

Influence of Outflow of Rural Funds on Financial Support for Agriculture

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Abstract Since the reform and opening-up, rural finance has made enormous contribution to rural economic development. However, with commercialization reform of financial institutions, the conflict between outflow of large funds and shortage of funds for rural economic development becomes prominent, leading to serious degradation of agricultural support function of rural finance. From the perspective of outflow of rural funds, this paper analyzes the problem of "deviation from agriculture" of rural financial business, and derives the conclusion that it is necessary and urgent to restore agricultural support function of rural finance. Then, it discusses restoration path for agricultural support function of rural finance. Finally, it comes up with some effective paths in accordance with existing problems in agricultural support function of rural finance.

Key words Outflow of rural funds, Rural finance, Support for agriculture

With rapid development of China's economy and gradual improvement of financial market, rural finance has realized substantial leap in the quality. This greatly boosts rural economic development. In recent years, profit seeking nature of capital leads to outflow of large rural funds. On the one hand, new socialist countryside construction lacks funds and has difficulty in financing. On the other hand, large amount of deposit of rural residents flows to developed areas through rural financial institutions. As a result, rural finance basically loses the fundamental agricultural support function.

1 Background

In the *Report to the Eighteenth National Congress of the Communist Party of China*, president of China, Hu Jintao, stressed that issues concerning agriculture, rural areas and farmers are still top priority of rural works. As everyone knows, developing rural economy is the fundamental approach to solve issues concerning agriculture, rural areas and farmers. Rural finance, as an important financing platform in rural areas, is the essential source of funds for rural economic development. However, rural finance has clear tendency of "deviation from rural areas" in recent years. Because rural areas lack favorable investment environment and farmers lack investment awareness, most income of rural residents turns into deposit, leading to deposit amount of rural financial institutions rising year by year. Inherent nature of capital for seeking profit leads to preference to high return, so rural financial institutions invest deposit absorbed to areas with higher prospective return. As a result, these deposits flow to developed areas through integrated urban and rural financial system, and turn into construction funds of developed areas, accordingly widen the gap between urban and

rural economic development.

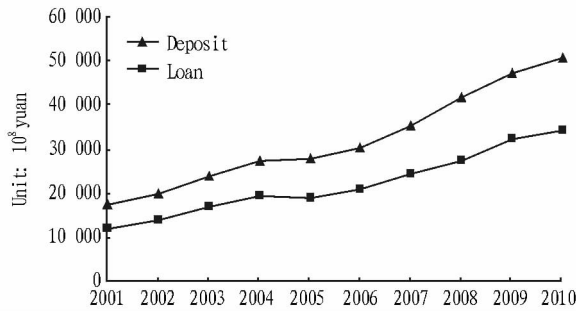
Main function of rural finance is to support rural economic development, raise funds and provide credit guarantee for rural development^[1]. In rural financial system, the Agricultural Development Bank of China, as a policy bank, conducts rural area related financial business in accordance with national agricultural policies, and serves agricultural and rural development; the Agricultural Bank of China is the sole agriculture related state-owned commercial bank, but its rural financial credit business serious shrinks after listing; rural credit cooperative is a rural cooperative financial institution, mainly engaged in rural credit, but due to strict loan condition, farmers have great difficulties in obtaining loan, so its agricultural support function is seriously degraded; the Postal Savings Bank of China provides many financial services for farmers nominally, but it started operating small amount credit only from June of 2008, and the credit amount is limited. Under the background of rural financial institutions deviating from rural areas, reform of rural finance should give priority to deepening reform of rural financial system and restoring agricultural support function of rural finance.

2 Analysis on outflow of rural funds and deviation of rural financial institutions from agriculture

At present, there is a wide gap between urban and rural economic development, and integrating urban and rural development is the fundamental approach. Dominant factor restricting rural economic development is lack of funds; construction of agricultural infrastructure, development of township enterprises, and farmers starting an undertaking are faced with difficulty of funds^[2]. Such situation is mainly resulted from farmers' low income, lack of investment awareness, and saving idle money in banks. However, rural financial institutions invest deposits of farmers to developed areas that have higher expected return. As a result, large amount of rural funds flows out and agricultural support function of rural finan-

cial institutions gets serious degraded. In 2010, the deposit amount of farmers in the whole country reached 5 908.35 billion yuan, while the amount of farmers' loan was 2 604.32 billion yuan, with the conversion ratio of deposit and loan only 44.8%.

