

A Research on the Development of Rural Banks and the Relief of Rural Financial Difficulties

--Taking Chengdu as a Sample Experiment Zone of Comprehensive Reform Package to Balance Urban and Rural Development

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Abstract

Starting from the connotation and functional localization of rural banks and set in the characteristics of current Chengdu's rural financial demands as well as actual financing difficulties, this paper analyzes the current development of Chengdu's rural banks and some possible problems during the course and puts forward relevant countermeasures and suggestions as for how to effectively exert the function of these banks.

Keywords: Rural financing difficulties, Rural economic development, Rural Banks, Supporting policies, Experiment zone

1. Research Issues and Relevant Backgrounds

Ever since the implementation of commercial reform in state-owned banks since 1990s, financial institutions have had large-scale non-agricultural conversion and urbanization and therefore rural credit cooperatives have become the main force in rural finance. However, due to their heavy historical burdens as well as their limited actual agriculture-supporting abilities, it is the rural financial difficulties that have harassed the development of rural economy (Wuwu Zhang, 2007, Junfang Liu, 2007). In conformity to this, China Banking Regulatory Commission issued *On the Adjustment of Admission Policies for Rural Financial Institutions to Better Support the Construction of New Countryside* at the end of 2006 in which rural banks got accepted as a typical representative for new countryside financial institutions.

Rural banks refer to those financial institutions approved by China Banking Regulatory Commission, invested by foreign and domestic financial institutions, corporations of non-financial domestic institutions and domestic natural persons, established in rural areas to support local peasants and agriculture and rural economic development. They have their own bright characteristics in ownership structure, management structure and operation features. In addition, they have geographical advantages as well. Moral risks and adverse selection in credit risks can be favorably solved and the space for safe profit tends to be larger compared with other financial institutions. As an experiment zone of China's comprehensive urban-rural package, Chengdu embodies the coexistence of a big city and a big countryside and prominent dualistic economic structure, hence quite representative. It is emergent to develop rural banks in order to lessen current financial difficulties in Chengdu's countryside and to narrow the gap between urban and rural areas. This research aims at exploring to develop rural banks in order to lessen the financial difficulties in rural areas based on the sample of Chengdu.

2. Characteristics of Financial Demands and Actual Financing Difficulties in Chengdu's Countryside

2.1 Theoretical Evidence

(1) R. I. Mckinnon and E.S. Show's Financial Deepening Theory

According to American economist R. I. Mckinnon and E. S. Show, financial repression widely exists in developing nations, manifested in excessively low or even minor actual interest rate, the claims to reject the nation's excessive administrative interferences in the financial market as well as the expansion of the scale of financial system. They oppose non-standard finance due to its repression on standard one. Rural banks are intended to loosen financial administration to develop, normalize folk finance, to diversify rural financial system and therefore to achieve positive competition.

(2) Endogenous Growth Theory

It is claimed in this theory that the financial system reform in rural areas depends on the development degree of

rural economic departments' internal financial organization system. It is shown in relevant international experiences that non-standard financial institutions will have to give way to the powerful standard ones naturally. It is not only against the principles of market economy but convert folk capital into the self-financing method with low productivity to simply shut down or eliminate the non-standard one. The "low threshold and strict supervision" principle adopted by China Banking Regulatory Commission conforms to this theory: breaking the limitations on the admittance into the financial industry to give priority to rural financial services by reducing the restrictions on their entry into the industry, establishing rural banks to make them important forces in supporting the development of local economy and small enterprises and introducing competition system into the rural financial market.

(3) Development Economics

According to development economics, the main factors to promote economic growth can be divided into three aspects: growth caused by capital input, growth caused by labor force input and growth caused by comprehensive elements such as management, science, technology and education. China has excessive rural labor force, therefore, the second seems not to be of great importance for China's rural economic growth. It takes a long process from the input to the output of comprehensive elements, which calls for capital support in system innovation, management improvement, S&T development, spread of results, development of compulsory education as well as vocational education. Accordingly, it is emergent to increase the capital input into agriculture, countryside and peasants, required by which rural banks should be established to facilitate the development of rural economy.

