

Xiang Junbo: Pushing forward the construction of a harmonious socialist society through developing a financial system for the disadvantaged

Speech by Mr Xiang Junbo, Deputy Governor of the People's Bank of China, at the "2006 China Financial Forum", Beijing, 26 December 2006.

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Distinguished guests, ladies and gentlemen:

I'm very pleased to attend the 2006 China Financial Forum jointly held by China Society for Finance and Banking and Financial News. This forum takes the theme of "A harmonious society – the social responsibility of China's financial sector", which is of great significance, because this theme not only reflects the characteristics of our times, but also aligns itself with the objective of constructing a socialist harmonious society, highlighting a very practical question facing the financial sector in China, i.e., what role the financial sector can play and what social responsibilities it should take as the core in the modern economy. It is fair to say that each of us as financial practitioners, especially those in leading positions, must take this issue seriously.

Not long ago, I published an article entitled "Push forward the construction of a harmonious socialist society through developing a financial system for the disadvantaged". Today, I'd like to take this opportunity to talk about the background against which this concept is put forward, the definition of the financial system for the disadvantaged, and its key aspects.

1. Background of the concept

As is known to all, in a modern society, finance and the economy are interdependent. Since China's reform and opening-up, the economy has been growing at a stable and fast pace. While our overall national strength keeps improving, some deep-rooted problems have emerged and accumulated, leading to structural imbalances in the economy and society, which is reflected in the uneven development among regions, between rural and urban areas, and among industrial sectors. One of the direct outcomes of the "three imbalances" is an emerging and growing group of disadvantaged regions, sectors and people. The support and involvement of the financial system is one of the important factors defining the development of this disadvantaged group. The financial sector has made great endeavors and undertaken some pilot programs in this area, in particular in supporting the development of the central and western China, the development of agriculture, rural areas and farmers, reemployment of laid-off workers, poverty reduction initiatives and student loans. We've put forward theories, carried out trials, and gained experiences, both positive and negative. But in general, the theories, practice and experiences are driven by isolated events instead of a systematic plan. There is no theoretical conclusion made from the strategic perspective of constructing a harmonious socialist society, and no practice under the guidance thereof. Because of the absence of a systematic financial theory, institutional and policy system to guide and push ahead the construction of a harmonious society, it is difficult to display the synergy of the entire financial sector in this cause.

In the new century, especially since the 16th CPC National Congress, we have clarified the strategic importance of building a socialist harmonious society for the socialist society construction drive. In addition, the just concluded 6th plenary session of the 16th CPC National Congress adopted the Decisions on Major Issues Concerning the Construction of a Harmonious Socialist Society. As the center of the modern economy, finance should and is able to play an important role in the construction of a socialist harmonious society. So far, the financial sector has not fully adapted to the endeavors to build a harmonious socialist society. We need to make major breakthroughs in financial reform in the future. One of the major tasks is to conduct theoretical analysis on how to utilize the financial sector to support the building of a harmonious socialist society, and find a way for the sector to do so.. Since structural imbalance is a major strain, finance should make its due contribution to solving the structural imbalances. To be specific, the financial sector should move away from the concept of "favoring the rich over the poor", and provide, based on the market principle, necessary support to industrial sectors, regions and groups that are short of funding and lag behind in economic and social development. This is not only a requirement for the financial sector to support the harmonious economic development, but also a responsibility. As such, I believe it necessary to put forward the

concept of “developing the financial system for the disadvantaged” to fully display the functions of the financial sector in the construction of a harmonious socialist society.

2. Definition of the concept

“Finance for the disadvantaged” refers to the financing activities for the underdeveloped areas and groups. So far in China, it is meant to be the support rendered to the disadvantaged sectors with agriculture as the primary one, less-developed regions mainly in central and western China, and disadvantaged groups of farmers and laid-off workers in urban areas. It is fair to say that finance for the disadvantaged represents a revision to traditional finance that seeks immediate return. Generally speaking, in countries with immature financial systems, the opportunities are only available to a small group of the population with certain capital accumulation, while those short of capital accumulation are deprived of development opportunities, and subsequently of the benefits from economic growth. However, for a mature financial system with various financial institutions and appropriate institutional arrangement, it is possible to give financial support to those people or regions lack of capital accumulation but equipped with productive skills or resources in one way or another, so that they have opportunities to grow and develop. Therefore, while conforming to the principle of efficiency in the market economy, finance allocates resources to backward regions and industrial sectors, and helps improve the welfare of disadvantaged groups, make them benefit from economic growth and promote a harmonious society.

