Chapter 4

Three-Agro Policy, Financial Institutions and the Pork Industry

The so-called "Three-Agro" problem, or "agriculture, countryside, and farmer" deeply involves political, economic and social activities in China. From a financial perspective, this problem encompasses ways to deliver financial services in order to serve agricultural enterprises, townships, village enterprises (TVEs), and farming households. These services have previously been delivered to large-scale, agro-linked corporations, but further efforts are now needed to deliver these services to SMEAs, small and medium-sized enterprises in agriculture.

1. Effective Three-Agro Demand for Financial Services

Along with the building of a new socialism in the countryside, structural changes in economic growth models and proceeding with the industrialization of the agriculture sector and urbanization of rural areas is resulting in the growing need for funds and diversified financial services. This section will outline these factors and the extenuating effects on financial services and policies.

1.1 Modernization and structural transformation in the agriculture sector

During the period 1989 to 2004, the value of outputs from the agriculture sector increased from RMB 422.8 billion to RMB 2.1 trillion, realizing an annual growth rate of 11.20%. At the same time there was a substantial structural improvement as the proportion of livestock grew from 27.60% to 33.60%. In 2006, the Chinese Ministry of Agriculture launched a series of initiatives for building a "new socialist countryside". These initiatives included a grain productivity boosting campaign, agriculture and poultry construction projects in 100 key counties and cities across the nation, and 30 demonstration agricultural and poultry districts used to set nationwide standards. As a result of these measures, this period witnessed phenomenal progress in the modernization of the agriculture sector and large increases in the amount of capital demanded from the financial sector.

1.2 Infrastructure construction in rural areas

To build this new countryside in the rural areas, heavy investment in infrastructure is needed for roads, irrigation and drinking water facilities, telecommunication, education, health care, and culture and entertainment services. In implementing the government's Eleventh Five-Year Plan to establish a transportation network connecting all counties and villages, the central government decided to disburse RMB 100 billion for building 19,000 kilometers of roads. By the end of 2004 the rural cooperative medical services had covered 22.5% of the rural areas, 8.1% of the total rural population was under the coverage of rural endowment insurance, 53% of the total villages were provided with tap water, and 47.8% of the total villages had access to cable television programs. In counties that were better off, the percentage for medical services, insurance, tap water supply, and cable television services were significantly higher at 60.4%, 14.5%, 85% and 91.8%. Through many rural areas realized an improvement in services of the last few years, there is a lot of room for further development.

The installed capacity of small hydropower stations accounted for only 29% of the total untapped potential as of 2004, representing no more than 10 million kilowatts. There are still 750 million people in the rural areas without access to power supplies and many of these small hydropower stations were scattered throughout remote mountainous areas, beyond the reach of the major power grids. For those areas that long-distance power transmission is currently unfeasible, the local people will have to resort to constructing small hydropower stations. According to the Eleventh Five-Year Plan, an additional 14 million kilowatts of installed capacity is needed and will require and estimated investment of RMB 80 billion.

If we estimate the unit costs of some of the infrastructural improvements outlined in the Eleventh Five-Year Plan, we get a distinct picture of the need for capital and financial sector service delivery. Assuming that per kilometer of road and for communication services networking to administrative districts are RMB 300,000 and 200,000, respectively, constructing 1.2 million kilometers of road and connecting 20,000 villages will cost approximately RMB 364 billion. Additionally, if it costs RMB 600 and 350 per household for power and water supply installation, respectively, it will cost RMB 6 billion and RMB 35 billion to provide 10 million people with power and 100 million people with water. The total sum of the capital gap for the construction of these infrastructure projects will come to around RMB 400 billion. One of the primary difficulties in securing financing for these kinds of infrastructure projects is that they tend to have high capital costs and very low returns given the relatively long terms of lending.

1.3 Urbanization of rural areas

In 2004 there were 19,171 small towns nationwide, accounting for 19.5% of the total population. Accelerating the development of small towns is becoming increasingly important. Most township enterprises are currently located in rural areas, but within the implementation process of the Eleventh Five-Year Plan, township enterprises are encouraged to locate themselves close to the towns and counties. Statistics from the State Development and Reform Commission and State Council Research and Development Center showed that in the next ten years, urbanization of rural areas would need loans of around RMB 400 billion to 1100 billion to support construction of communications networks, roads, water supplies, residential properties, municipal infrastructures, and public facilities. At present, rural urbanization relies more on fiscal revenue and private investment than bank loans.

