

**THE CREATION OF A FAVOURABLE ENVIRONMENT FOR INVESTMENT IN RURAL  
CHINA: CURRENT SITUATION AND FUTURE PROSPECTS**

**By HAN Jun**

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# THE CREATION OF A FAVOURABLE ENVIRONMENT FOR INVESTMENT IN RURAL CHINA: CURRENT SITUATION AND FUTURE PROSPECTS

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## Abstract

*Since the late 1990s, the rate of increase of China's rural population income has begun to fall while the gap between urban and rural income is expanding year by year. Currently, China still has a rural population of more than 100 million whose daily per capita cost of living is less than USD 1 and who are classified as the impoverished stratum. Chinese leaders in the new era have clearly advocated the further promotion of rural development and the reduction of poverty so as to realise the long-term goal of establishing a well-to-do society. The realisation of these goals is inseparable from support for rural finance. Currently, the channels for rural investment in China include investment by individual peasants, investment through government financial channels, investment from banking channels and funds directly from foreign capital and the stock market. This report gives a concise introduction to the sources and use of rural investment in China with the emphasis of the discussion on the main problems which exist at the moment and the direction of policy development from now onwards. Research has shown that the total amount of financial funding support of agriculture and the countryside by the Chinese government is still low and that there are many irrational points in the rural capital investment structure supported by government finance. The amount of support for rural credit is insufficient, the internal credit structure of rural financial institutions is unbalanced and peasant households have great difficulty in obtaining loans from financial institutions. Agricultural insurance is contracting and is far from being able to meet the requirements of agricultural development. The creation of a good environment for investment in China is bound to further increase the amount of capital investment by government finance in support of agriculture with the formation of stable investment channels for funds to support agriculture. The direction of the use of government financial funds to support agriculture should be adjusted in accordance with the need to set up a public financial system. The reform and renewal of rural finance should be promoted and financial services to peasant households and small and medium-sized enterprises in the countryside should be improved. Guidance by government investment should be fostered and a pluralistic agricultural investment structure should gradually be established.*

## 1. The main sources of rural investment in China

### *Rural investment through public financial channels*

The use of government financial channels for rural investment mainly consists of investment in such areas as agricultural production, agricultural science and technology, the spread of technology, agricultural ecology and environmental protection, together with investment in related areas such as water conservancy, meteorology and forestry. The total public expenditures for Chinese agriculture in 2000 were 220 billion Yuan, being 8.8% of the total agricultural output value for that year. According to a similar measurement, the level of support for developed countries is approximately 30% - 50% and about 10% - 20% for developing countries such as Pakistan, Thailand, India and Brazil. Of the twelve "Green Box" policy measures permitted by the WTO, China uses six (government payment for general services, safe storage of foodstuffs, support for domestic foodstuffs, relief for natural disasters, ecological environmental protection and support for regional development). On the basis of the 1996 - 1998 base calculation period, annual average "Amber Box" expenditure was 29.7 billion Yuan, 1.23%

of the total agricultural output value. When compared with the 8.5% (174 billion Yuan) permitted through negotiations, there is still a 144.3 billion Yuan gap in China's "Amber Box" support.

In recent years, an important source for the Chinese government's capital for supporting agriculture has been the national debt. Between 1998 and 2001, total additional state agricultural national debt capital was 144.6 billion Yuan, being 28.35% of the overall additional national debt of 510 billion Yuan. Priority provision of agricultural national debt capital was for construction projects for important basic facilities such as water conservancy, forestry, agriculture and meteorology and for ecological and environmental construction projects in key areas. In the distribution of projects and provision of capital, the focus of attention was inclined towards areas of central and western China. By industry, provision was as follows. Between 1998 and 2001, the state provided 104.1 billion Yuan of national debt capital in all for the water conservancy industry, accounting for 72% of the national debt plan for agricultural departments under the government. Over the four years, a total of 27 billion Yuan in capital was provided for forestry construction, the overall scale exceeding the total of investment in forestry construction for the twenty years prior to reform and opening up.

