

Food Supply and Rural Financial Services in China

—Speech at the 2nd World Congress on Agricultural and Rural Finance

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Respected chairman, ladies and gentlemen:

As an old Chinese proverb says, food supply is the single most important thing for people. Food is the foundation for the survival and development of mankind, and ensuring food supply is a global topic. With a population of 1.3 billion people, China is one of the largest food producing and food consuming countries in the world. What is the food status in China? How does China's rural financial system serve its food production? These are the questions in which people are most interested. I am pleased to have the opportunity today to share with you information on issues concerning food and rural finance in China.

I. Major periods of China's food supply since China reformed and opened to the outside world

The Chinese government is greatly concerned with the food supply. It has been making tremendous efforts to promote grain production. With about 7% of the world's arable lands, we managed to feed 22% of the world population. Since the beginning of the rural reform program in 1978, China has made 4 major breakthroughs in total grain output; increasing from 300 million tons through 350 million, 400 million, 450 million to 500 million tons. In 2005, the World Food Programme (WFP) ended its 25-year food aid to China. Total grain output of 2006 increased by 1.62 times from that of 1978. Today, China has the largest grain output in the world, and its per capita grain output is approximately 380kg, about the world average. Of note is our per capita outputs of meat, aquatic products, eggs and fruits, which are 62kg, 40kg, 22kg and 130kg respectively, which are above the world averages.

In general, the development of China's food production since the beginning of the reform can be divided into 3 periods:

The first period: 1979-1984: The total grain output of China reached 407.3 million tons in 1984, ending the nation's history of severe food shortages. Grain output maintained a fast growth during this period, thanks to a series of reform programs in the rural area, particularly the household contract system, and the system of unified management combined with independent management, and major policy adjustments including the substantial increase in grain purchase price, which significantly stimulated the enthusiasm of farmers.

The second period: 1985 - 1999: total grain output exceeded 500 million tons for 3 years, i.e., in 1996, 1998 and 1999. Particularly in 1998, the output was 512.3 billion tons, an all-time high in our history. As the agriculture sector entered a new development stage, China eventually maintained a "general balance in overall volumes and surplus in good years" for its food supply. Thank to the government's encouragement of mixed farming, a rapid development was achieved for the nation's efforts to diversify its food supply, along with fast growth in meat, egg, milk and fruit outputs and substantial improvement in the people's living standard.

The third period: 2000 - the present: After its recovery and a multi-year growth, total grain output reached 497.46 million tons in 2006. With the background of building new countryside program in this period, the government adopted a guideline of "industry nurtures agriculture, and cities support the development of rural areas", and a number of other policies to the ideal of "giving more, taking less, and loosening control", the scope and intensity of which were never seen in history. While ensuring the general supply-demand balance of agricultural products, China eventually achieved a comprehensive development of its agriculture, forestry, animal husbandry, sideline production and fishery. As a result, the structure of its agricultural products continued to be optimized; its competitiveness in the international market improved; the income of the farmers increased steadily and showed a trend of acceleration; the ecological environment continued to improve. In general, this is the period of the greatest benefits for farmers in our history.

There are a number of reasons for these great achievements in food production. Throughout the years, the Chinese government has held issues concerning agriculture, rural areas and farmers as

its top priorities, and tried its best to ensure the stable growth of the total grain output. It has introduced a number of initiatives to reform the relations of production in the rural areas, adopt and maintain the household contract system, and the system of unified management combined with independent management. With the end of the state monopoly in grain purchase and marketing, the market mechanism is allowed a fundamental role in the allocation of grain resources, while the government has been enhancing its macro-adjustment in the grain market. Infrastructures for agricultural production have improved steadily amidst efforts to accelerate progresses in agricultural science and technology, upgrade the level of agricultural equipment and protect the ecological environment. Efforts have been made to establish and support the new grain production structure. The agricultural tax, which has been in place for more than 2,600 years, and taxes on special agricultural products have been abolished. A number of other policies, including those for direct grain production subsidies, subsidies for planting grains of good breeds, and integrated direct agricultural input subsidies, have been adopted. Supportive prices have been set by the government for grain purchase. Strict measures have been taken for the conservation of arable land and the control of the prices of agricultural production materials. More resources have been invested in the agricultural sector. As a result, farmers have received more benefits. With such a macroscopic background, the rural financial system has played an important role in the support of grain production.

II. The roles of the rural financial system and Agricultural Development Bank of China (ADBC)

After more than 2 decades of rural financial reform, a comprehensive rural financial system has been formed consisting of cooperative, policy and commercial institutions. Specifically, there are cooperative financial institutions (including rural credit cooperatives, rural cooperative banks and rural commercial banks), the extensive branch networks of the Agricultural Bank of China (ABC) and Agricultural Development Bank of China (ADBC). The China Postal Savings Bank opened officially in March this year. As a state-owned commercial bank, ABC adopts a market-oriented

business operation and provides credit support to agricultural commercial projects in the rural areas, leading agricultural enterprises that integrate agricultural production with processing and marketing operations, rural electric power grid upgrade projects, large irrigation and hydraulic power projects and other rural infrastructure development projects. As of the end of 2006, ABC maintained a total loan balance of RMB 3,122.8 billion, including about RMB 1 trillion for agriculture-related projects and a total deposit balance of RMB 4,745.2 billion, a network of 25,000 branches and sub-branches and a workforce of 450,000 employees. Rural cooperative financial institutions are the most numerous in the field of rural credits. As of the end of 2006, there were 72,261 rural credit cooperatives, 4,241 rural cooperative banks and 2,035 rural commercial banks. While supporting a number of agricultural activities, including crop growth, livestock raising and the agricultural product processing, these financial institutions provide farmers across China with community financial services including lending and joint liabilities credit service. With a total loan balance of RMB 2,623.6 billion, including RMB 1,210.5 billion for agriculture-related projects, these financial institutions have outreached to about 31% of the rural families in China. As a provider of basic financial services, particularly retail and intermediary services to rural residents, the Postal Saving Bank maintains a total savings balance of RMB 1,540 billion as of the end of 2006.

