

Central Intelligence Agency

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DIRECTORATE OF INTELLIGENCE

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China: Bank Support to Rural Development

Summary

Beijing is adjusting its rural banking system to meet the needs of the rural reform program. In recent years:

- Agricultural banks and credit cooperatives have altered their loan priorities to support the development of specialized households and rural industries.
- The State Council has granted rural banks and credit cooperatives increased autonomy to conduct bank operations.
- The central government has raised interest rates on loans and deposits while allowing banking authorities greater flexibility in setting rates.

Rural banking reforms are designed to increase the ability of banks to respond to local credit needs and to improve the allocation of funds in the countryside.

We believe that the rapid growth last year in rural industrial production results, in part, from rural credit reforms already implemented. Government policy encouraging further development of diversified farming and township and village

This memorandum was prepared by [redacted], China Division, Office of East Asian Analysis. Comments and questions are welcome and should be directed to Chief, Domestic Policy Branch

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industries, however, will put increasing pressure on the rural banking system to provide funds for investment. Although risking local failures and some loss of central control over rural credit, continuing bank reforms should improve the rural banking system's ability to support rural development.

REFORMS IN RURAL BANKING

Introduction of the household responsibility system, increases in purchase prices of agricultural staples, and extensive development of rural industries have caused a surge in the supply of and demand for funds in China's countryside. The volume of work conducted by the rural banking system has increased enormously in the last six years, with the number of farm clients increasing from 6 million production teams to over 170 million peasant households. Beijing has responded by shifting rural loan priorities, by allowing greater decisionmaking autonomy at all levels in the rural credit network, and by raising interest rates on loans and deposits offered by rural banks and credit cooperatives.

Beijing's commitment to continued reform of the system was underscored in a speech by Vice Premier Wan Li at a national rural work conference last December. Complaining that the rural banking system is not yet adept at absorbing and efficiently distributing idle funds in the countryside, Wan maintained that it is imperative to speed up the transformation of agricultural banks and rural credit cooperatives from fund distributing administrative organs to independent banks operating under broad state supervision. Wan also praised the efforts of peasants in raising and pooling funds outside the rural banking framework.

RURAL CREDIT POLICY

China has initiated two major changes in rural credit policy since 1983 to support the readjustment of production in the countryside. First, agricultural banks and credit cooperatives have switched from primarily supporting communes, production brigades, and collectives to offering greatly enhanced support for individual, and particularly specialized, farm households. Second, rural banks have shifted from mainly supporting agricultural production to encouraging development of rural industry, including storage, transport, and marketing operations.¹ Apropos of the second change, agricultural banks

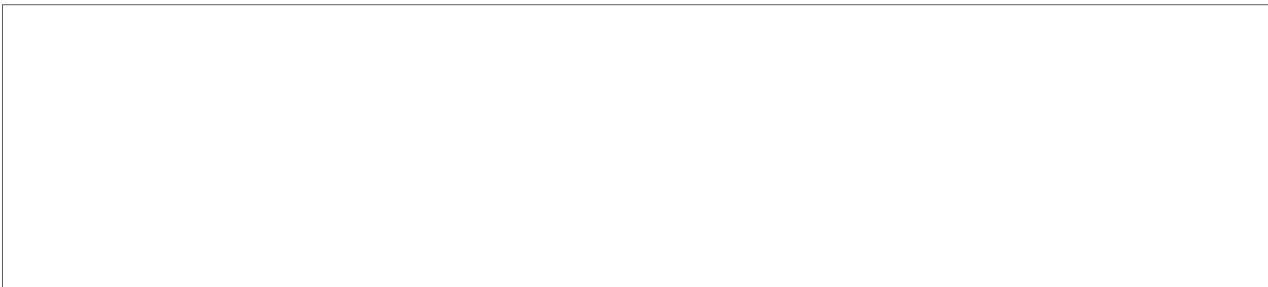
¹Table 1 lists assets and liabilities for the Agricultural Bank of China in 1983 and 1984, as reported by Embassy Beijing. Some of the amounts in the table do not correspond to Chinese published amounts and we have not yet attempted to reconcile them.

have been given primary responsibility for handling monetary affairs for industrial and commercial operations in the rural areas.