Capital in support of agricultural development from government financial channels also includes Government investment in education, medical treatment and health. In all, investment in compulsory education in rural China has increased continuously, rising from 48.6 billion Yuan in 1994 to 92 billion Yuan in 2000 with expenditure in the budgeted outlay for compulsory rural education rising from 28.7 billion Yuan in 1994 to 59.8 billion Yuan in 2000. However, investment in compulsory rural education in the national Chinese financial budget is seriously insufficient. Between 1994 and 2000, the budgeted outlay on compulsory rural education accounted for a proportion of 57.7% of the total outlay on compulsory rural education. The outlay on compulsory education budgeted in the rural budget was mainly borne by the government at township level. Town and township governments undertook about 78% of the national investment in compulsory education, with county financial administration undertaking about 9% and provinces about 11% while the central financial administration only undertook about 2%. In June 2001, the State Council promulgated the "Resolution on the Reform and Development of Basic Education" which made clear that the governments at county level bore the major responsibility for local rural compulsory education and requiring that governments at county level take responsibility for the central payment of teachers' wages. In April 2002, the central government also emphasised two important changes namely that the main responsibility for rural compulsory education should be transferred from the peasants to the government, and that main government responsibility should be transferred from towns and townships to counties.

Government investment in rural health mainly refers to the allocation of funds and subsidies by government departments at every level to rural medical and health organisations at county level and below. Generally speaking, as the economy develops, government action in relation to safeguarding health is gradually being strengthened and this is represented by the increased ratio of government health expenditure to total health costs. However, in China, the ratio of government health expenditure to total rural health costs has constantly fallen. Between 1991 and 2000, the proportion of government investment in total rural health costs in China fell from 12.54% to 6.59%, while social health investment fell from 6.73% to 3.26%. During the same period, personal expenditure by peasants rose from 80.73% to 90.15%. From the perspective of the structure of this expenditure, the central government only pays 2% of the health budget and the rest is all paid by local governments. This type of expenditure structure has been maintained continuously over the past ten years. Existing data shows that, in local government, it accounts for 55 – 60% in all of county, town and township budgeted expenditure. Between 1991 and 2000, the cumulative total of budgeted government expenditure on rural health was only 69 billion Yuan, accounting for just 15.9% of its total budgeted expenditure on health. In the period between 1991 and 2000, the Chinese government's budgeted expenditure on

health increased by 50.7 billion Yuan but expenditure used for health in the countryside only increased by 6.3 billion Yuan, just 12.4%.

### ***Investment in agriculture and the countryside through financial channels***

The Agricultural Development Bank of China, the Agricultural Bank of China and rural credit co-operatives are the three main financial institutions serving Chinese agriculture and the countryside. The government's policy of credit support for agriculture is mainly realised through these three financial institutions. The growth in the total amount of loans through rural financial institutions in China has been very rapid. In 1979, the total amount of loans was 45.4 billion Yuan rising to 3 238.7 billion Yuan by 2000, a 70-fold increase 1979. On this, loans by the Agricultural Bank of China were 41.1 billion Yuan in 1979 and 1 449.7 billion Yuan in 2000, a 35.3-fold increase over 1979. For the Agricultural Development Bank of China, the figures were 298.2 billion Yuan in 1994 and 740.1 billion Yuan in 2000, a 1.5-fold increase. The figures for rural credit unions were 4.8 billion Yuan in 1979 and 1 048.9 billion Yuan in 2000, with the figure for 2000 being 218.5 times that for 1979.

Rural credit co-operatives play a decisive role supporting agriculture and the development of the rural economy. At the end of 2001, there were over 40 000 rural credit unions throughout the country with a balance of deposits of 1 700 billion Yuan and a balance of loans of 1 200 billion Yuan. Of this, the balance of agricultural loans was 441.7 billion Yuan and, as a proportion of agricultural loans by financial institutions, those by rural credit unions rose from 26% in 1979 to 77.7%. Currently, rural credit unions have become the main financial institution for agricultural loans. Loans issued by rural credit unions are mainly to peasant households and provide key support for their cultivation, fish breeding and poultry, processing, transport, study and consumption. Over 60% of loans by rural credit unions are to peasant households, *i.e.* their main orientation is towards peasant households.