2.1 Rural credit cooperatives having high balance of deposit and loan Rural credit cooperatives are rural cooperative financial institutions engaged in providing services for development of agriculture, farmers and rural areas. They organize and adjust rural funds to support agricultural production and integrated development of rural areas. Due to limitation of small peasant awareness and bad rural investment environment, most idle money of farmers becomes deposit of rural financial institutions. Every year, rural credit cooperatives absorb large amount of deposit. But the growth of loan amount lags far behind, and the balance between deposit and loan widens year by year (as shown in Fig. 1). From Fig. 1, it can be seen that the balance between deposit and loan in 2001 to 2010 reached 10 121.99 billion yuan, the average annual loss of rural funds up to 1012.199 billion yuan, which seriously impairs rural economic development.



Note: Data source: Almanac of China's Finance and Banking (2000–2011).

Fig. 1 Amount of deposit and loan in rural credit cooperatives in 2001–2010

Outflow of funds of rural credit cooperatives is mainly resulted from following factors. (1) Legal reserve is the fixed channel for funds of rural credit cooperatives flowing out. According to provisions of the People's Bank of China, financial institutions should turn over legal reserve to People's Bank of China according to deposit amount as per legal reserve ratio. This is no exception to rural credit cooperatives. Payment of legal reserve reduces amount of funds for loan and consequently the agricultural support function shrinks. (2) Changes in financial business of rural credit cooperatives also lead to outflow of funds. Because of weak nature, risk and long term of investment return of agricultural production, rural credit cooperatives always take strict control over loan of agriculture, farmers and rural areas. Majority of deposit is invested to developed areas, while there is only a small amount left to support rural economic development. In 2008, there were 4 965 rural credit cooperatives; in 2010, there were only 2 646 rural credit cooperatives, reducing about 47%. Merge of these cooperatives and changes in their focus of work generate many blind financial areas, which makes the opportunity of farmers getting loan from rural credit cooperatives meager^[3]. (3) Lack of rural credit is al-

so an important reason for outflow of rural funds. Weak credit awareness of farmers increases loan risk of rural credit cooperatives for farmers. Agriculture-related financial institutions will reduce credit loan amount to avoid bad debts. Besides, farmers do not have effective mortgage, so it is difficult for them to get loan, accordingly rural areas are faced with serious shortage of funds.

2.2 Shrinkage of agricultural support business of the Agricultural Bank of China The Agricultural Bank of China is the sole agriculture related state-owned commercial bank. Its vision is to establish urban and rural integrated financial enterprise. However, its credit business is oriented towards state-owned agricultural operating enterprises and institutions, and has no direct connection with farmers. After commercialization reform of the Agricultural Bank of China, it implements centralized system of credit management. In this situation, it becomes more difficult for farmers to get loan. The credit mechanism of widely raising deposits but distributing loans in a centralized way results in outflow of large amount of rural funds.

The proportion of agriculture-related loan to various loans of the Agricultural Bank of China drops year by year. According to statistical data in Almanac of China's Finance and Banking, agriculture-related loan dropped from 794.315 billion yuan in 2001 to 450.878 billion yuan in 2005, and the proportion of agriculture-related loan to various loans dropped from 54.8% to 16.5%. Due to changes in scope of statistics in 2006 and 2007, the loan amount of farming, forestry, animal husbandry, and sideline production in the Agricultural Bank of China accounted for only 4.6% and 4.05% in total loan amount. From 2008, in commercialized operation mode, the Agricultural Bank of China reduced branch banks below the county level and strictly controlled amount of loan related to agriculture, farmers and rural areas, leading to serious shrinkage of its agricultural support function.

2.3 Limited small amount credit business of the Postal Savings Bank of China The Postal Savings Bank of China provides convenient financial services for farmers. But before 2007, it implemented the operating strategy of "deposit only, no lending". For a long time, it absorbed large amount of rural deposits, but invested deposits to non-agricultural businesses. In June 2007, it started pilot project of small amount credit in Xinxiang City of Henan Province. By 2008, the business had covered the whole country. On October 16, 2010, the sum of small amount credit in Postal Savings Bank of China exceeded 100 billion yuan. In the end of 2010, the sum of RMB deposit amount was 2 847.173 billion yuan, but the sum of small amount credit was only 93.415 billion yuan, the conversion ratio was only 3.28%. Thus, the distribution of small amount credit fails to satisfy fund demands for rural economic development. Through postal savings, large amount of rural funds flows out, so it restricts rural economic development.

2.4 Single agricultural support business of the Agricultural Development Bank of China The Agricultural Development Bank of China, as a policy bank, conducts supply of funds and

credit business in accordance with policies concerning agriculture, farmers and rural areas. Its major business is loan for purchasing crops such as grain and cotton. Funds mainly flow to related agricultural institutions and "work-relief" projects, while the agriculture-related financial business is very limited. In 2010, the deposit balance of the Agricultural Development Bank of China was 398.294 billion yuan, and the loan balance was 1 670.986 billion yuan, with an increase of 15.14% compared with the same period of last year. However, business of the Agricultural Development Bank of China is not oriented towards farmers, and single agricultural support function seriously restricts scope of services farmers can enjoy.