1.4 Rural non-agricultural sector development

The rural non-agricultural sectors include organizations for economic cooperation, leading enterprises, and all kinds of small and medium-sized enterprises (SMEs). In 2004, employees working in these sectors exceeded 180 million. The Eleventh Five-Year Plan also encouraged the further development of labor-intensive and service industries and to establish professional organizations for economic cooperation. Currently, there are only 23.63 million members of professional organizations in rural areas, which represents only 9.8% of total farming households. Professional organizations for economic cooperation, needing funds for procuring production materials, providing technical services, acquiring agricultural products, and constructing facilities for post-harvest processing purposes, have often suffered from lack of registered capital. Because they can only extend very small amounts of fixed assets as eligible collaterals, or resulting from undisciplined management, they often have problems when applying for bank loan support[1].

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[1]Examples: The rural cooperative of Bajiazi Village, Chaoyangpo Town, Gongzhuling City, Jilin Province, planned to build up eight live-hog plants, each needing approximately RMB 800,000. However, the funds applied for still have yet to be obtained. The Duck Breeding

In recent years, the industrialization of agriculture picked up pace. It is the goal of the Ministry of Agriculture to develop one hundred leading industry clusters in the field of plantation and specialty production by the year 2010. To meet this goal, there is a great demand for capital. In 2005, only leading agriculture-linked enterprises in Shandong generated revenue over RMB 300 billion and the city of Lin Yi alone had 1057 leading enterprises engaged in food, vegetable, and tobacco manufacturing. Among these 1057 leading enterprises, one is at the state-level, 20 are at the provincial level, and 130 are city level enterprises.

A significant number of industry clusters involving SMEs have also taken shape in some areas. The total number of SMEs in China amounted to 30 million by end of 2005. Zhejiang Provinces alone had 604 industrial clusters whose output values exceeds 100 million RMB, 283 clusters over one billion RMB and 35 clusters over the 10 billion. The output from these clusters contributed to 60% of the province's industrial total. Shengzhou neckties, Wenzhou shoes, Haining leather, Yongkang hardware have become industry clusters widely recognized nationwide. During the Eleventh Five-Year Plan period the state will intensify its support to technological innovation, and help SMEs expand into the international market. The expansion of SMEs will usher in a new development era. The central and local governments have strengthened their support for these organizations. The fiscal bureau of Shandong Province in 2005 alone arranged RMB 200 million to help these leading enterprises, pelagic fishing companies, and peasants' organizations for economic cooperation.

From a perspective of financial demands, we can classify leading firms in the agro-industrialization into two types, fast developing SMEs and matured agricultural firms. Developing SMEs are in the stage of initial development or rapid expansion; they normally need substantial capital to fill funding demands and their own poor capital accumulation. They need not only short-term liquidity loans, but also medium to long-term loans for technology upgrades and fundamental construction. These newly developing SMEs do not have much in terms of credit records, qualified collateral, or complete financial information, which means bigger risk, harder management, and higher costs for corporate loaning by banks. This results in funding demands by SMEs

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Association of GongAn County, Hubei Province's 210 members and 5000 farming households were repeatedly denied access to loan facilities, eventually being forced to rely on private fund-raising channels shore up its capital gap.

that are difficult to meet. For example, Hog Wholesale Market in the town of Huaide, Jilin Province invested more than RMB 1.2 million in construction in 2006, which included RMB 700,000 in housing construction and RMB 500,000 in pigsty construction. The market had to rely on self-raised funds for all investments because the credit cooperatives had limits on the amount of available credit and the Agricultural Bank of China (ABC) required collateral for loans of more than RMB 500,000.

The funding situation is markedly different for well-developed large agricultural corporations resulting from their having more stable profits and good repayment capability. Their loan demands come mainly from the incentive to increase production capacity, upgrade technology, and expand market penetration. These corporations are the primary focus of marketing for all commercial financial institutions. However, they still have problems with the seasonality of some purchasing funds for both agricultural products' retail and processing corporations. Most corporations face problems of inadequate collateral because they need to purchase raw materials seasonally, but process the entire year. This creates an assets-liabilities ratio higher than standards normally set by financial institutions. The above analyses demonstrate the higher costs and greater difficulties agricultural corporations face in getting bank loans compared with other non-agricultural corporations.

1.5 Development of logistics in rural areas

Construction and development of logistics in rural areas has become more urgent with the prosperity of rural area economies and urbanization, which has brought increasing demand for liquid funds. The Ministry of Commerce planned to build 250,000 new village supermarkets in the rural area by 2008, covering 70% of towns and 50% of villages. The National Supply and Sales System planned to complete the reconstruction of the traditional National Supply and Sales System Networks in order to set up more than 200 regional companies at the town and village levels in 20 provinces and then integrate over 30,000 village retail networks covering 700 smaller villages around the areas, or one-third of the villages nationwide. During the period of the Eleventh Five-Year Plan, the Ministry of Agriculture will focus on building up 500 wholesale markets for agricultural products and the Ministry of Commerce will restructure 100 large-scale, wholesale markets for agricultural products and strengthen the capacities of 100 large-scale agricultural products logistics companies.