The Agricultural Bank of China specialises as a commercial bank. Between 1980 and 2001, it cumulatively issued 14 282.7 billion Yuan, of which 9 448.9 billion Yuan involved agriculture, accounting for 66%. At the end of 2001, the balance of loans of all types was 1 604.6 billion Yuan, of which 866.1 billion Yuan involved agriculture, accounting for 54%.

The Agricultural Development Bank of China is a policy-related bank and operates a policy-related agricultural business as provided by the state. Appropriately, its capital sources are also greatly different from those of commercial banks. Apart from registered capital funds granted by the state financial administration, it mainly relies on the Central Bank for its borrowing. Over 90% of loans from the Agricultural Development Bank of China are capital loans for the purchase of such important state agricultural and sideline products as grain, cotton and oil.

The People's Insurance Company of China is the only company running an agricultural insurance business on a national scale. From 1982 to 2001, its cumulative income from its agricultural insurance premiums was 7 billion Yuan and it paid out 6.2 billion Yuan in compensation. With the addition of its disbursements for the same period, its cumulative losses came to 0.6 billion Yuan. In 2000, the income from agricultural insurance in China as a proportion of agricultural added value was only 0.043%. On average, each peasant households only paid approximately 2.6 Yuan in agricultural insurance premiums and received approximately 1.8 Yuan in compensation.

***Direct financing by the stock market is becoming an effective way of resolving the shortfall in agricultural income***

Apart from these two main channels, namely financial administration and credit, agricultural investment in China at present, the use of direct stock market financing has become an important supplementary route. By the end of 2001, of the listed companies in the Shanghai and Shenzhen markets, listed agricultural companies, the main businesses of which involved cultivation, forestry, livestock feeds, fisheries, agricultural product processing industry, agricultural product circulation industry and stock breeding industry, numbered 54. At the same time, there were three agricultural companies listed in Hong Kong with funds raised totalling some 40 billion Yuan. With regard to listed agricultural companies, by the end of 2001 their numbers accounted for 4.47% of listed companies, raising funds accounting for 4.46% of the market total.

***Some funds are raised for agricultural development using foreign capital***

Currently, the use of foreign capital in Chinese agriculture mainly takes four forms, namely foreign loans, foreign aid, direct investment by foreign firms and investment from such means as compensatory trade. Before the Eighth Five-Year Plan, the use of foreign capital in agriculture mainly consisted of foreign loans and aid predominately for the construction of basic agricultural facilities and projects to aid the poor. In recent years, the number of soft loans has gradually decreased (during the 1992, 1994 and 1995 financial years, the proportion of soft loans was respectively 38%, 30% and 21%). As the strength of the Chinese economy and the level of *per capita* income continuously increased in, the difficulty in obtaining preferential loans and voluntary aid increased daily. In recent years, direct investment by foreign firms has become the main means by which Chinese agriculture uses foreign capital. According to statistics of the Ministry of Agriculture, in 1999 direct investment by foreign firms already accounted for 50% of foreign capital attracted to the domain of agriculture. By the end of 2001, Chinese agricultural projects absorbing investment from foreign firms totalled 11 260, with the amount of contractual investment by foreign firms standing at 13.9 billion Yuan. Between 1997 and 2001, real investment in agriculture by foreign firms was respectively USD 628 million, USD 624 million, USD 710 million, USD 676 million and USD 899 million.

**2. Some outstanding problems in Chinese agricultural investment**

***Capital support from public finance for agriculture and the countryside in China is still at a low level with many irrational aspects in the investment structure and imperfections in the management system of government financed funds to support agriculture***

Firstly, the part of the expenditure of government finance for agriculture used for personal support and administrative expenses is generally maintained at about 60%, while the proportion use for construction is not high.

Secondly, a considerable proportion of public funding for agricultural construction is used for large or medium-sized water conservancy construction while a smaller proportion is used for the construction of small and medium-sized basic facilities, from which peasants can receive direct benefit. Between 1996 and 2000, central finance arranged for the investment of a total of 23 billion Yuan in forestry construction, accounting for 14.3% of central investment in basic agricultural construction over the same period. With significant social benefits in water conservancy, forestry and ecology, beneficiaries were not limited only to agriculture. Investment in them has, for a long time, been calculated as agricultural investment and this has to some degree exaggerated the scale of government agricultural investment.