To sum up the above analysis, except the Agricultural Development Bank of China, other rural financial institutions have outflow problem of rural funds. Severe shortage of development funds and outflow of rural funds further widen the urban and rural gap, and weaken the agricultural support function of rural financial institutions.

3 Necessity for restoration of agricultural support functions of rural finance

Financial business of rural financial institutions deviating from agriculture seriously restricts agricultural economic development, results in shortage of agricultural funds, weak infrastructure construction, and difficulty financing of farmers^[4]. Functions of rural financial institutions are degraded in raising funds for agriculture, rural areas and farmers, and providing credit loan. Therefore, it is necessary and urgent to restore their agricultural support functions.

3.1 Shortage of agricultural funds In the *Report to the Eighteenth National Congress of the Communist Party of China*, president Hu Jintao stated that we should deepen reform of the financial system and improve the modern financial system so that it will better contribute to macroeconomic stability and support development of the real economy, and we should accelerate development of a multilevel capital market. Agriculture is the foundation of national economy. Agricultural modernization depends on financial support of government and increase of farmers' input. Rural financial institutions should also take due responsibilities, bring into full play their agricultural support functions, provide funds for agriculture, rural areas and farmers, and make effort to solve the problem of shortage of funds for rural and agricultural development. Agriculture is a weak industry with high social benefits but low comparative benefits, so it is difficult to get high return from investment in agriculture in a short term. Driven by profit, rural financial institutions invest absorbed deposits to urban areas where the expected return is higher. In consequence, financing for agricultural modernization construction has great difficulty. In addition, agriculture-related loan is mainly oriented towards large agricultural organizations and agriculture-related institutions operated by the state, but most of these organizations and institutions are concentrated in urban developed areas. China is a large agricultural

country. In 2010, agricultural GDP of China reached 4 053.36 billion yuan, accounting for 10.1% of total GDP. Rural population was 671.13 million, accounting for 50.15% of the total population. The domestic and foreign currency balance of agriculture, forestry, animal husbandry and fishery was 6 658.411 billion yuan, accounting for 1.43% of the total loan. These indicate that agricultural position is extremely inconsistent with financial loan it obtains. Thus, restoring agricultural support function of rural finance is the key to developing rural economy and reforming rural financial system.

3.2 Widening urban and rural gap Large amount of rural funds flows to urban developed areas, rural areas develop slowly and urban and rural gap further widens. Wang Xiuhua and Qiu Zhaoxiang (2011) made an empirical study on the relationship between rural financial development and urban and rural income gap on the basis of data of 1978 – 2008. They believed that expansion of rural finance widens urban and rural income gap to a certain extent. *The Report to the Eighteenth National Congress of the Communist Party of China* states that resolving issues relating to agriculture, rural areas and farmers is the number one priority in the Party's work, and integrating urban and rural development provides the fundamental solution to these issues. Rural finance is an important support for rural economic development, but existing urban and rural integrated financial system, extensive deposits raised and centralized distribution of loans lead to outflow of large amounts of rural funds. The opportunity to obtain development funds is not equal in urban and rural areas. Rural areas have fewer opportunities than urban areas. Rural economic development lacks effective fund support. In addition to outflow of large amount of rural funds, the urban and rural gap is widening. Only through restoring agricultural support function of rural financial institutions, may the gap be effectively bridged.

3.3 Backward construction of rural infrastructure The urban and rural dual economic structure, backward construction of rural infrastructure and, lack of favorable investment environment are also important reasons for outflow of rural funds. As a financing platform for development of agriculture, rural areas and farmers, rural financial institutions should get rid of the "profit first" operating philosophy, and make effort to restore agricultural support function, to provide powerful fund support for construction of rural infrastructure. Besides, it is required to bring into full play functions of government and finance, give priority to development of agriculture, rural areas and farmers, energetically give impetus to rural infrastructure construction, and create favorable investment environment, to realize intensive and localized use of rural funds, and gradually narrow and eliminate the urban and rural gap.