1.6 Integration of urban and countryside

The promotion of building “new countryside” and city-expansion has contributed to the convergence of towns and villages around large cities. The development of this convergence has increased the fundamental municipal facilities and created a large number of residential, commercial, and office buildings. At the same time, the commerce, catering, and other have absorbed a lot of workers from rural areas. Those who lost their fields become citizens and are taken in by the urban social security system. Urban industries have accelerated diversion and expansion to suburban districts, while urban agriculture continues to grow in the same areas. Because of all of these factors, a variety of financial services have become increasingly necessary. Thses services include not only development and liquidity loans, but also large amounts of credit, fund settlements, and bank cards.

1.7 Financial demands from village residents

Financial demands by village residents include credit demands for production and financial demands for labor transfer. Labor transfer-related financial supports are mainly start-up funds for those who want to change jobs and work in the cities. These start-up funds generally include training fees, travel fees[2], basic living expenses, and funds for workers to return to villages or start their own businesses. Household-level farmers normally do not have the ability to obtain funds for buying seed, agricultural chemicals, fertilizers, and feed. However, funding options those for professional large-scale farmers are relatively much more because of the scale of production and operations. The financing demanded by large-scale farmers is quite large and mainly for participation in the agricultural product circulation process. This included transportation, tourism, and connecting with retail canteens and corporations.

In less developed areas, farmers’ demands for funding take the form of consumption loans and are mainly for fundamental emergency expenses, hospitalization, and education. In more developed areas, consumption credits are used in building or purchasing houses, or for buying vehicles. In both of these cases, these loans are financed mainly through personal credits or credit associations due to lack of qualified collateral or pledges. These demands are expected to change drastically along with

[2]Some areas have explored new options. For example, the Rural Area Credit Associations in Heilongjiang Province set up labor export loans for farmers providing joint guarantees, collateral, or pledges, which has realized substantial, positive results.

increases of farmers' incomes. As incomes increase, those living in rural communities will not only need traditional banking services like deposit accounts, money exchange, financial settlements, and bank cards, but also mortgage loans, consumer loans for durable goods, wealth management services, and electronic banking.

2. Reasons for Insufficient Supply and Irrational Structure of Finance

Despite strong rural financial demands, there are many financial sector difficulties that have been brought about by the rural-urban dual structure in China and need to be addressed. In rural areas, potential client groups are generally scattered and their financial needs at a primary level. Crop production and comparatively low commercialization levels keeps farm sizes small, causing farmers to be easily affected by natural disasters. Because of these basic conditions, commercial banks and other financial institutions in rural areas suffer from high operational costs and risk, long turnovers, and low returns. Farmers' financial needs in this situation and under these conditions cannot be satisfied efficiently. Capital outflows and difficulties in getting loans are a couple of outstanding contradictions depicting the reality in rural financial systems. SMEs and farmer households greatly rely on the rural credit cooperatives (hereafter, RCC)equity funds and non-governmental credit.

The supply structure of rural financial products and services is irrational. Geographically, the outstanding balance of deposits and loans in the eastern regions accounts for 60% and 57% of the national totals, respectively. As a result of insufficient outlet coverage and financial supply, the comparative loan percentages of the middle, western, and northeastern areas are 14.9%, 16.4%, and 7.7% respectively. From an industry perspective, agricultural-related lending portfolios mainly tend to focus on large-sized companies and construction projects in key industries such as coal, electricity, and mining. These financial service portfolios are low on ordinary agriculture product processing enterprises, farmer households, township enterprises, and small businesses in countryside areas. The following sections attempt to detail the main reasons for this insufficient supply and irrational structure of rural financial services.

2.1 Imperfect collateral system and credit environment

Generally speaking, most agricultural-related enterprises are small. They face challenges from natural disasters and severe market competition. To provide financial services directly to these small agro-businesses come with high operating costs for banks. The current corporate credit rating system is designed based on the conditions of medium and large-sized enterprises in urban areas. Because of this, rural SMEs are typically underrated.