Thirdly, of government investment in agriculture, the subsidy used directly for circulation intermediaries is too high. Since 1998, of government investment in support of agriculture, the annual subsidy for the circulation of grain, cotton, oil and sugar has been between 50 billion Yuan and 70 billion Yuan, accounting for more than 30% of the total of government agricultural support.

Fourthly, agricultural research and publicity lack adequate investment guarantees. According to relevant data, the current annual investment in agricultural science and technology in China is over 6 billion Yuan accounting for approximately 0.25% of the total agricultural output value while the average in developed countries is 2.37% and 0.7 – 1% in developing countries.

Fifthly, delineation of responsibility for agricultural investment between the central and local governments is not clear. The development of agriculture and the rural economy both come within the powers of central and local governments. There is no clear-cut demarcation as to which project should receive central government investment and which should receive local government investment. Such a system increases the arbitrariness of the process of arranging and using funds and local governments find all ways and means to load responsibility for agricultural support onto the central administration.

Sixthly, government investment in rural social development is far from adequate. The development of such social matters as rural education and health is lagging seriously behind. Considering the structure of the allocation of financial resources between governments, initial changes to the previous, long-term situation of an excessively low ratio of central financial income were made through the reform of the system of tax distribution in 1994, and the proportion of this income as part of the overall financial administration income has increased by more than 50%. This indicates that the central macroscopic ability to regulate and control are continuously increasing. In the current structure of the allocation of financial resources, central and provincial-level governments hold the main resources but are basically free from any responsibility for expenditure on compulsory education. Most of their educational expenditure is used on higher education: where compulsory education is concerned, they are only responsible for providing assistance to impoverished and minority nationality areas. County and township governments have poor financial resources yet they bear the vast majority of outlay on compulsory education. Also, since reform, profound changes have occurred to the public financial economy everywhere. There is an extreme imbalance between the financial resources of different areas and this has further exacerbated the strain on basic rural educational expenditure in less-developed areas.

Local government support for rural health depends entirely on its financial capacity and autonomous policies. Since tax resources are limited, county and township governments in central and western areas have difficulty in guaranteeing investment in town and township clinics and are basically powerless to meet the demand of rural inhabitants for the most basic public health services. In recent years, improvement to the health of Chinese peasants and the raising of standards of health have both tended to ease. In the countryside, the incidence of sickness and infectious diseases has picked up again in some places where they had been controlled and even returned to what it was before.

***The total amount of rural credit support is insufficient, the structure of credit within rural financial institutions is out of balance and it is very difficult for peasant households to obtain loans from financial institutions***

In 2001, the balance of loans in China was 11 200 billion Yuan of which agricultural loans only accounted for 570 billion Yuan, *i.e.* 5.1%. Loans to town and township enterprises were 640 billion Yuan, *i.e.* 5.8%. Even if loans by the Agricultural Development Bank for the procurement of

agricultural products are added, the balance of loans by financial institutions to support agriculture and the countryside only account for 17% of the balance of loans nationwide.

Support for by the Agricultural Bank is growing weaker. Before the mid 1980s, the investment orientation of over 98% of all loans from the Agricultural Bank was concentrated on the countryside. From the mid 1980s to the early 1990s, in order to resolve difficulties in selling agricultural products and to support the rapid rise in town and township enterprises, the Agricultural Bank carried out a major adjustment of the structure of credit and used 60% of credit planned for agricultural credit to support the purchase of agricultural by-products and the development of town and township enterprises. After the mid 1990s, as progress in the commercialisation reform of the Agricultural Bank quickened, the allocation of its financial resources was no longer limited to agriculture and the countryside and its support for rural power grids, transport and communications was strengthened. After the 1990s, its institutional network gradually withdrew from the countryside, the rate of growth of agricultural loans eased, the ratio of take-up began to fall and business was sought increasingly in cities and with industry. Currently, agricultural loans only accounts for 10% of the balance of all the Agricultural Bank's loans.