2.2 The Characteristics of Chengdu's Rural Financial Demands

Influenced by the restrictions of the dualistic economic structure and the macro financial climate in rural areas, financial difficulties seem particularly obvious in Chengdu's countryside with its own characteristics. According to the needs of our research, we divide rural financial demands into three aspects including peasants' financial demands, medium and small enterprises' financial demands and rural local governments' financial demands, shown in Figure 1 (Xia, Zhang, Cui, 2008).

2.2.1 The Characteristics of Rural Financial Demands and Actual Financing Difficulties

1) Peasants' Financial Demands

Based on different advantages in location and resources, there is a disparity among different counties or different villages in a country in economic development. As a result, peasants at different economic levels have diversified financial demands. A small proportion of rich peasants are mainly non-agricultural by replacing the traditional agricultural production with new agricultural production (such as cultivation). They have great capital needs and definite plans for their capital use as well as the repayment term and hence little risk. On the contrary, average peasants who take up a large proportion of the total rural population, have financial demands for both agricultural production (chemicals, seeds and so on) and living (children's education, medical health). Due to the short cycle and strong seasonality, they mainly turn to their relatives and friends and they can repay their loans punctually if turning to banks. For another small proportion of poverty-stricken households, they have financial demands for medical care, food, housing and so on, which embody great risks due to the large amount of capital and the long repayment term. Generally speaking, different types of peasants have great demands for capital to be used in diversified ways.

2) Medium and Small Enterprises' Financial Demands

As a significant force in promoting China's economic development, medium and small enterprises have exerted an essential role in the coordinative development of economic society. It is shown in the latest data that medium and small enterprises take up over 90% of the total in Chengdu, absorbing 75% of the employed population, over 70% of the excessive rural labor force and creating nearly 50% of the total taxes. It is their significant achievements in production and employment that have made them an indispensable force in Chengdu's economy. These enterprises can be divided into three types: professional agricultural materials companies combining production, supply and marketing, raw materials bases for downtown companies and industrial and mining enterprises. Generally, agricultural companies call for less capital in their establishment and operation while the latter two call for either larger scales or a large amount of start-up capital and therefore need strong financial basis. Accordingly, from the perspective of the intensity of capital demands, the former exceeds the latter two.

3) Rural Local Governments' Financial Demands

Seen from the actual responsibility taken by relevant administrative organizations, rural local governments here refer to county governments and administrative village committees (although they are not legal governments). In

reality, public materials used in the renovation and expansion of general rural roads, the construction of basic water conservancy works, the construction of drinking water projects are provided by government directly or indirectly. Influenced by the revenue-sharing system in 1990s, China is lacking in perfect financial transfer payment system as well as scientific system of duties and rights and local governments, especially those in the western areas, have great economic pressure, hence having strong eagerness for financial support. It is shown in the survey on some typical regions of Chengdu in 2008 that 39.07% of their peasants lay their hope in government to enhance the construction of agricultural production and technology service organizations, to strengthen agricultural production and technology service system; 60.41% of them suffering from great difficulties in getting drinking water for livestock as well as themselves after serious droughts hope that government will intensify the construction of rural basic facilities. Obviously, local governments hope that they could find effective investment and financing channels to guarantee sound agricultural development and to provide necessary public materials.

2.2.2 Causes for the Financial Difficulties in Chengdu's Countryside

Patrick (1966) proposed two financial development patterns: supply-leading pattern and demand-following pattern. The former claims that financial institutions and relevant financial services should have greater supplies than demands and emphasizes the role of financial services in promoting economy; the latter claims that it is the financial demands arising during the process of economic growth that lead to the establishment of financial institutions and services. In the elementary stage of economic development, the former pattern was of dominance. However, with further economic development, it has to give way to the latter (Chen, Cao, 2008). With Chengdu's economic and social development taken into consideration, the causes for its rural financial difficulties can be explored from the perspective of supplies and demands.