At the same time, rural credit guarantee and insurance systems are not perfect. Foremost is that under these systems several guarantors are needed. Cooperative agricultural production organizations and industry associations do not fit very well in the guarantor system. Secondly, farmers tend to lack of sufficient collateral. For banks, only land and properties are generally acceptable collateral, while personal property mortgages, depot bills, and contract bills are not. Farmers lacking sufficient certificates and limited by law regulations find that their biggest properties, such as houses and land, cannot be used as collateral. Most rural SMEs lack relevant policy supports and their rights to the use natural resources also cannot be used as qualified collateral. The imperfect guarantee systems and credit environments discourage banks from lending to rural SMEs.

2.2 Insufficient innovation in rural financial services

In the countryside, most of agricultural related clients are SMEs, along with some micro-businesses. Past domestic financial institutions' entire operational modes, lending procedures, and technologies have not been in line with the realities of SME clients. Also, the current lending systems are not suitable for agro-businesses, especially regarding threshold controls, guarantees, authorized credit, and internal processes. For example, banks' credit supplies are mismatched to the needs of rural SMEs' funding. Compared to most rural clients' long-term loan requirements, the agro-related lending's terms are often limited to within 12 months. Recently, according to agro-related loans characteristics like small-volume, short-term, and urgent needs, financial institutions have refined their rating system, optimized business procedures, and built a set of specific credit management systems. They are also developing some new products. ABC launched a “Golden Ear Agro Support Card” for easy application of micro financing where cardholders can employ six financial services. These services include micro financing supporting, revolving credit, money transferring and remittance, bill payments via internet banking, getting loans for production and personal consumption, as well as cashing agro subsidies.

2.3 Bank outlets difficulty to survive in poorly developed, rural area markets

At present, the country's agricultural financial system is a diversified financial body, consisting of the Agricultural Bank of China (ABC), the Agricultural Development Bank of China (ADBC), Rural Credit Cooperatives (RCCs), the Postal Bank, and Agricultural Insurance as well as newly emerged township banks. The system however, is not in line with the development requirements of the agricultural industry, farmers, and county land. RCCs have not provided continuous support to farmers, financial institutions' agro-supporting functions have been weakened, political financial institutions' agro-product line has been imperfect, postal banks have misallocated farmers' liquidity to urban areas, and non-government finance has not yet been legalized. Furthermore, in some less-developed areas, the small size of deposits and loans cannot even support the construction, or sustain the costs, of local outlets. Under the pressures of business operation requirements, the big four banks have had to withdraw large numbers of outlets in counties and rural areas. In addition, RCCs represent the majority market share in rural areas, primarily because of the single procurement service of ADBC. We can see through these examples that there are many anomalies regarding competition in the rural financial systems of China.

2.4 Regulation and policies affect ABC's influence over rural financial markets

Banking regulations are a set of universal standardized criteria and are not in compliance with the realistic situations of rural areas, especially those of the middle and western areas with small deposit and loan balances. The policy for agro-related financial services is therefore currently insufficient. The People's Bank of China (PBOC), China's Central Bank, takes the same policy on reserve rates, discount rates, and benchmark interest rates, which discourages banks' willingness to lend money to farmers. From the perspective of finance policy, commercial banks are not entitled to tax preference and financial support in network construction and lending businesses in less-developed areas, which is the main reason for insufficient financial supply there.

Other reasons include the lack of an effective credit guarantee system and that agricultural insurance is not yet well developed in most counties. Agro-businesses have limited access to equity markets and depend too much on indirect finance. Also, the roles of political finance and commercial finance have not been defined clearly. Too much interference by the government has resulted in the destruction of the credit environment. The rural credit information system is still very backward and the legal environment in rural areas is also not in a good situation so for financial institutions, the cost of defending loan rights is high. In many cases, financial institutions may win the lawsuits, but remain unable to collect on their loans because of lack of enforcement.

3. Desirable Policy Support for Rural Financial Development

According to historical statistics on total investments from fiscal inputs, lending, and social contributions for rural development, even with the growing amount of fiscal inputs earmarked for establishing the “new countryside” society, a major part of construction funding needs were financed by banks. This exemplifies the importance of promoting commercial financial institutions’ active involvement in rural financial markets. Rural financial development experiences in the U.S.A., Europe, Japan, Brazil, and Indonesia show that governments should be responsible for providing supportive incentives and good investment environments for financial institutions to participate agro-financing businesses in order to upgrade rural financial supplies and promote the sustained, healthy growth of financial institutions involving agro-business. Without government policy support, it is difficult to develop sound and steady rural financial systems. Necessary government supporting policy is critical for encouraging financial institutions to manage agro-linked business, especially during the primary rural financial development stage.