Rural credit unions need support from all sides. Since the Agricultural Bank has substantially cut back its basic rural business, rural credit unions have become the main financial institution for agricultural loans. Although rural credit unions are formal financial institutions which directly covers a vast area of the countryside with an extensive network, their provision of loans to peasant households is very limited. According to statistics, the scale of loans to peasant households nationwide is 25%. The proportion of agricultural loans in rural credit union loans was 46.2% in 1990 and this had fallen to 34.2% in 2000. After all major commercial banks one by one withdrew from the countryside, dependence solely on the strength of credit in the rural credit union system will by no means be capable of resolving the difficulties of the peasants in obtaining loans.

The role of the Agricultural Development Bank in supporting agriculture is weakening. In its role as a policy-related agricultural financial institution specialising in the supply and management of funds for the procurement of agricultural and sideline products, as the course of marketisation in the buying and selling of grain and cotton has quickened, the room for policy-related operations in the circulation of these products has diminished, and a considerable fall has occurred in the Agricultural Development Bank's loan business for purchasing grain and cotton.

The proportion of bad loans by Chinese rural financial institutions is quite large while credit quality has declined. At the end of 2002, rural credit unions throughout the country had bad loans amounting to 514.7 billion Yuan, accounting for 37% of the total sum of its loans. There is a serious lack of an equivalent part of rural credit unions' capital funds and the business has fallen into a serious predicament. Currently, of the four major state-owned commercial banks, the ratio of bad assets is highest with the Agricultural Bank.

Government control of interest rates has affected the enthusiasm of financial institutions for providing loans. From the perspective of current experiments of limited scope, floating of loan interest rate margins has reached 100%, that is to say, on the basis of an upper limit on current loan interest rates of 5.14%, the actual annual interest rate has increased to 10.3%. Since the amounts of rural loans are small and risks high, corresponding loan costs are also high. Therefore, this scope for floating is still not sufficient for commercial institutions to obtain reasonable repayment of assets and capital to make up their costs. The losses caused to loan providers by strict limits on loan interest are becoming every greater and finally also bring contingent liability to the government.

Micro-finance coverage is low. Drawing lessons from the experience of such countries as Bangladesh, there have been almost ten years of micro-finance experiments in China. In 2001, the People's Bank initiated a project to encourage rural credit unions to develop micro-finance. The coverage of this project was quite broad and, by the end of 2001, there were 32 000 rural credit unions developing a micro-finance service, almost 80% of all rural credit unions, with about 25% of peasant households obtaining loans of this sort. However, the majority of micro-finance projects depend on re-loans from the People's Bank for maintenance and support, have not achieved a definite coverage rate and are not sustainable.

Informal credit is quite widespread. Considering sources of borrowing, the main channel through which peasant households borrow is popular private loans. It is estimated that between 50% and 60% of peasant households have obtained informal loans while the ratio of their popular borrowing exceeds 70%. This is commensurate with a part of town and township enterprises which seeks high interest financing through popular channels. However, informal credit has no legal position.

***Agricultural insurance is contracting and is far from being able to meet the demands of agricultural development***

During the early 1990s, there was large scale increase in rural insurance in China for a time. Later, as financial reform intensified, the People's Insurance Company changed from a policy-related company to a commercial one and was not strong enough to bear excessive losses from rural insurance. Therefore, from 1994, the scale of rural insurance fell year by year with income from premiums falling from over 800 million Yuan in 1993 to under 400 million Yuan in 2001. Hence, it was very limited where the distribution of agricultural insurance risks and the provision of agriculture with economic compensation were concerned. Since the 1990s, when natural disasters in China have been exceptionally serious with crops suffering disaster remaining constantly above 30% and the rate of disasters staying at over 50% with a maximum of 60.9%, the supply of insurance for the cultivation industry as part of agricultural insurance did not increase but instead fell. The function of agricultural insurance of providing economic assistance to agriculture could not be fully brought into play.