Internationally, there are two types of financial support to disadvantaged industrial sectors, people and regions, namely direct government involvement and indirect policy guidance by the government. Direct government involvement means that the government establishes policy financial institutions to lend to disadvantaged industrial sectors and regions, while policy guidance means that the government adopts preferential policies to guide the market to increase input to the disadvantaged. Policy support is an important feature of finance for the disadvantaged. However, finance for the disadvantaged is more than policy financial activities, it is a relatively complete financial system that includes commercial, cooperative and charity financial activities,. Specific forms of finance for the disadvantaged varies from country to country.

Generally speaking, a relatively complete financial system for the disadvantaged at least includes three aspects: financial institutions, a legal system and policy supports..

First, there is a full spectrum of financial institutions that provide finance for the disadvantaged. A lot of countries have put in place a well-developed system, including government-backed financial institutions, private partners, commercial institutions and private lending institutions. They interact with and complement each other to support the development of backward regions, industrial sectors and disadvantaged groups. For example, as far as support for agricultural development is concerned, in the US there are government-backed agricultural lending institutions, farmers cooperative financial institutions, commercial financial institutions and private lending institutions; in Japan, the Agriculture, Forestry and Fisheries Finance Corporation acts as the policy financial institution, and Japan Agricultural Cooperatives as cooperative financial institutions; in India, cooperative agricultural lending institutions, policy financial institutions and commercial banks work together to support the agricultural development; in addition, in over 40 countries governments have established agricultural insurance scheme to conduct agricultural insurance business. To support development in backward regions, various countries have applied policy finance, development finance, and other supportive measures. So far, there are over 750 financial institutions (40% of which are in Latin America) working for the sole purpose of developing backward regions. Almost every African country has set up a bank for regional development. To support disadvantaged groups, over 150 countries have pension insurance institutions, and half of all the countries in the world have established policy medical insurance institutions. Furthermore, many countries have student loan schemes in various forms, which have played an important role in promoting economic development and social stability.

Second, a legal system governing finance for the disadvantaged. Most countries regulate financial institutions through a fully-fledged legal framework, and strictly separate financial legislations and regulations into those regulating commercial finance and those targeting policy and cooperative finance, so that the latter group of financial institutions has their own laws and are free from intervention. Thus, they are able to serve agriculture, rural areas, disadvantaged industrial sectors and groups better. Many countries have promulgated special laws to emphasize the importance of the finance for the disadvantaged, such as Federal Agricultural Loan Act, Agricultural Credit Union Act, and Community Investment Statute in the US, Law on Japanese Development Banks, Law on Japan

Scholarship Society in Japan, KfW-Gesetz (Law on KfW Development Bank) in Germany, Law on Korean Development Bank, Law on Long-term Credit Bank of Korea in South Korea, Act on Agricultural Intermediary Credit and Development Companies in India, etc. These laws are gradually improved to support and safeguard the development of financial institutions for disadvantaged regions, industrial sectors and groups.

Third, a system of supportive policies. Investment in less-developed regions disadvantaged industrial sectors and disadvantaged groups has lower efficiency, diminishing returns, and high risks; therefore, it is very unlikely to secure capital investment if completely market-oriented. As such, a lot of countries provide preferential policies, such as capital infusion in development financial institutions, guarantee, tax holiday, interest subsidy, etc. For example, the German government guarantees all the liabilities of KfW incurred in supporting the development of disadvantaged industrial sectors and regions, grants it special treatments such as tax exemption and zero dividend payout to shareholders, and allows all profits to be used to increase capital. Japan Development Bank is exempted from all local tax, state tax and corporate tax. The Korean government guarantees the principal and interest payment of financial bonds issued by Korean Development Bank's to support development of disadvantaged industries. The US federal government provides credit guarantee to private financial institutions that give credit to backward regions. In building the railway network in western states, the federal government granted various favorable financial policies to railway companies to boost their financing capabilities.