1) The Financial Difficulties of Chengdu's Countryside from the Perspective of Rural Financial Demands

The seasonality of agriculture and the small-scale extensive agricultural production caused by Chengdu's special landforms and traditional production methods have endowed its rural financial demands with its own characteristics, leading directly to its rural financial difficulties. According to our on-the-spot survey, the specialty of Chengdu's rural financial demands can be manifested in peasants' loan structure, loan scale and loan term. To be more specific, in the aspect of loan structure, peasants, who take up the largest proportion of population, need loans for production as well as life. However, quite a few local financial institutions refuse to offer living loans to peasants, so do rural local governments' financing projects. In terms of loan scale, there is a great disparity among different financial subjects in their capital demands while a majority of financial institutions lay down different loan limits at different levels, hence failing to satisfy local governments' loan demands. To sum up, the specialty of Chengdu's rural financial demands increases the complexity of financing and therefore restricts the actual financing ability.

2) The Financial Difficulties of Chengdu's Countryside from the Perspective of Rural Financial Demands

The current rural financial institutions' failure to satisfy huge financial demands can be considered to be closely related to the transition of China's financial institutions with its insufficient economic development excluded. Through the commercialization reform of state-owned banks in 1990s, the current insufficient effective supplies of rural financial institutions have led to rural financial difficulties. At present, rural financial vacuum has become a core element restricting Chengdu's economic development. As is shown in relevant material, Chengdu has reduced its rural financial outlets on a large scale since mid 1990s, only remaining those in developed counties. As a result, in order to really achieve its coordinated development of urban and rural areas, Chengdu has to facilitate the construction of rural banks to solve the financial vacuum in its counties.

3. Suggestions on How to Effectively Exert the Role of Rural Banks

3.1 Steadily Promoting the Establishment of Rural Banks

Based on Chengdu's rural financial demands, when both the basic financial equipments and supervision conditions are all right, active efforts should be made to build new rural banks in every county, to perfect the network of rural banks, and then to make it an important part in Chengdu's rural finance. In addition, peasants' financial sense should be overall improved to lay down economic and ideological basis for the establishment, development and prosperity of rural banks in countryside.

Efforts should also be made to deal with the relationship between rural banks and other rural financial institutions, to clarify the orientation of rural banks, base their measures on the multi-level financial demands of financial subjects in 20 counties in Chengdu and actively innovate financial products and services according to rural financial demands based on foreign and domestic rural banks' success stories.

3.2 Actively Implementing Rural Banking Business

Once established, rural banks should make efforts in the following measures:

First, local governments should have active cooperation with rural banks to publicize the significance and purpose to establish rural banks, to offer positive guidance for a variety of financial subjects to fully learn about and accept rural banks and to offer convenience for the implementation of rural banking services, hence guaranteeing the capital resources of rural banks from fountainhead.

Second, based on the geographical location and population distribution of Chengdu's counties, a rural bank service network should be established and perfected gradually, in which corresponding branch institutions are established to expand the service semidiameter in order to give corresponding support to the peasants in the remote areas and to gradually enhance the competitiveness of rural banks.

Third, rural banking staff is expected to go down to agriculture, countryside and peasants, to get familiar with a variety of capital demands, to have prompt, comprehensive and correct information accumulation, to reduce the risk in repaying loan capital and to strengthen the potentials of rural banks.

