens up a new era in the nation's insurance industry for cooperation between local agricultural insurers and global reinsurance providers and signals the start of an exciting period of growth and development for the agricultural reinsurance industry in the country.

People's Insurance Company of China Property and Casualty Company Limited (PICC P&C), the largest property insurer, is considering setting up an agriculture arm to develop farm insurance business. The move, encouraged by CIRC, will consolidate resources in the agriculture sector and better protect the interests of Chinese farmers. The company plans to set up a wholly-owned subsidiary. By the end of August of 2006, PICC P&C's 31 branch offices had all launched agriculture insurance policies, racking up premium income of 205 million yuans, up 39.3 percent year-on-year. The PICC P&C's policies cover more than 40 kinds of agricultural activity, including farming, breeding and fisheries.

In 2006, premiums from agricultural insurance in China recorded a 16.05 percent year-on-year rise to 846 million yuans (US\$108.46 million). This second highest growth came after a rise of 84.26 percent in premium from 396 million yuans in 2004 to 729 million yuans in 2005, ending a decade-long decline. In 2006, China's agricultural insurance expenditure totalled 584 million yuans, up 4.6 percent from 2005 (558 million yuans in 2005). The insurance mechanism initiated in 2004 began trial operation in Shanghai, Jilin and Heilongjiang and later extended to Jiangsu, Liaoning, Xinjiang, Ningxia, Inner Mongolia, and Sichuan. These regions contributed nearly 78% of total premium income from agricultural insurance in 2006, up 16% from the previous year. There were 160 agricultural insurance products on the market, covering farmer household properties and planting and breeding industries. Three specialized agricultural insurance firms – Anxin (Shanghai), Anhua (Jilin province) and Yangguang (Heilongjiang province) together with the two comprehensive insurers, PICC-Property and Casualty Insurance Company Limited and China United Property Insurance Company, raked in total premiums of 842 million yuans, about 99% in 2006.

The growing enthusiasm of Chinese farmers for insurance is attributed to subsidy and fiscal allowances by local governments. The Shanghai municipal government, for instance, paid 33 percent of the crop insurance premiums for farmers, while Meishan city government (in Sichuan province), offered a 66 percent subsidy on premiums for dairy herd insurance.

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<sup>17</sup> These two companies were launched as a pilot model that is both subsidized and promoted by the government but operated as a private commercial entity. They sell comprehensive insurance packages concerning crop and livestock insurance, agro-related property insurance and liability insurance, as well as short-term life accident insurance and health insurance for rural residents.

<sup>18</sup> It is the first co-operative agricultural insurer in China.

Farmers in Suzhou (in Zhejiang province) only need to pay 38 percent of the premium for rice insurance, while those in Xinjiang were spared 12 percent of the premium for cotton insurance.

On June 15, 2006, the State Council issued “the Opinions of the State Council Regarding the Reform and Development of the Insurance Industry”. This document acknowledges the achievements of China’s insurance business since 2002, and urges further reform and development of the industry. One of the highlights is the incorporation of agricultural insurance into the state agricultural support system. The document sets out the principle for the stable advancement of agricultural insurance programs through multiple channels. It puts forward the explicit policy of “three subsidies”: subsidy to farmers, insurance companies and agricultural reinsurance. It also demands acceleration in building up legislation for agricultural insurance.

### **3.8 Agricultural products’ futures market and payment system**

There are two agricultural commodity exchange in China: Zhengzhou Commodity Exchange (ZCE), established on October 12, 1990, wheat (including strong gluten wheat and hard white winter wheat), cotton, white sugar, pure terephthalic acid, rapeseed oil and green bean futures contracts are traded on ZCE; Dalian Commodity Exchange (DCE), founded on February 28, 1993, the listed futures products are soybean, soybean meal, soybean oil, corn, and malting barley. The trading volume and value of agricultural products futures have increased continuously in five years. The price in futures market has become an important reference for the determination of price in current market. It plays a positive role in avoiding price risk, natural disasters’ risk, preserving and increasing agricultural products’ value, and promoting agricultural production. In addition, weather derivatives imitated from American market should be introduced.

“Banking card service” pilot program has been initiated at the end of 2006 in 12 provinces/municipality by commercial banks for peasants who have left their villages and work in cities. According to the statistics, the number of peasant-workers has exceeded 100 millions, and the number increases 4-5 million per year. Peasant-workers account for 57.6% of active population in secondary industry, 80% in construction. The annual net income for them is 350-400 billion yuans. So it’s important to facilitate the carrying money for them and resolve the funds security problem.