† ADBC is an agricultural policy-oriented financial institution in China. Since its establishment in 1994, its mission set by the government has been to support the purchase of grains and sideline products, protect the interests of farmers, and promote the stable development of agriculture, particularly grain production. In terms of its functional development, ADBC has undergone 3 major stages. 1994-March 1998, the initial stage: the bank provided loan services primarily for the purchase, storage, distribution and marketing of grains, cotton, and edible oil products, as well as agricultural development and poverty relief projects and processing businesses of grain/cotton companies; March 1998 - July 2004: the stage of closed management of loan funds for the purchase of grains, cotton and edible oil products; and July 2004- the present: the new development stage of multi-dimensional support to agriculture. Since the late half of 2004, ADBC has been expanding the

scope of its support to agricultural in line with the requirements for building new countryside program initiated by the government. A multi-dimensional agriculture support structure has gradually come into being, with the loan provision of grain, cotton and edible oil purchase as the main body, loan services for agricultural production and processing, medium/long-term loan services for agriculture and rural development projects as two wings, and intermediary services as supplementary. The amounts of loans disbursed for the purchase and storage of grain, cotton and edible oil have been on the rise. Each year, about 23% of the grain outputs, over 55% of the commodity grains and over 50% of the cotton outputs are purchased with ADBC loans. In 2006, ADBC introduced a new loan service for leading agribusiness and processing enterprises. At the end of the year, RMB 110.3 billion of loan facilities were granted in total, providing strong support to the agricultural industrialization program. In the meantime, ADBC made positive efforts to support rural infrastructure projects, integrated agricultural development projects, agricultural supply business and agricultural science and technology development projects. As of the end of 2006, ADBC maintained a total loan balance of RMB 884.4 billion, a total deposit balance of RMB 191.7 billion, a total financial bond balance of RMB 313.2 billion and a total central bank refinance balance of RMB 387 billion. With 2,175 branches and sub-branches, and 50,000 employees, the bank achieved RMB 8.8 billion in before-tax gross profits, averaging RMB 178,000 per person.

III. Food supply challenges and the deepening of rural financial reform in China

In spite of the fast and stable development of the national economy, and the continued improvements in the agricultural production and the recovery and the multi-year growth in grain output, China still faces a number of challenges in its food security. Primarily, the supply/demand relationship of grains and other main agricultural products has been transforming toward the pattern of "tight balance of supply and demand", adding difficulties to the macro-control of food supply. Affected by the decline of arable lands, and the increase in grain consumption for feed and ethanol processing, pressure on the grain supply has been mounting. In general, wheat outputs have been larger than demands; rice outputs and demands have been basically in balance; the corn

supply/demand balance has given way to a short supply; a bulk part of the domestic demands for soybean and edible oil products—specifically about half the amount consumed in China depends on import. Driven by a number of factors, including cost, demand and international market changes, the prices of agricultural products have increased substantially since later 2006. As the resource restriction for grain production tightens, arable land area per capita declines to less than 1.5 mu. The shortage of water resources is becoming increasingly severe. Water resource per capita is as low as 1/4 of the world average. With severe imbalance of geographical distribution, more than 80% of the water resources are located in areas south of the Yangtze River. Draught and water resource shortage have become the bottlenecks for grain production in many regions. With weak agricultural and rural infrastructures, out-of-date irrigation and water conservation projects, soil and water loss and desertification have been deteriorating, while the support of agricultural science and technology is far from being strong enough. In terms of laws and regulations, the protection of the farmers' land is yet to be enhanced. With too wide a scope of land expropriation, there has been the problem of the abuse of land expropriation rights. As the reform of the rural financial system has not been able to keep up with the rising demand of rural economic transformation, rural financial institutions are facing a number of challenges including a short supply of financial resources, unsatisfactory service levels.

To address the challenges, it is our imminent task to build a long-standing mechanism to ensure the strengthening of agriculture sector, to build a new countryside and to ensure the food security of the nation. In the meantime, it is expected to accelerate rural financial system reforms to increase rural financial resource and to improve the service levels. After the latest round of reform of the rural credit cooperatives, a number of rural commercial banks, rural cooperative banks and county-level rural credit cooperatives federation have been established. Furthermore, with the establishment of the province-level rural credit cooperatives federation, the system has been reinvigorated, and more farmers are expected to be covered by its services. Currently, ABC is accelerating its joint-stock equity structure reform in accordance with the principles of "for agriculture, farmers and rural areas;

overall restructuring; commercial operation; and preparing for an IPO at an optimal time." By accelerating the joint-stock equity structure reform, it should be able to play a better role in linking the urban areas with the rural areas, serving counties across the country and supporting agriculture, farmers and rural regions. While trying to enhancing its basic services in the fields of saving, remittance, payment settlement in rural areas, the Postal Savings Bank is going to introduce a number of new services including lending against the collateral of micro-deposit book, expand the scope of its support to agriculture, and channel more funds to agriculture and rural regions. ADBC, on its part, will continue to transform its operation mechanism, expand its business activities and improve the government subsidized programs in an effort to play a better role as one of the pillars in the rural financial system.

Thank you!