3.1 Innovating rural credit collateral and guarantee policies

To solve the so-called “hard for collateral, hard for guarantee” problem of rural lending businesses, suggestions for government policies include setting up fiscal rural funds and establishing experimental rural credit guarantee funds that specialize in guarantees for agro-linked loans financed in all county levels of central and western China. Based on improved property rights and guarantee laws, these policies could work to stipulate the implementation details with innovations for collateral policies that would include transforming accounts receivables, inventories, and other non-fixed assets into eligible collateral. Also, mortgage pilot policies should be created which could cover collective construction land and legal farm housing land rights as well as gradually extending collateral and guarantee coverage according to local countryside reality. Through such innovations, it will greatly loosen and extend the potential supply of rural credit, resulting in effectively expanded rural market space for rural financial institutions[3].

3.2 Setting up rural insurance mechanisms

Agro-production is easily affected by natural disasters and changing physical and market climates. The main agricultural economic entities including farming households, SMEs, and individual businesses are all generally small-scale operations with low risk-preventing capacity. All these factors combine to a comparatively high risk in agro-linked lending businesses and thus result in high non-performance loans (NPLs) ratios. According to experiences in Brazil and France, rural insurance is an effective way to compensate for losses from natural disasters and to reduce market risk, as well as to ensure farmer households' income. As policy restricting land utilization and eligible collateral shortage constrain rural financial institutions from the issuance of loans to rural households, the rural insurance is especially important in China.

The slow development of rural insurance in China is mainly due to high risk and high loss ratios in rural insurance. For example, the rural insurance premium was RMB 460 million, less than one percent of total non-life insurance premiums, in 2003. Therefore, one suggestion is that the government should quicken its pace in building comprehensive rural insurance mechanisms; encouraging and guiding various insurance institutions to provide insurance products and services which are suited to agriculture the needs of farmers. It should also assist financial institutions in setting up joint commercial insurance companies to provide special rural financing guarantees, gradually establishing rural policy-insurance and rural re-insurance mechanisms, and improving the development of agro-futures market, so as to de-centralize and transfer risk in agro-production and build a sound base for rural financial development.

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[3]To solve the problem of rural lending guarantees, many financial institutions have made innovative localized guarantee policies, such as loans with mortgages on farming machine, purchase orders, and forest utilizization rights, and achieved sound performance. The ABC Sichuan Branch designed a "six-party cooperation plus insurance" model to support a pig-raising project (six-party here means the bank, the Agricultural Guarantee Company, the feed supply company, the pig farm, the farming household cooperative, and the meat processing company). The ABC Fujian Branch issued loans based on forest asset mortgages and assisted in setting up a joint-venture guarantee company of local government and farming households. Both branches received good results through such innovations, but more policy support from government is needed.

3.3 Promoting rural financial institutions' cooperation and building financial service platforms

At present, though rural financial systems continue to improve, there still exist problems in risk control, such as where local governments consider only its own infrastructure construction and resources cannot be shared. The suggestion here is that the government should integrate the office network, system platforms, and customer information of rural commercial policies and cooperatives, as well as newly established financial institutions. Through this, exploration into the establishment of uniform rural financial clearing platforms at the county level can be undertaken.

This has the benefit of strengthening inter-banking cooperation, mainly on credit asset re-purchase, and inter-bank borrowing and deposit. It will also allow for exploring branch network efficient utilization regarding agent settlement (domestic and international), bill issuing, bill exchange, payment and collection, fund transfer and clearing, bond trading, and repurchasing. Promoting cooperation on human resource and information exchange, as well as client service through trust asset management, agent small amount NPLs collection, joint business databases, and institutional development assistance will also help to add value. Finally, benefits will be realized through establishing joint service platforms for better services targeted at county level economic entities. These services platforms could include consortium agent services, syndication loans, package loans, asset managements, uniform cash management, and free cross-bank booking transfer. These measures would be good not only for solving problems existing in rural fund transfer and exchange between rural financial institutions, but also for leading their cooperation on traditional business, banking cards, and staff training so that institutions could work jointly against various debt escaping and in build sound county level economic and financial orders.

3.4 Massive subsidies in special regions

Many regions in Tibet, Qinghai, and Xinjiang are deserts with extreme climate conditions. These conditions and shortages of financial clients prevent financial institutions from operating in sustained commercial way. According to commercial principles, most financial outlets in those regions should be closed. However, the financial institutions, as the state financial policy executors in minority areas, have been taking on special functions in supporting local economic development and providing needed public financial services. Thus, the suggestion is that the state government should provide the financial institutions with a transitional subsidy to compensate for overheads and investment in fixed assets and IT systems and establish rational risk compensation mechanisms according to returns on loans in order to ensure the loans are profitable.