## **4. Prospects and Recommendations**

### **4.1 “Rural Market Economy” & increasing peasants’ income—indispensable condition for creating a rural dynamic financial market**

Rural economy determines rural finance, and rural finance influences rural economy.

In China, conventional banks have no interest in household credit in rural areas because of high repayment risks and operational costs. Thus, rural productivity has been hampered by a lack of access to reliable and affordable credit to purchase inputs and to invest in small, off-farm, income generating activities. How to attract capitals to come back to the countryside? Lowering the entry threshold of banking sector and creating new financial institutions in rural areas are not enough. Whether peasants can afford interests, whether financial institutions can

gain, remain the key questions for the development of rural finance. If banks can't make a profit, they will retreat as before. Finance is based on economy. In order to have a financial break-through, it should create market economy and increase peasants' income. It should create farming-breeding-processing, production-supply-sale, commerce-industry-agriculture integrated operation. A unified market for farm produces and labour should be created. Only in this condition, farmers can obtain credits more easily for expanding production and increasing their profits. It's "win-win" for farmers and banks.

The problem at the kernel in *Sannong* issues is that of peasants' income. Peasants' income increases slowly. The income gap is still widening between the urban and rural areas, so is the cleft between the regions and among the rural population. The peasants can't get the benefit of economic expansion.

At the initial stage of China's opening-up and reform, the grain output was only about 300 million tons a year. It exceeded 500 million tons in 1996 and levelled off for several years and 1998 saw it hit the record high (512 million tons). Since then, China's agriculture entered into a new stage featuring a balanced gross output and surplus stock in years of good harvest. The upsurge of farm produce output and the slow growth in consuming farm produce by urban residents keep grain prices low. The price curve plummeted to the bottom-line. In addition, China's entry in the WTO is set to accentuate the downward pressure on peasants' income as the gates are opened for overseas agricultural produces from more efficient producer countries. The agricultural productivity is of low efficiency and staple farm produces<sup>19</sup> has poor competitiveness in the global market. The staple farm produces are sold at unreasonably low price for years. Peasants get low profits in deduction of the cost and in turn they had less initiative to invest in grain growth. Much land is left uncultivated in some areas.

Another important reason lies in the surplus of rural population and excessive rural labour force. 70% of population and 50% of active population depend on agriculture which produces less than 20% of GDP. So agricultural development can never stimulate fast growth of income among 800 million peasants. The only way to ensure a long and sustainable growth in peasants' income is to reduce population in rural areas, i.e. encouraging the rural labour force to shift to non-agricultural industries (in secondary and tertiary industry, in cities and in towns). It can bring about several benefits. The outflow of labour force can leave more land to those staying in rural areas to till so that they can expand their operation on land and their farm produces can be more commercialized. The labour force transferred from rural areas will be changed from suppliers of farm produces to consumers, thus boosting the demand for farm produces and pushing up the prices. The combination of the two forces will keep the peasants' income rise fast. According to Green Book of Rural Economy published by Chinese Academy of Social Sciences (2006), per capita annual net income of rural households reached 3 587 yuans, of which wages income was 1 375 yuans (the contributing rate to income increase was 60.2%), while household business income was 1 931 yuans (the contributing rate to income increase was 26.5%).

At the same time, the government has adopted a series of agriculture-friendly policies to boost rural economy and increase farmers' income, including direct subsidies for grain growers and more subsidies for farmers to buy crop strains, agricultural machinery and tools. And in order to lighten their burden, China's 2600-year-old agricultural tax was rescinded on January 1, 2006. Furthermore, the government should work to improve education, health and cultural

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<sup>19</sup> Such as wheat, corn, cotton, vegetable oil, sugar, sheep's wool, milk.

undertakings in rural areas so that residents can enjoy more social welfare benefits. Tuitions for nine-year compulsory education in rural areas will be exempted within two years (2006, 2007). The central government and local governments at various levels will allocate a total of 218.9 billion yuans (27.36 billion US\$) to subsidize compulsory education in rural areas in five consecutive years (from 2006).

Generally speaking, acceleration of agricultural and rural economic restructuring, industrialization of agricultural operations, modernization of traditional agriculture, standardization of agricultural production, and urbanization are important to narrow the urban-rural residents' income and to resolve *Sannong* issues in order to promote more balanced development and build a harmonious society.