3. The focus in developing the finance for the disadvantaged in China

We have made some progress in developing the financial system for the disadvantaged, but there is a lot to do compared with that in developed countries and in order to build a harmonious socialist society. In my opinion, we should make efforts in the following three key aspects to in order to develop a financial system for the disadvantaged.

First, new measures should be taken to create a financial system for the disadvantaged. Since reform, some financial institutions have been established for the disadvantaged in China, but there are not fully fledged. For example, there are structural and operational problems in the rural financial institutions, such as extensive operational mode, weak management, low profitability, yet-to-be improved staff quality, and high risks associated with rural credit cooperatives; the Agricultural Bank of China has not fully functioned as a major player in commercial finance for farmers and rural economy; the risk compensation, sharing and transferring mechanism is not sound for policy agricultural loans, guarantee mechanism in rural areas and agricultural insurance are yet to be developed. There are not enough innovations of financial institutions and supportive policies to meet the needs of farmers' productive activities and livelihood. Generally speaking, there is room for improvement in the financial system for the disadvantaged, which should not only include traditional financial institutions, such as policy, development, commercial and cooperative financial institutions, but also include innovative financial institutions such as venture capital investment, guarantee, insurance, leasing, micro-credit financial institutions. Endeavors should be made to create a system in which various types of financial institutions coexist, complement and compete with each other, each with well-defined functions and responsibilities to satisfy the demand of disadvantaged industrial sectors, groups and backward regions for financial services. It is worth mentioning that, micro finance, as a new measure of poverty reduction, has evolved from the micro loans for farmers in the 1970s, to micro-credit for micro-businesses in the 1980s, and finance that seeks commercial viability and loan coverage. It has become an important part in the financial system for the disadvantaged. We have made some trials in micro finance in the past, and in the future, we will explore a development mode with multiple players in line with the Chinese situation by drawing on positive and negative experiences in other countries, so that micro finance can truly and effectively support the majority of disadvantaged.

Second, progress should be made in creating a legal system for finance for the disadvantaged. The finance for the disadvantaged is part of the financial system, so it carries the features and conforms to the general principles of the financial system on the one hand; while on the other, its development follows certain special rules. Thus, it is necessary to strengthen the legal system for finance for the disadvantaged. The first is to strengthen legislation for policy finance. From the international perspective, the primary principle here is a separate law for each type of policy financial institutions. Policy banks in China do not have its own legal framework; instead, they are regulated with reference to the laws and regulations governing commercial banks. This not only hinders the smooth operation of policy banks, but also affects how they position themselves. Therefore, we must actively explore

independent legislation for policy financial institutions. Administrative regulations may be promulgated before they gradually become laws. Second, strengthen regulation and guide of informal finance. Informal finance, as a complement to formal finance, plays a role in boosting economic activities in rural areas and poor regions and promoting regional economic development to some extent. However, due to absence of laws and regulations, it contains a lot of hidden risks. In recent years, informal finance's positive role is increasingly recognized, but the legal framework is not being developed at the same time. Therefore, laws and regulations should be created and improved to protect legitimate informal financial activities and crack down on loan sharks, underground banks, illegal fundraising and other illegal activities.

Third, adopt new measures in policy support to finance for the disadvantaged. Policy guidance and support from the government is common in developing finance for the disadvantaged. Government support should be multifaceted and mutually reinforcing, including legal, economic and administrative measures, both direct and indirect. As mentioned earlier, from the inception and development of finance for the disadvantaged in various countries, we can see that government support has played a central role. Finance for the disadvantaged is based on the effective combination of government credit and market credit, and reflect the synergy of government support and market performance. To be more specific, firstly, the government should provide reliable source of capital for specialized financial institutions, and provide guarantee for their policy lending to ensure sustainability of operations. Second, emphasis should be laid upon coordination between fiscal and financial policies, reflected in tax breaks and fiscal subsidies to relevant financial institutions and activities, and in close cooperation between fiscal and financial departments. Third, more transfer payment should go to disadvantaged groups, industrial sectors and backward regions in the form of agricultural insurance, unemployment insurance and minimum subsistence, to support their risk management and debt servicing capability.

These are my personal opinions toward the financial system for the disadvantaged, some food for thought. Hope they will provoke further research in this area, and hopefully more practice to make the financial sector more socially responsible in building a harmonious society. I'm open to questions and challenges.

Thank you!