***The proportion of foreign commercial investment in agriculture is very low***

By the end of 2000, the number Chinese agricultural projects absorbing foreign commercial investment by only accounted for 2.85% of the total number of foreign commercial investment projects while contractual foreign commercial investment funds stood at only 1.82% foreign commercial investments nationwide. After 1997, the proportion of actual foreign commercial investment in agriculture to total foreign commercial investment was respectively 1.39%, 1.37%, 1.76%, 1.66 % and 1.84%, which were far from being commensurate with the position of agriculture in the national economy. The average scale of individual foreign commercial investments in agriculture is small, there is a single field of investment, the proportion of funds actually made available is small and areas of distribution are uneven. Currently, 70% of Chinese agricultural projects absorbing foreign commercial investment are concentrated on such coastal areas as Guangdong, Fujian and Shandong while areas of the centre and west, which urgently need capital, can rarely import foreign capital. At present, the Agricultural Bank transfers loans down in accordance with the World Bank interest rates for hard loans. More interest is added with each layer of transfer so that, when transferred to a grass-roots bank, the interest rate is quite high. In addition, World Bank loans are generally long or medium term loans, during the loan transfer process, the unit implementing the project is required to repay the loan in advance and this also adds to its burden. If the unit of account for the loan is US dollars, interest rate risks are borne by the unit implementing the project.



***Use of the stock market for raising funds for agriculture is limited and changes to the investment orientation of funds raised are quite serious, affecting the growth of the main business and operational achievements of agricultural companies.***

### **3. Direction of policy development from now on**

#### ***The formation of channels for the stable growth of investment in basic agricultural facilities***

Currently, the main support for basic agricultural facilities is national debt funds. Since 1998, national debt funds have continuously accounted for more than 70% of capital construction investment in the central authorities' annual budget. From now on, if government loans cease to be issued, agricultural investment will fall by a big margin. Over the last few years, the Chinese economy has maintained fairly rapid growth and central financial income has been comparatively large and the pattern of distribution of national income needs to be adjusted so that the mechanism for the steady growth of investment in basic agricultural facilities is formed. The government's newly increased financial capacity should incline investment towards basic agricultural facilities.

#### ***In accordance with the need to establish a system of public financial administration, the direction of the use of public financial funds for supporting agriculture should be adjusted***

First, the WTO's "Green Box" policies should be fully used to increase investment in such areas as agricultural scientific research and publicity, quality, safety and inspection and testing, facilities for the circulation of agricultural products and training of peasants.

Secondly, subsidies for intermediate links in circulation should gradually be reduced and a system of direct subsidies for peasant incomes established. In recent years, the state financial administration has invested a huge amount of capital for use in subsidising intermediate links in the circulation of agricultural products such as grain and cotton. Practice has proven that the effectiveness of such practices is low, the benefits to agriculture and peasants are not great and reform is needed. The direction and measures of reform are as follows. The financial administration's methods of subsidy should be improved with the gradual adoption of direct subsidies for peasants. For example, the risk funds for the main agricultural product markets (such as the grain risk fund) should be transferred to a direct subsidy for peasant incomes. A system of direct subsidies for the use of advanced technology by peasants should be established. Part of the export subsidies for agricultural products should be transferred as a direct subsidy for peasant incomes. The Chinese government has issued an undertaking not to use export subsidies for agricultural products. In 2001, export subsidies for Chinese grain and cotton were 2.7 billion Yuan. After entry into the WTO, China undertook to follow a policy of not subsidising the export of agricultural products. It is worth considering transferring this part of the subsidy as a direct income subsidy for peasants in grain and cotton producing areas. Ecological and environmental subsidies for peasants should be increased. The opportunity presented by the supply of grain still being higher than demand should be seized and increased allowances should be given to peasants turning ploughed land over to forestry and pasture.

Thirdly, the central government's responsibilities for supporting basic rural education and rural public health should be enhanced. Basic education is a most typical public product. If the central government's necessary financial resources are lacking, a serious imbalance in the development of basic education is bound to arise. The central administration's basic education investment should be biased towards basic rural education in central and western areas and other places experiencing difficulties in order to promote the approximately even development of basic rural education in different places. Practice bears out that with responsibility for rural public health services mainly resting on county and townships, it is completely impossible to guarantee investment of funds. A rural

public health service is a government function and investment in it should be guaranteed through the establishment of a special payment transfer system earmarked for rural health work. The key focus of rural health funds should be the support of town and township clinics in developing a public health service.