The goal of rural finance is to increase peasants' income and ameliorate their living conditions. It should create necessary conditions so that they could leave their home and work in cities and in industry/service. Credit capitals should be invested into urbanization, rural infrastructures and TVEs, and also to business skills training for peasants. For example, channelling investment to small-sized infrastructure projects in rural areas, including roads construction, water and power supply, which are featured with small investment, short construction period and quick return and generous social and economic benefits. They can create many job opportunities to the rural labour force which is cheap, thus adding to peasants' income sources. Furthermore, it can improve the living conditions, help boost consumption, and absorb the excessive production capability in rural areas.

## **4.2 Diversified and complete rural financial system**

The government is trying to recycle funds back to rural areas so as to promote the modernization of the agricultural industry and urbanization of countryside. Economic development in China is not balanced judged from many aspects. Multi-layered economic development level and complicated economic structure require multi-level financial institutions to provide relevant services. Accordingly, various financial institutions should divide the credit market according to "cost-efficiency" principle and comparative advantages to precisely choose their target markets and development strategies. Financial product innovation should be encouraged so as to provide peasant households or other business entities with different financial instruments including loans, credit guarantee, securities finance, insurance, leasing, and settlement of payments in order to adapt to the diversified need for rural finance.

### **✧ Commercial finance, cooperative finance, policy finance, other finance**

Complete rural financial system including commercial finance, cooperative finance, policy finance and other finance should be created. Farmers can maintain simple production through policy finance and other finance, primary enlarged production through cooperative finance, and advanced enlarged production through commercial finance with competition.

There is a widening gap between the east, west and central region. The rural population in the east is largely enjoying a better living and production condition, and the market economy is almost established. The rural areas in the west are still in small-scale farming. The rural areas in the centre have the biggest rural population, limited natural resources, most serious poverty and the fastest ecological deterioration. So it should have more policy finance in West, by contrast more commercial finance in East.

### ❖ **Collateral and Credit Guarantee System**

Residential houses, collectively owned land, and courtyards can't be mortgaged, so farmers have difficulty to get loans, in particular loans for breeding and planting industries. While full-fledged private land ownership rights are not likely in the near future, farmers should be able to use long-term land use rights as collateral. Movables, bills of storage, rights can also be used to mortgage. Once the mortgage problem is solved, productive enterprises will develop rapidly.

Credit guarantee system should be created in rural areas so as to help rural banks cope with the hardship at the initial stage of development. Relevant protective policies such as government credit guarantee for farmers and credit guarantee among farmers themselves should be allowed. The leading company can also be allowed to create a credit guarantee institution in order to provide guarantee to peasants related. Moreover, due to great risk of agricultural investment, farmers can buy agricultural insurance when they demand credits.

### ❖ **Interest rate**

The successful microcredit institutions in foreign countries have an interest rate much higher than the one in commercial banks. For instance, in Indonesia, the microcredit's interest rate is above 28% while 18% in commercial banks; in India, 20%-40% vs. 12%-15%; in Bangladesh, 20%-35% vs. 10%-13%. So generally, the microcredit's interest rate is above 10 percent higher than the one in commercial banks. However in China, the microcredit's interest rate is slightly higher than the one in commercial banks. So it should increase the floating range of interest rate so that it could close up to the market one. In the one hand, government finance can be mitigated. In the other hand, the microcredit can be granted to the poor who need really the money, but not the rich who want to get loans with lower interest rate ("rent-seeking" phenomenon).

According to Jennifer Isern, a micro-finance expert at the World Bank's Consultative Group to Assist the Poor (CGAP), reductions in interest rates are achieved through a competitive market. For example, in Bolivia, micro-credit interest rate decreased to 20% from a high level of 70-80% due to competition. Only when micro-credit companies do not benefit from government subsidies do they have the incentive to lower costs, develop themselves and expand the scale of service to poor people.

Transparency is critical. Transparency not only makes supervision easier, it helps donors, investors and loan applicants make sober judgments about the risks and returns.

### ❖ **Agricultural insurance**

Agriculture serves as the foundation of the national economy and faces special difficulties in its production process, some other countries have supported the development of agricultural insurance in order to protect farmers' interest. Subsidies to agricultural insurance are legitimate according to the World Trade Organization's "green box policies" and they've become an important means by which developed countries support and protect their agricultural industries. Hence, to promote agricultural insurance in accordance with WTO rules is a matter of urgency for China's agricultural development.

