

RETURN TO COUNTRYSIDE: A NEW ATTEMPT OF RURAL FINANCIAL TRANSFORMATION

In July 2009, the China Banking Regulatory Commission (CBRC) issued a three-year plan¹ on the development of New Rural Financial Institutions. The plan proposed to set up 1294 New Rural Financial Institutions including 1027 Village Banks by the end of 2011. According to the plan, 75.2% of the proposed New Rural Financial Institutions would be set up in the area where agriculture plays an essential role in local economy, 65.9% in the Central and Western provinces and 35.7% in the poor area. It is remarkable that the rural and underdeveloped areas have been put in the privileged position in this financial arrangement. To make sure that fund could flow between the developed and underdeveloped, rural and urban area, the plan required that the promoters who intend to create a new institution in urban or other developed area have to set up a counterpart in the ru-

ral or other underdeveloped area simultaneously. However, this plan is not the beginning of the Rural Financial Transformation. The transformation in fact has been carried out from December 2006 when the CBRC decided to set up experimental rural financial institutions in Sichuan, Qinghai, Gansu, Neimenggu, Jilin and Hubei Provinces. The first list experimental institutions included 21 Village Banks, 10 Rural Mutual Cooperatives and 5 Loan Companies. In 2007, the experiment was extended to 23 provinces. By June 2009, 118 New Rural Financial Institutions had been established, which were composed of 100 Village Banks, 11 Rural Mutual Cooperatives and 7 Loan Companies, of which 87 were in Central and Western area. Regardless of the aggressive plan of 2009-2011, the progress from December 2006 to July 2009 of the Rural Financial Transformation was also conspicuous.

In the statement of the three-year plan, one fact was particularly highlighted, which was the poor coverage of the financial institution in rural area. It was reflected by two issues: the first is that there were still 1424 townships which hadn't been covered by any financial institutions by 2008; the second is it was still difficult for rural residents and enterprises to gain loans. Why has the financial supply in rural area been not able to meet their demand? Is this situation a newly emerged problem or a long-term dilemma? To answer these questions, we should throw light on the financial scheme in rural area.

Financial Scheme in Rural Area before and after the 1997 Asian Financial Crisis

By 1997, the rural financial structure was composed of four parts: the Big Four State-owned Commercial Banks, the Rural Credit Cooperatives, the Postal Savings Bank and Rural Cooperative Foundations. During the period of late 1970s to mid-1990s, with the deepening reforms in Chinese economy, the county territory economy in China had experienced rapid growth which was not only revealed by its proportion within the whole economy, but also characterized by a variety of growing financial bodies within the county territory. In addition to the Rural Credit Cooperative and local branches of the Big Four Banks, varied types of Rural Cooperative Foundations had

played an active role in meeting the financial demand of rural people and enterprises. In 1992, there were 17,400 Rural Cooperative Foundations set in township and 112,500 set in villages². During the period from 1993 to 1996, different types of foundations continued booming under the policy supports of central government. By the end of 1996, just before the central government ordered emergent shutdown of the Rural Cooperative Foundations, the number of foundations at township level was up to 21,000.

However, in the wake of the 1997 Asian financial crisis, abrupt changes in the rural financial arrangements had taken place. Although Chinese government boasted their success in fighting against the crisis, the rural financial scheme in fact had suffered immense setback.

In this year, due to the financial crisis and the following deflation in Chinese economy, the Central Financial Work Conference decided to contract the branches of the Big Four Banks at the county and the township. According to the transformation plan produced in June 1998, all the branches with average savings below 500,000 *yuan* per staff should be closed; branches with average savings between 500,000 and 1,000,000 *yuan* per staff should be closed selectively and branches with savings between 1,000,000 and 1,500,000 *yuan* per staff should be combined. In

the three years between 1998 and 2001, the Four State-owned Commercial Bank had closed 44,000 branches within China mainland. All the closed branches were located in rural area under the county-level. Furthermore, the Big Four Banks have taken back the authority of loan from county-level branches. From then on, the major



business of the Big Four Banks in rural area has become absorbing savings, which caused the ongoing flow of fund from rural area to the developed and urban area.

At the same time, to avoid the risks involved with the rapid development in the unofficial financial market, the People's Bank of China and Ministry of Agriculture made the decision to close all the Rural Cooperative Foundations. The order was issued in 1999. The sudden shutdown has caused credit crash and the run on bank in spite of the rescue from central government. To meet the debts, the burden had to be transferred to the public finance of local government, which eventually were passed on to local people.

Why reform?

From mid-1990s, the policies in industrial structure and strategies have been skewed in favour of urban and developed area, and the county territory economy has fallen into recession as a result. This situation has been worsening since the funds were continuously extracted to the major cities and industrial area. This unidirectional flow of money left a growing financial gap in the county territory economy, which has brought about the prosperity of underground financial market in rural area. As far as local people concerned, the supply of underground financial market has been usually not reliable and more expensive than that of official financial institutions. On the other hand, due to its illegal identity, the underground financial market has usually been beyond the regulation of financial regulatory authority as well as the control of monetary policy. It would very likely increase the risk of government failure in Macro Economic Control.

Another context that has to be taken into consideration is the cancellation of agricultural tax since 2005. The influence of this reform is never defined to the alleviation of farmers' economic burden, but concerns the relationship between the government and the people. The agricultural tax as well as various levies attached has developed in-

dividual farmers' awareness of their linkage with the country while the government could keep their control on grassroots by collecting the tax. When all these charges were abolished, the local governments, including the county and lower level governments, had no longer direct connections with their people, and the shrinkage of local financial income resulted from this transformation has also triggered the retreat of governance from grass roots society.

Under the above context, the extension of New Rural Financial Institutions could not only be a measure to meet the increasing demand for financial service in rural area, but also be a governmental strategy of the return to rural society. If we turn to review the practice of this movement, we can find this three-year plan is not entirely market-oriented, but in some sense government-oriented. Though the main components of the New Rural Financial Institutions, Village Banks, were claimed to be run as a profitable institution, they are in reality subject to the admission control which requires the promoters to set up at least one Village Bank in rural or underdeveloped area while creating a Village Bank in urban or developed area.

Notes:

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1. China Banking Regulatory Commission (CBRC) on the development of New Rural Financial Institutions 2009-2011: Question and Answer Session 银监会有关部门负责人就发布《新型农村金融机构2009年-2011年工作安排》答记者问http://www.songyang.gov.cn/zwgk/xxgk/00266401_1/03/0302/201109/t20110927_89598.htm
2. Wen Tiejun. "Rise and Fall of the Rural Cooperative Foundations (Nongcun Hexuo Jijinhui de Xingshuaishi 农村合作基金会的兴衰史)". *Zhongguo Laoqu Jianshe*, 2009 (9).