Fourthly, public financial investment to aid the poor should be increased and the structure of use of such funds should be altered. From the point of view of developing aid for the poor, China is still faced with an enormous task. On the basis of an investigation of the State Statistical Bureau monitoring rural poverty throughout the country, at the end of 2002, the rural population in absolute poverty throughout the country was 28.2 million, a reduction of 1.1 million from the end of the previous year, with a poverty occurrence rate of 3.0%. The low-income rural population, where problems of food and clothing have initially been solved but not in a stable manner, was 58.3 million, a reduction of 2.8 million over the previous year. As a proportion of the rural population, the low-income population accounts for 6.2%. On the basis of World Bank statistics, there are 106 million persons in China, equivalent to 11.5% of the rural population, whose daily expenditure is less than one US Dollar. In the years between 1994 and 2000, when the investment of funds to aid the poor was at its maximum, the central government's annual investment of funds to support the poor rose from 7.7 billion Yuan to 24.8 billion Yuan with the cumulative investment over seven years reaching 112.7 billion Yuan, an annual *per capita* investment of only 200 Yuan. Most of the impoverished population of China is concentrated in the economically and socially undeveloped minority nationality areas of the centre and west where natural conditions are very bad. Not only is direct investment in production-related capital required but also much needs to be invested in improving basic facilities and basic living conditions such as power, transport, communications, education, health and drinking water for humans and livestock. Relative to such requirements, a level of investment of 200 Yuan is far from adequate. On the basis of the experience of World Bank loans for Chinese projects to aid the poor, *per capita* investment to solve the problem of adequate food and clothing in a stable manner would be 5 000 Yuan. Previously, China focussed its resources to aid the poor in production projects or construction projects for basic facilities connected to economic development. Investment in long-term social development and human capital construction projects was inadequate. An examination of the allocation of state expenditure to aid the poor between 1991 and 1995 shows that 60% of funds to aid the poor was allocated directly to production, with 29% for agriculture and 31% for industry. Basic facilities accounted for 35% of the total expenditure while expenditure on education and public health was less than 2%. The levels of education, public health and nutrition among the impoverished population of China are still low. In order to realise the aim of aiding the poor, more help to the impoverished population should be given with the provision of more support for social development matters so that they have the conditions for basic education, health and nutrition.

### ***Promote a comprehensive reform of the rural financial system as a whole***

A fundamental resolution of the current outstanding problems of Chinese rural finance cannot be confined to minor repairs and adjustments to the current rural financial system. It is necessary to have the system as a whole in mind and again perform functional orientation and adjustment of the Agricultural Bank, the Agricultural Development Bank and the rural credit unions with the aim of establishing a more complete, more vigorous rural financial system which truly serves the "Three Agricultures" and in order to promote a comprehensive reform of rural finance. The key points of the reform of rural finance are as follows.

In the first place, a thorough solution should be found to such problems commonly found in rural credit unions as unclear proprietary rights, incomplete legal person administration, comparatively low levels of management together with a lack of effective inspirational mechanisms and control of insiders. The overall demands put forward by central government with regard to the reform of rural

credit unions are that property right relationships should be clear, the mechanisms of restraint should be reinforced, service functions should be strengthened, there should be appropriate state support and that local governments should be responsible. As a result of the differences between places throughout the country, it would obviously be inappropriate to compel rural credit unions to reform in line with a centralised model. Currently, there are two schools of thought about this reform. The first is that rural credit unions should be reorganised as institutional structures. If business is reasonably good in developed areas and it is more appropriate to commercialise the running of credit unions, they should be changed into local joint-stock commercial banks. Such a structure has the localisation of proprietary rights and autonomous, independent management as its basis. The second type is to reorganise rural credit unions with a stratified setup. Drawing lessons from the successful experience of the development of co-operative banking abroad, credit unions can be changed into truly co-operative financial organisations. Otherwise, the current rural credit unions can be changed to the grass-roots network of the Agricultural Development Bank of China with policy-related loans as their main business. This second type of thinking is mainly suitable for areas where the level of economic development is rather low, which lack the necessary knowledge and skills of risk management and other financial operations. Whichever type of organisational form is adopted, it is necessary that problems of unclear proprietary rights and poor legal person administration. Only in this way can there be a true solution to the problem of the government actually always having final overall responsibility for the bad loans of rural credit unions.