Firstly, the State should take all necessary measures to increase farmers' income to transform their potential demand into effective demand for agricultural insurance. Meanwhile, the government should also encourage concentration of farming activities to realize economy of scale and enhance farmers' dependence on agricultural insurance.

Secondly, it should not follow a single model for agricultural insurance development but will build up a multi-level system. Each region may choose its own model to expand agricultural insurance coverage according to its fiscal strength and natural conditions. Some local governments, for example, have been working together with insurance companies to develop agricultural insurance that combines fiscal and policy support with commercial operations.

Thirdly, the State should improve legislation to provide a sound legal environment for the development of this insurance. In comparison with commercial insurances, agricultural insurance is so risky that the government should invest a lot in the initial phase of its development. It is suggested that the State should lay down the laws and regulations on agricultural insurance as soon as possible to ensure constant government support for this undertaking.

Fourthly, the government should make more efforts to raise farmer's insurance awareness and foster grassroots insurance professionals. It takes time for hundreds of millions of farmers across the country to understand the nature, role and advantage of agricultural insurance. The government should try to organize farmers on a voluntary basis to participate in agricultural insurance. Grassroots insurance professionals should master not only theories about agricultural insurance but also related knowledge about agricultural management, agro-technique and prevention of natural calamities. The government should make full use of advanced foreign experience to foster a group of qualified local insurance professionals.

Finally, the function of agricultural insurance companies should be improved to reduce concerned insurance risks. Because of the unique position of agricultural insurance companies in risk management, they could and should provide services like consultation and supervision on policy holders' disaster prevention and reduction. This is particularly useful for small-sized farming economies. In addition, establishment of agricultural insurance companies in rural areas can be combined into that of a comprehensive agricultural service system to multiply functions and cut down operational cost. A sound evaluation system is the prerequisite for making reasonable compensation. Since the country has not developed a unified index yet, agricultural insurance companies can try to set up a relatively scientific evaluation system suited to local conditions to minimize insurance risks.

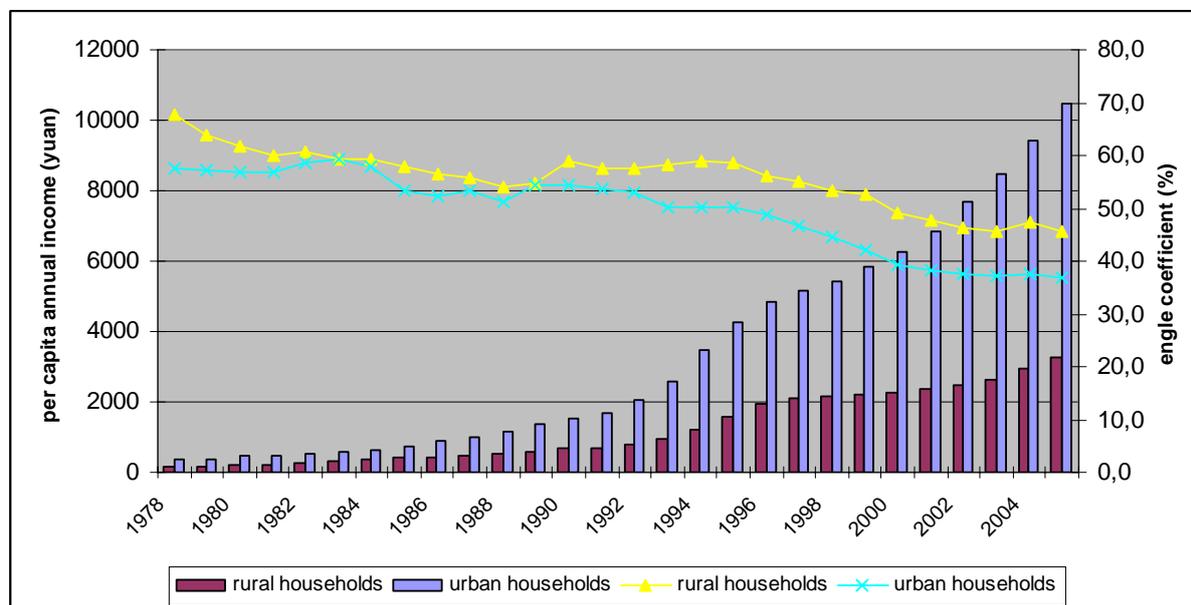
#### ✧ **Informal finance**

Informal finance exists since long time ago. And the emergence of informal lending is of growing importance for small-scale farmers and small businesses in rural areas that lack collateral and are virtually excluded from the formal financial sector. If private funds participate in lending activities in accordance with relevant rules on interest rate, informal financing is unlikely to damage social economic order rather it could be a beneficial supplement to formal financing and even a barometer of social financial demands. Judged from past experiences, problems in informal finance stemmed from illegal public financing activities without permission. A good policy to prevent social and financial disorder should focus on establishing a governing mechanism that guides its healthy development while