3.5 Improving rural social credit systems and building comprehensive rural financial service mechanisms

In order to improve rural social credit systems, there are several measures that need to be carried out. First is to include the rural social credit system in the national social credit information system and implementing necessary punitive measures for credit defaults, along with educating people about credit culture. Second is to update and revise current bankruptcy laws and regulations, enhancing related execution and protecting the rural financial legal environment as well as strictly punishing debt-dodgers in order to guard the sound economic and financial order in rural areas. Last is to rationalize the rural financial agent market, reduce price standards, improve efficiency, and to take improvement of the financial environment into the government's target performance evaluation and execute related supervision.

Enhancing local government's coordination on local financial system construction would allow various tiers of governments to collaborate, increasing performance. Supporting local financial regulators on coordinating financial institutions' services and management, upgrading local financial institutions' capital adequacy and NPLs coverage ratios may also help to effectively prevent a financial crisis. In addition, they should build good, reputation-based, social credit mechanism with clear incentives and punishments.

3.6 Favorite fiscal and monetary policies for rural financial institutions

To make a fair, competitive, and incentive-based rural financial market environment, the government should regulate at the county level the portion of incremental deposits raised by financial institutions for lending according to local rural financial supply conditions and evaluate the relevant performance. Financial institutions that are able to reach the set targets should be given the same favored fiscal and monetary policies as are enjoyed by local RCCs. For those institutions that continue reaching targets for three years, let them enjoy another round of favorite policy treatment. Also, governement policy should encourage and guide financial institutions at the county level to provide diversified financial services on the pre-condition of fund safety.

RCCs have enjoyed special fiscal and monetary policy, mainly in terms of income and operating tax exemption, differential deposit reserve ratio, and greater decision-making on pricing. The State Council's series documentations on deepening RCCs' trial reform were issued in 2003 and 2004. These reforms were effectively implemented through two pilot programs, one beginning in each year, where RCCs were given 6 years of favored taxation treatment. RCCs in central and western provinces participating in the pilot program enjoyed income tax exemption and RCCs participating in other areas had their income taxes halved.

In line with newly promulgated taxation laws beginning in 2008, all banks registered in China will enjoy the same 25% income taxation rate. Based on some preferential clauses indicated in these laws, we suggest 15% or 20% income tax rates for all financial institutions involving agro-linked business, or in certain regions, execute different tax rates on financial institutions providing for agro-businesses in minority and border areas, national poverty counties, provincial poverty counties, and grain producing areas. For example, we suggest applying international practices to the transfer of operating taxes to value-added taxes by first piloting transfers in poverty areas and then extending nation-wide, adjusting the operating tax base of agro-business by financial institutions from loan interest income to interest margins. At the same time, release the restriction on loan price ceilings for commercial financial institution at the rural county level and permit them to implement the same pricing policy on loans as micro-financing company and village banks (four times the central bank's benchmark rate), increasing their provision ratio to 2% and making adjustments before counting the pre-tax base. Through such differential loan pricing and adequate provision, the credit risk can be covered effectively.

The Ministry of Finance at different administrative levels must guide agro-linked business through investing part of rural fiscal funds as loan guarantee funds in order to lead commercial financial institutions supply rural markets. They should also guide through interest subsidies for agro-linked loans where commercial financial institutions would then be able to charge borrowers lower interest rates, releasing the rural borrowers' burden and gradually attracting more commercial financial institutions for lending in agricultural and rural markets and for important government projects in rural areas. Another measure administrations could take is to provide a fiscal fund as a rural risk fund for banks' agro-linked NPLs write-offs.

The People's Bank of China should reduce the deposit reserve ratios for financial institutions involving rural business according to the related business sizes, assisting their cash supplies and settlements as well as guiding funds flowing into rural markets using macro controls. For financial institutions with funding problems, the central bank should give them temporary fund support and permit banks in poverty areas to deposit less or no required reserves. In terms of interest rate, the central bank should permit banks in poverty areas set differential lending rates. At present, there are a series of favored treatments provided to RCCs, yielding good experiences like with the deposit reserve ratio for RCCs, which has been kept at 6% since 1999.