In the second place, problems of interest rate controls and the lack of an effective supervisory framework should be resolved. The negative effects brought about by interest rate controls are not only distortion to the price of using funds and irrationality in the allocation of financial resources, the level of earnings by commercialised financial institutions in the rural financial market is also directly affected. The floating of interest rates on a large scale should be realised on the basis of market demand, with the interest rate controls gradually relaxed so that the demand for commercialised financial institutions to carry on financial activities in the rural financial market can be met. The establishment of an effective supervisory framework will not only strengthen supervisory staff but, more importantly, should enhance ideas about supervision, improve supervisory technology and raise the quality and efficiency of supervision.

In the third place, a rational system of rural financial institutions should be formed. The heavy burden on rural credit unions should be removed and ability to support agriculture strengthened. A solution to the current cumulative losses and dead or bad debts of credit unions amounting to 400 billion Yuan is a prerequisite for the strengthening of their ability to support agriculture. With regard to the sedimented funds of rural credit unions formed as a result of all the state policies during the reform period, such bad loans should be cut out in the light of the policies for the state-owned commercial banks. With regard for rural credit unions where there is no hope of saving them from decline and no prospect of continuing, they should be resolutely shut down. The state can learn from the experience of co-operative finance abroad and exempt interest income from agricultural loans from business tax, reduce income tax, lightening the burden on rural credit unions. The Agricultural Bank of China should mainly provide comprehensive financial services for agriculture and rural economic development. A certain ratio of the deposits taken in by the Agricultural Bank in the countryside should be used for rural credit. The state should guide commercial banks through such policies as tax revenue to using a certain proportion of their funds for agriculture. Policy-related finance is an important means of giving support basically meeting the requirements of the WTO agreement and in general use in all countries throughout the world. The Agricultural Development Bank should be re-orientated and genuinely play the role of a policy-related bank. The entry of non-state-owned capital into the banking sector and small-scale commercial banks under development should be permitted. Other motivational policies should be provided to encourage other commercial banks to

serve rural development. Micro-finance should be developed in the direction of systematisation, institutionalisation and sustainability.

***The establishment of a policy-related agricultural insurance organisational system***

A policy-related insurance system, directed from above by the government, should be established running with high supervisory costs. A co-operative management model and mutual insurance operational model, both with government support, have been quite successful in some countries and pilot schemes might conditionally be encouraged in some places in China. However, since Chinese peasants lack a tradition of co-operation and knowledge of insurance, it would be difficult for these two management models to become the main models for agricultural insurance in China. Since shareholder investment is made in order to obtain earnings and agricultural insurance risks are high, an agricultural insurance joint stock limited company model with government support would probably not be attractive. Therefore a government-led model should be established combining government and commercial insurance company management to act as the leading form of rural insurance in China.

***Channels for funding resources to support agriculture should be widened and a pluralistic funds investment system should be established***

According to relevant research, the overall investment in agriculture by Chinese society was 1 200 billion Yuan. Of this, agricultural credit investment accounted for 40%, independently-raised peasant investment accounted for 37%, government investment at all levels accounted for 17% while other investment (including listed companies and foreign capital) was only 6%. This shows that investment in agriculture by industrial and commercial enterprises, the capital market and foreign firms was extremely low. When seen from the perspective of developmental trends, China has great potential to be tapped through encouraging investment by social investors, developing the stock market and using foreign capital to raise funds. A multi-channel, pluralistic rural financial setup should gradually be created with individual investment by peasants as its mainstay, guided by state policy-related investment and supplemented by such funding as credit and foreign capital. In order to make social agricultural investment more attractive, it is necessary to further establish the means of encouraging agricultural investment through fostering support of agriculture through the support and guidance of public finance. The state should give preferential treatment and encouragement to agricultural investment through such means as tax revenues, subsidies and discounted interest in order to attract social financial investment in agriculture. It should alter the methods of investing public finance, reduce projects directly run by the government and increase support for projects run by peasants and society. It should also encourage the use of profits from agriculture for reinvestment in agriculture through such policy measures as preferential tax revenues. An improvement environment for investment will tap the potential for using foreign capital.