imposing harsh punishment on irregularities. The government is considering “lender rules” to regulate informal financial institutions, especially for usury.

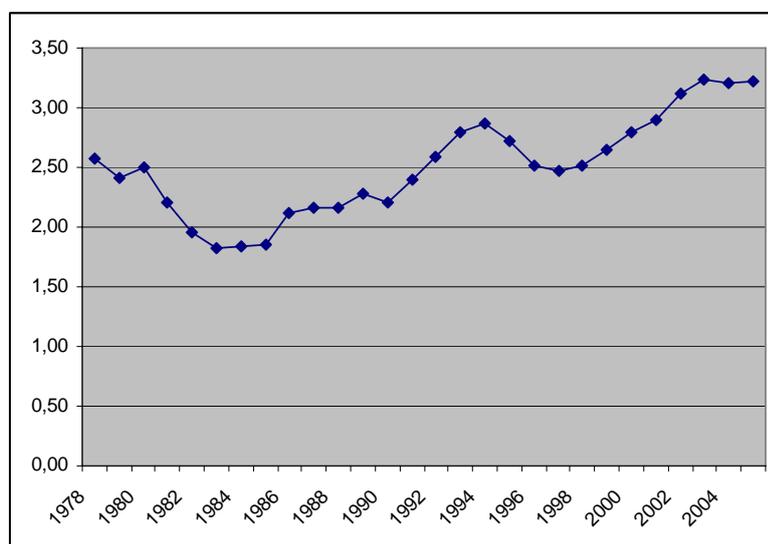
## ANNEX 1 - Per Capita Annual Income and Engle Coefficient of Urban and Rural Households

**Figure 1 - Per Capita Annual Income and Engle Coefficient of Urban and Rural Households**



*Source: China Statistical Yearbook, various editions.*

**Figure 2 – Ratio of per capita annual disposable income of urban households to per capita annual net income of rural households**



*Source: China Statistical Yearbook, various editions.*

Engel's coefficient—the proportion of expense on food to the consumption expense. According to the FAO's criteria that an Engle Coefficient above 59 percent denoted poverty, 50-59 percent means enough food and clothing, 40-50 percent stands for well-off, while people living with 30-40 percent Engle Coefficient are rich and those below 30 percent are the richest.

**ANNEX 2 – Per Capita Annual Net Income of Rural Households & their basic conditions in Eastern, Central Western and Northeastern Region**

**Table 8 - Per Capita Annual Net Income of Rural Households**

Item	1990	1995	2000	2004	2005
<b>Net Income</b>	<b>686.31</b>	<b>1577.74</b>	<b>2253.42</b>	<b>2936.4</b>	<b>3254.93</b>
<b>By Source</b>					
<b>Wages Income</b>	138.8	353.7	702.3	998.46	1174.53
<b>Net Income from Household Business</b>	518.55	1125.79	1427.27	1745.79	1844.53
Farming	344.59	799.44	833.93	1056.5	1097.71
Forestry	7.53	13.52	22.44	34.13	45.77
Animal Husbandry	96.81	127.81	207.35	271.08	283.6
Fishery	7.11	15.69	26.95	36.34	42.52
Industry	9.15	13.63	52.67	58.65	61.13
Construction	12.18	34.53	46.73	49.56	47.12
Transport, Post and Telecommunication Services	13.45	27.76	63.63	72.9	84.19
Wholesale and Retail Trade and Catering Services	12.69	34.26	78.54	94.07	108.55
Social Services	6.55	17.18	28.09	31.26	32.61
Culture, Education and Health Care			6.86	8.35	10.13
Others	8.49	41.97	60.08	32.94	31.19
<b>Transfer Income and Property Income</b>	28.96	98.25	123.85	192.15	235.87