In 1985, Beijing plans to provide enhanced banking support to rural industries. According to press reports early this year, the Agricultural Bank of China (ABC) and the rural credit cooperatives (RCCs) will increase their total volume of loans by 20 percent, with loans to rural enterprises projected to increase by 30 percent, while loans to the agricultural sector are expected to grow only 10 percent.² Loans for animal husbandry, forestry, and fisheries are projected to increase by 70 percent, 50 percent, and 15 to 20 percent, respectively. If the planned allocations are realized, by the end of 1985 the combined loan portfolio for the ABC and the RCCs will have the following composition: 41.4 percent will be loans for agricultural production, 49.2 percent will be loans for rural enterprises, 1.1 percent will be loans for animal husbandry, and 8.3 percent will be loans for forestry, fisheries, and side-line activities.

Rural banks will adjust interest rates to support Beijing's rural development policies. Preferential rates will be offered on loans to nonfarming enterprises including food and fodder processing industries, small-scale energy projects, and building materials production. Preference also will be given to existing enterprises seeking funds for modern technology to upgrade facilities. Agricultural banks will continue to support irrigation projects, rural mining operations, transport and marketing activities, and the adoption of scientific farming methods. Rural banks will offer loans to farmers for use in purchasing agricultural inputs, but farmers will be urged increasingly to make use of their own funds to finance agricultural production.

The ABC plans to promote rural development by offering grants of 300 million yuan a year for the next six years to China's most economically deprived counties. In 1985, the ABC will also provide 300 million yuan in special development loans for the same areas.



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BANK AUTONOMY

Beijing recognizes that budgetary problems will prohibit the state's financial departments from increasing their investments in the countryside for some time. Since continued rural development will depend largely on the ability of the rural banking system to acquire funds from peasants, rural banks and credit cooperatives have been granted increased autonomy and a broader range of operations.

Agricultural Bank of China

Beijing has reduced the proportion of savings that the ABC must hand over to the People's Bank of China (China's central bank) and now allows the ABC to redistribute funds within the rural banking network. Rural banks have increased flexibility in approving (or denying) loan requests for technological transformation and other projects. To enhance the ability of rural banks to support industrial development, Beijing has removed the restriction that all ABC loans be made during the spring planting season.

For the past two years, rural banks have been allowed to extend loans to small, privately-owned businesses in the countryside. Similarly, families engaged in rural production are allowed to hold individual accounts at rural banks and credit cooperatives. Some provincial branches of the ABC now offer loans to farmers for purchasing automobiles and large farm machinery (provided the farmers supply one-half of the required capital), while other provincial agricultural banks have expanded their network of RCCs, establishing credit cooperatives at the village level.

Rural Credit Cooperatives

In order to increase rural savings and to improve the allocation of rural funds, the State Council last August released a circular encouraging reform of the credit cooperative system. The circular proposed a gradual transformation of the credit cooperatives into independent economic entities responsible for their own profits and losses, collectively owned at the village level through peasant shareholding.

Guidelines announced at the provincial level suggest that the RCCs:

- Will be controlled locally by a "cooperative members' representative assembly" which will elect cooperative directors and oversee planning and financial management.
- Will have freedom to determine the nature, recipients, amounts, and terms of loans it offers, without ABC approval.

- Will be allowed to set loans rates within a 20-percent band of the state-determined rate.
- Will give priority to shareholders (which may include village workers and rural enterprises) when extending loans.

Agricultural Bank officials, however, have used the credit cooperatives as their own branches, and continue to oppose an independent role for the RCCs. According to Embassy reporting, the ABC thus far appears to have been successful in stalling the reforms.

Popular Credit Institutions

In what is perhaps a concession to an already established practice, Beijing has recently encouraged peasants to form private credit institutions to support the development of rural factories and transport and power networks. These "popular" credit institutions--often taking the form of local credit unions or joint stock operations--were praised by Wan Li in his December speech as important supplements to the ABC and the RCCs. According to provincial media, popular credit institutions often outbid rural banks and credit cooperatives for funds by offering higher rates of return, and extend loans at above-bank rates to peasants and enterprises that have no other place from which to borrow.

We believe that Beijing's willingness to loosen control of rural credit and risk complaints about usurious interest rates reflects a disappointment with the pace of reform in the rural banking system. In his speech, Wan referred to unresolved structural problems that limit rural banks and credit cooperatives. Supporting the development of private credit forms may also be an attempt to diminish the control of rural cadres over credit in the countryside.

INTEREST RATES

On 1 January, 1984, China raised the basic monthly interest rate for agricultural production loans from approximately 0.45 percent to 0.6 percent, giving the head office of the ABC discretion to adjust the rate upward or downward within a 20-percent range.³ The increase was designed to bring loan rates in line with credit conditions in the countryside and the discretionary range was instituted to enhance the ability of rural banks to differentiate between borrowers.