3.4 Farmer having many obstacles to obtain loan In the framework of existing rural financial system, farmers have many obstacles to obtain loan. On the one hand, rural credit cooperatives reduce rural credit and use most of deposits to buy government securities. On the other hand, farmers have many limitations

to obtain loan from rural credit cooperatives, such as credit guarantee and mortgage in kind; the small amount credit is weak in the Postal Savings Bank of China is weak; upward concentration of credit business of the Agricultural Bank of China increases difficulty of farmers in getting loan; the financial business of the Agricultural Development Bank of China is not open to farmers^[5]. Narrow financing channel of farmers leads to serious shortage of agricultural input funds and weak construction of agricultural modernization. The fundamental problem of issues concerning agriculture, rural areas and farmers is the shortage of funds. Deviation of rural financial institutions from agriculture results in outflow of large amount of rural funds. This conflict is a major difficulty faced by reform of rural finance. Thus, the fundamental approach to solve outflow of rural funds is to restore agricultural support function of rural finance.

4 Paths for restoration of agricultural support functions of rural finance

4.1 Improving policy, commercial and cooperative rural financial system Restoration of agricultural support functions of rural finance is closely related to construction of rural financial system. Existing rural financial system includes policy type Agricultural Development Bank of China, commercial Agricultural Bank of China, cooperative rural credit cooperatives, and other relevant financial institutions, which raise rural idle money to make contribution to agricultural development^[6]. At the background of outflow of rural funds, to restore agricultural support functions of rural finance, we must improve rural financial system. (2) Strengthening policy of agricultural support of rural finance. The essential function of rural finance is to circulate necessary funds for agriculture, rural areas and farmers, and raise idle money of farmers to serve rural economic development. However, the existing profit oriented rural finance leads to outflow of large amount of rural funds. Therefore, strengthening policy of agricultural support of rural financial institutions is the policy guarantee for restoration of agricultural support functions of rural finance, and it is required to stabilize agricultural support functions of rural finance in the form of system, to prevent outflow of rural funds^[7]. (2) Improving commerciality of agricultural support of rural finance. The essence of commerciality is to seek after profit. It is recommended to build effective forward and backward market for agricultural production, increase price of agricultural products, increase farmers' income, raise credit of farmers, and reduce risk of agricultural support loans, to encourage commercial financial institutions to invest in rural economic development. (3) Enhancing cooperative of agricultural support of rural finance. Realizing localization of use of rural funds is an important approach to prevent outflow of rural funds. Rural credit cooperatives should bring into full play agricultural support functions, put financing for agriculture, rural areas and farmers in the first position, and should make effort to realize cooperation and localization of use of rural idle funds. In sum, reform of rural financial system should focus

on agricultural support, enhance policy, cooperative agricultural support, and improve commercial agricultural support, to realize policy and system based agricultural support of rural financial institutions.

4.2 Opening the rural financial market and developing private financial institutions In the *Report to the Eighteenth National Congress of the Communist Party of China*, it is required to speed up developing private financial institutions. In the tide of state-owned commercial banks leading financial development, the profit is a basic indicator for evaluating operating performance. Since the investment in agriculture and rural areas has a long period of return and high risk, state-owned commercial banks are unwilling to invest in rural areas to support rural economic development^[8]. Private financial institutions lack competitiveness and scale advantage in urban developed areas, so their services are mainly oriented towards rural areas, to provide convenient financial services to support rural economic development. In the framework of existing market economic system, developing private financial institutions in rural areas is an important approach to prevent outflow of rural funds. On the one hand, private financial institutions can provide agricultural loan to increase agricultural input and develop agricultural economy to narrow urban and rural gap. On the other hand, private financial institutions can compete with other financial institutions, increase operating benefits of rural financial institutions, and increase agriculture-related loan of financial institutions, to raise more funds for rural economic development.

4.3 Advancing reform of rural financial business and increasing effort of agricultural support Existing business of rural financial institutions is single, and credit business of some financial institutions is not accessible to farmers, so farmers enjoy few modern financial services. Deepening the reform of rural financial system to make business of rural financial institutions orient towards farmers is the essential direction of reform of rural financial system^[9]. (1) The People's Bank of China should reduce or exempt legal reserve of rural credit cooperatives and limit their financial investment business, to provide more opportunities for farmers to get loan, and make farmers really enjoy cooperation and convenience of rural credit cooperatives. (2) Credit business of the Agricultural Bank of China should incline to rural areas, and the Postal Savings Bank of China should start more small-amount credit businesses, to expand financing channel and loan source of farmers, and increase agricultural input of farmers, to promote rural economic development. (3) Policy type rural financial institutions should open their businesses to farmers, and let farmers enjoy financial services is the key to restore agricultural support function of rural finance.

4.4 Implementing agricultural insurance policy to reduce risk of agricultural investment Agricultural insurance is an institutional arrangement in which agricultural producers pay small amount of premium to shift risks of agricultural production to insurance companies. Agriculture as a weak industry has high social