*Source: China Statistical Yearbook (2006)*

**Table 9 - Basic Conditions of Rural Households in Eastern, Central Western and Northeastern Region (2005)**

Item	Eastern Region	Central Region	Western Region	Northeastern Region
<b>Per Capita Annual Net Income (yuan)</b>	<b>4720.28</b>	<b>2956.595</b>	<b>2378.913</b>	<b>3378.981</b>
Wages Income	2198.078	1052.64	674.5244	709.6816
Household Business Income	2140.621	1774.916	1537.758	2310.792
Property Income	159.7126	36.82889	49.29894	170.6319
Transfer Income	221.8681	92.21013	117.3308	187.8756
<b>Living Expenditure (yuan)</b>	<b>3408.969</b>	<b>2276.9</b>	<b>2022.882</b>	<b>2557.304</b>
Food	1435.916	1094.065	1007.171	1009.581
Clothing	191.4571	134.4863	112.7635	191.001
Residence	537.4635	307.1583	265.5402	403.3624
Household Facilities, Articles and Services	163.195	97.5754	82.54818	84.37417
Transport, Post and Telecommunications	367.4577	197.5059	167.5364	278.3732
Cultural, Educational and Recreational Articles and Services	414.7372	260.2267	216.4638	303.4414
Medicines and Medical Services	218.5107	137.6242	134.6443	230.1367
Other Commodities and Services	80.23107	48.25836	36.21467	57.03424

*Source: China Statistical Yearbook (2006)*

### **ANNEX 3 - RCCs' ownership reform**

- ❖ In regions where cities and villages have a great unification, the RCCs are big scale, there is little demand of support for rural economy, and the management is commercialised, we can create rural commercial banks or rural cooperative banks.

#### **Condition for creating rural commercial banks**

- Strong management capability;
- The total assets are more than 1 billion yuans;
- NPL ratio is less than 15%;
- The registered capitals are no less than 50 million yuans;
- Adequacy capital ratio reaches 8%.

#### **Condition for creating rural cooperative banks**

- There are at least 1 000 sponsors;
- NPL ratio is less than 15%
- The registered capitals are no less than 20 million yuans;
- Core capital adequacy ratio reaches 4%.

- ❖ In populous cities/counties, or counties/cities as the commercial bases of grain, cotton, we can create only one legal entity based on RCCs and RCCU at county/city level.

#### **Condition for creating only one legal person based on RCCs and RCCU at county/city level**

- The assets are equal to the liabilities for all of RCCs in this region;
- The RCCs are voluntary;
- The RCCU at county/city level has relatively strong management capability;
- The registered capitals are no less than 10 million yuans (They can be adjusted with CBRC's authorization);
- Adequacy capital ratio reaches the criteria.

- ❖ In other regions, we can maintain a system of 2 levels, i.e. RCCs and RCCUs at county/city level

- ❖ RCCs which have a big risk will be restructured and/or amalgamated. The RCCs whose assets are less than liabilities, and which are located in cities or suburbs of cities, and which have little demand of support for rural economy, will be revoked, according to "norms of revocation of financial organisms" (effective from 15/12/2001).

The reform of RCCs in poor and distant regions is the most difficult, it's the major point in this reform.

## Abbreviations and Acronyms

AAIC	Shanghai Anxin Agricultural Insurance Co. Ltd
ABC	Agricultural Bank of China
ADBC	Agricultural Development Bank of China
ARE	Aon Re China Limited
BOC	Bank of China
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CDB	China Development Bank
CIRC	China Insurance Regulatory Commission
CPSRB	China Post Savings and Remittance Bureau
DCE	Dalian Commodity Exchange
FAO	Food and Agriculture Organization
FPC	<i>Fu Pin</i> Community (Poverty Alleviation Community)
ICBC	Industrial and Commercial Bank of China
NBS	National Bureau of Statistics
NPL	non performing loan
PBC	the People's Bank of China
PICC P&C	the People's Insurance Company of China Holding Company , Property and Casualty Company Limited
PSBC	Postal Savings Bank of China
RCCs	Rural Credit Cooperatives
RCCU	Rural Credit Cooperative Union
ROSCA	Rotating Savings and Credit Association
SMEs	small and medium sized enterprises
SOCB	State-Owned Commercial Bank
TVEs	township and village enterprises
UCC	Urban Credit Cooperative
WTO	World Trade Organization
ZCE	Zhengzhou Commodity Exchange

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