³Table 2 gives monthly interest rates on loans and deposits at rural banks in 1984.

The increase in loan rates was also implemented to correct the inverted interest rate structure that was adversely affecting the profitability of rural banks and credit cooperatives. The success of the household responsibility system in agriculture caused a large increase in savings deposits held by individual peasants (which earned a monthly interest rate of 0.24 to 0.75 percent compared with the 0.15 percent received for deposits by commune and brigade collectives). As the proportion of high-interest-rate deposits increased, the cost of rural deposits exceeded the interest that agricultural banks and credit cooperatives received from rural loans.

OUTLOOK

We believe that the rapid growth in China's rural industrial production last year resulted, in part, from loan support provided by the ABC and RCCs. Loans from private credit institutions also appear to have provided an important boost to village-level enterprises. Beijing's policy encouraging further development of diversified farming and rural industries, however, will put increasing pressure on the rural banking system to provide funds for investment.

Reports that interest rates on private loans are considerably higher than rates on bank loans, along with official criticism of the rural banking system for its inability to absorb and efficiently use idle funds, suggest to us that substantial barriers exist which inhibit the transfer of credit within the system from surplus to deficit areas. Granting rural banks and credit cooperatives more latitude to set interest rates and screen potential borrowers should help improve the allocation of funds in the countryside.

Expansion of credit to specialized farm households and privately-operated rural enterprises will inevitably lead to instances of borrowers who are unable to repay loans. Beijing maintains that because the state owns the land, peasants cannot go bankrupt and will always have claim to a plot of "food grain" land. Supposedly, the state and local authorities will aid peasants who become financially overextended. Beijing, however, has not spelled out a policy for handling bankruptcies in the countryside, and we believe it may not understand fully the dimensions of the potential problems.

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Table 1

Balance Sheet for Agricultural Bank of China
(figures in billions of yuan)

SOURCES OF FUNDS	1983	1984	Percent Change
Deposits by State-Owned Agricultural Enterprises and Institutions	5.6	6.6	18
Deposits by Industry and Commerce in the Rural Areas	3.9	9.6	147
Deposits by Township Enterprises ¹ Savings Deposits in the Rural Area	2.1	0.8	(62)
Deposits by Credit Cooperatives	6.8	9.7	43
Deposits by Government Organs and Other Organizations	35.5	32.8	(8)
Other Deposits	4.1	3.5	(15)
Deposits from Funds Alotted by the State for Agricultural Production	3.6	3.4	(6)
Intercourse Among Banks	1.0	1.2	20
Funds Owned by ABC	15.0	35.8	139
Surplus	22.0	21.1	(4)
Total	1.4	1.7	21
	101.0	126.2	25
<u>USES OF FUNDS</u>			
Loans to State-Owned Agricultural Enterprises	3.9	5.1	31
Loans to Industry and Commerce in the Rural Areas	45.0	71.4	59
Loans to Township Enterprises ²	16.3	7.7	(53)
Loans to Peasants	1.9	4.4	132
Loans to Credit Cooperatives	1.6	3.1	94
Loans for Advances ³	0.7	0.7	0
Other Loans	2.1	2.1	0
Agency Services ⁴	29.5	31.7	7
Total	101.0	126.2	25

¹Formerly titled "Deposits by Communes and Production Brigades."

²Formerly titled "Loans to Communes and Production Brigades."

³Formerly titled "Loans for Forward Purchases."

⁴Formerly titled "Business Done on Other Banks' Behalf."

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Table 2

Monthly Interest Rates at
Rural Banks in 1984

LOAN RATES

- 0.42 - 0.54 percent for energy development loans (rates were lower for small hydropower development),
- 0.48 - 0.90 percent for loans to contract, specialized, or key households (lower rates were for short-term personal loans, higher rates were for farmers engaged in commercial activities),
- 0.60 - 0.66 percent for loans to collectives and brigade-run enterprises,
- 0.72 percent for loans to individuals engaged in rural sideline industries, commerce, and transportation.

DEPOSIT RATES

- 0.24 percent for demand deposits,¹
- 0.48 percent for one-year deposits,²
- 0.57 percent three-year deposits,
- 0.63 percent for five-year deposits,
- 0.75 percent for eight-year deposits.

¹Prior to 1980, the monthly interest rate for demand deposits was .18 percent.

²Prior to 1980, the monthly interest rate for one-year savings deposits was .33 percent.

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