3.3 Intensifying Policy Support and Monitoring Rural Banks' Services for Agriculture, Countryside and Peasants

The fundamental aim of rural banks lies in serving local economic development related to agriculture, countryside and peasants, which cannot be changed at any time. Accordingly, relevant government departments should offer necessary policy supports:

First, in view of the geographical location and survival environment of rural banks, the People's Bank of China should loosen its restrictions on rural banks' interest rate by giving them corresponding floating space in interest rate and permitting them to confirm their own one according to their local economic development level, capital supplies and demands, the affordability of the debtor so as to guarantee the survival of rural banks as well as the full exertion of rural banks' service for agriculture, countryside and peasants.

Second, taking into consideration the inferiority of its agriculture and frequent natural catastrophes in some counties, Chengdu government should make some efforts to organize, guide and encourage relevant insurance institutions to open up rural insurance market, to establish policy-based agricultural insurance institutions to serve agricultural development specifically, hence providing effective guarantee for rural banks' secure capital operation.

Third, due to some peasants' poverty, Chengdu government and the People's Banks should have joint efforts to establish risk compensation system intended for rural banks, to encourage rural banks to offer clean loan in proper cases, to establish stimulation system to guarantee rural banks serving agriculture, countryside and peasants and the construction of new countryside and to offer policy-based spread subsidies.

Fourth, in view of the current situation of rural banks, China Bank Regulatory Commission and other supervision departments are expected to issue supervision policies, greatly support ordered competition among rural banks and rural credit cooperatives, to enhance rural banks' vitality and to activate rural financial market.

3.4 Effectively Enhancing Financial Supervision and Promoting Rural Banks' Sound Operation

Chengdu is expected to establish strict rural banks admittance system according to its reality, with specific standards for different regions, especially to strengthen the examination of the directors of rural banks and advanced managing staff's qualification in order to guarantee every rural banks equipped with a powerful core.

Financial supervision departments are expected to highly emphasize, guide, and encourage every rural bank to establish perfect legal person management structure and bank organization system in order to guarantee rural banks to establish perfect internal control system and feasible risk management system, hence helping rural banks to improve their risk prevention ability, to realize their steady operation and sustainable development.

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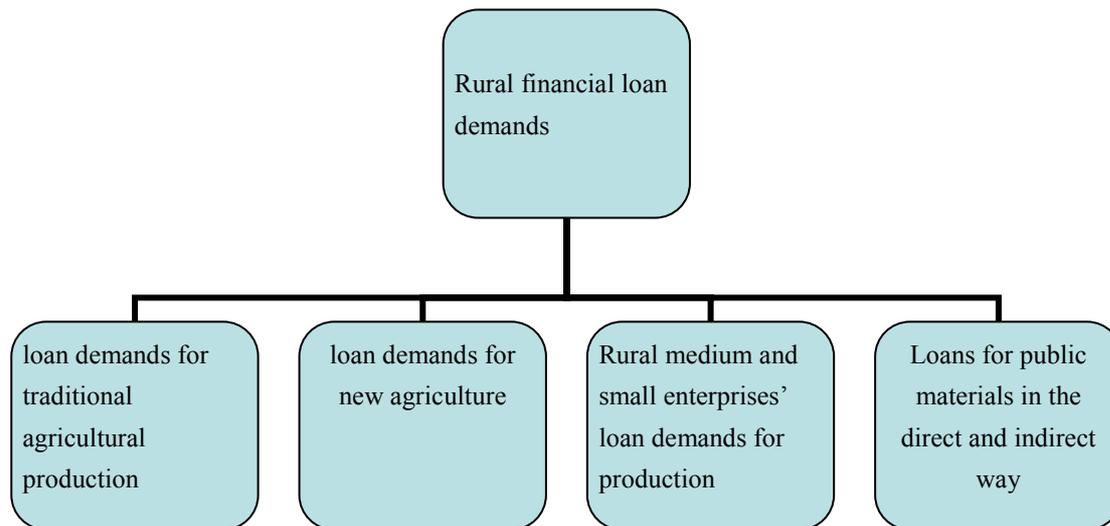


Figure 1 Specific Demands in Rural Finance