Since 2006, the People's Bank of China have adjusted deposit reserve ratios six times and the applied ratios for commercial financial institutions are at least 5 percentage points higher that of RCCs. Additionally, as indicated in the State Council's documentation issued in 2003 on deepening RCCs reform, RCCs are permitted to utilize special lending prices with floating ceilings, under which the price could be within 1 to 2 times the benchmark price. Since April 29, 2004, the floating ceilings of RCCs were changed to allow for a maximum 2.3 times the central bank's benchmarked price, while commercial banks were bound by a maximum of 2 times the benchmarked price. Furthermore, to support RCCs reform, some provincial governments carried out favored treatments like eliminating operating taxes and local paid deposit interest taxes in addition to the support policies of the central government. Therefore, to effectively tunnel adequate funds to rural markets, it is suggested that the government extends the above-mentioned supports to banks like ABC and village banks that have a greater involvement in rural business.

3.7 Improving NPLs write-off mechanisms

To solve the write off problems that exist on agro-linked NPLs generated from farmer households, agro-nature enterprises, and banking card overdrafts, it is suggested that relevant regulators revise policies on NPLs write offs, setting different write off criteria based on NPLs' histories and special cases. ABC's booked NPLs, including those transferred from the central bank, the Agricultural Development bank of China, should be rewritten and packaged with simplified approval procedures and lower criteria and processing costs. Also fitting this need for write offs are government-issued loans, farmer household loans that were allocated as part of loans lent by dismissed collectives, farmer household loans eligible for write off but short of written witnesses, and the state-based student loans,.

4. Financial Institution and Hog Industry

4.1 ABC and RRC as the main transaction partners

From the survey undertaken in this publication, we were able to determine that the main transaction partners of the Chinese hog industry were the Agricultural Bank of China and Rural Credit Cooperatives. ABC's share proved to be slightly higher than that of the RCCs, with the Industrial Bank of China following. Other than four big state-owned banks and RCCs, many banks appeared reluctant to have transactions with hog slaughtering or processing firms. Particularly, no shared banks had any transactions with these firms, as can be seen in Table 4-1 below.

Table 4-1 Name of banks the firm has transaction

	Name of Banks	Freq.	Percent
1	Industrial Bank of China	28	14%
2	Agricultural Bank of China	73	38%
3	Bank of China	7	4%
4	Construction Bank	10	5%
5	Share banks	0	0%
6	City Commercial banks	6	3%
7	Rural Credit Cooperatives	66	34%
8	Others	3	2%
	1+2	1	1%
	Total	194	100

(Source) CAAS-IDE Jilin Henan hog industry survey

4.2 Loan approved ratio is high

A main question regarding the financing situation of the hog industry is whether or not firms have difficulty obtaining loans. Table 4-2 summarizes the number of loans applied for and approved throughout the industry. It can be seen here that 11% of firms have never applied loan to financial institutions, 70% of firms stated it was rare for them to apply for loans from financial institutions, and 59% of firms have applied for loans 3 or less times since the firms were established. However, once they applied for the loan, it was approved with a relatively high probability, with only 20% of applications being refused and the greater the number of applications, the higher the probability of being approved. Figure 4-1 shows the distribution of applications and the probability of being approved. Here, we can see that 60% of firms' applications were approved with 100% probability, but 20% were approved with 0% probability.

This data implies that loan applications themselves are rare for hog slaughtering firms. This might mean that firms either have no financial need to apply for loans, or the application itself is a high hurdle for them and they explore substitutive channels for financing. The data also implies that access to loans from financial institutions by the hog industry may be polarized.

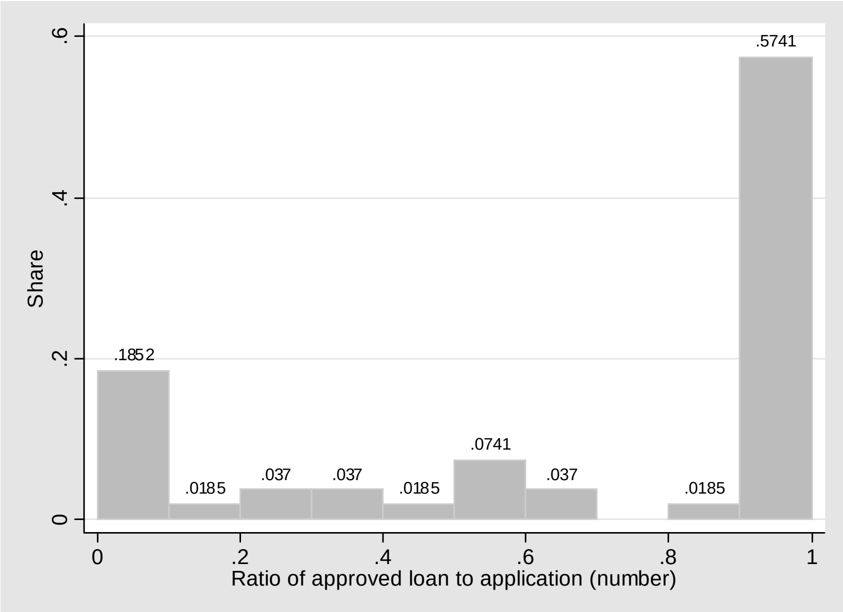
Table 4-2 Number of loan applied and approved for the firm's history

Number of loan applied	Freq.	Percent	Number of loan approved	Freq.	Percent
0	13	11%	0	20	19%
1	38	31%	1	38	35%
2	25	20%	2	16	15%
3	10	8%	3	8	7%
4	2	2%	4	2	2%
5	6	5%	5	2	2%
6-10	10	8%	6-10	12	11%
11-15	5	4%	12-13	2	2%
16-20	8	7%	16-20	4	4%
25	1	1%	25	1	1%
26	2	2%	26	2	2%
31	1	1%	41	1	1%
41	1	1%			
Total	122	100		108	100

(note) Number of loan approved is the data whose number of loan applied is one or more.

(Source) CAAS-IDE Jilin Henan hog industry survey

Figure 4-1 Distribution of loan approved ratio



(Source) CAAS-IDE Jilin Henan hog industry survey

4.3 Liquidity demand and investment demand

Next, we use the data gathered through our survey to examine demands for financing and whether or not these demands are met. Liquidity demand by the hog industry appears to be relatively met by the financial institutions. Among the firms who have encountered financial distress, 88% of loan applications were approved.

Table 4-3 Financial distress and loan approval

	Have you met financial stress recently?			
Number of approved loan	No		Yes	
0	20	35%	7	12%
1 to 41	37	65%	51	88%
Total	57	100%	58	100%

(Source) CAAS-IDE Jilin Henan hog industry survey

With investment demand, we were able to obtain information on both past investment experiences and future investment plans. For those firms who have made investments (Table 4-4) or who are planning to invest (table 4-5), the application approval rate was 84 and 81%, respectively.

Table 4-4 Investment experience and loan approval

	Did you invested in last 3 year?			
Number of loan approved	No		Yes	
0	18	30%	9	16%
1 to 41	42	70%	46	84%
Total	60	100%	55	100

(Source) CAAS-IDE Jilin Henan hog industry survey

Table 4-5 Investment plan and loan approval experience

	Do you have investment plan in the near future?			
Number of loan approved	No		Yes	
0	17	27%	9	19%
1 to 41	46	73%	39	81%
Total	63	100%	48	100

(Source) CAAS-IDE Jilin Henan hog industry survey

For both liquidity and investment demand, it seems that around 80% of applications were approved. This is a relatively high ratio, so we can concluded that the financial demand of hog slaughtering and processing firms were able to obtain sufficient amounts of capital to meet their demands.

4.4 Collateral and Guarantee

In the surveyed firms, we found that an average of 5.41 loans were applied for, 0.58 loans were refused because of no security, and 0.23 applications were rejected because of lack of guarantees. In total, about one-fifth of the loan applications were refused because of insufficient collateral or guarantees at the mean. Security appears to still be a substantial factor affecting loan-lending decisions. On the other hand, 3.92 out of 5.41 loans were approved. Among this, 0.93 cases were approved because management of personal assets was extended to the financial institution and 0.61 cases because a firm's assets were extended as collateral. Collateral was the key factor to obtaining loans in 1.5 out of 3.92 cases. It is interesting that personal assets were evaluated more than firms' assets. This is probably because financial institutions see more in controlling personal incentives of management than in the size of asset itself as collateral.

Table 4-6 Impact of collateral and guarantee

	Mean	Std. Dev.	Min	Max	Obs
Number of loan applied	5.41	7.44	1	41	109
Application is refused because;					
No guarantee	0.23	0.69	0	4	109
No security	0.58	2.11	0	18	109
Number of loan approved	3.92	6.61	0	41	108
Applicatiois approved because ;					
Personal asset is taken as collateral	0.93	2.50	0	18	109
Firm's asset is taken as collateral	0.61	1.55	0	10	109

(Source) CAAS-IDE Jilin Henan hog industry survey

In summary, the gap between financial demands by hog slaughtering and processing firms and the supply by financial institutions may not be that large. Though loans were not applied for very often, once the application was done, 60% were approved with 100% probability and 20% were rejected with 100% probability. We can say that access to loans are polarized in that those who received a loan once can get them anytime, but it is difficult for those who have never applied. In addition, 80% of firms who met with financial distress or have investment plans were able to get loans from financial institutions and if the firms extended secured personal assets as collateral, it seemed certain that financial institutions would approve the loan.