REVIEW AND OUTLOOK OF AGRICULTURAL
FINANCE SYSTEM IN TAIWAN

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FOREWORD

Agricultural development is considered as the foundation of industrial development and, consequently of a country's overall economic development. However, to attain agricultural development, every government must view agricultural credit as an important policy.

Agricultural finance is vital to the achievement of agricultural policy objectives, and should not be regarded and treated as a general finance system, especially during this era of agricultural trade liberalization when the agricultural sector, the rural society and the farmers need all the help and assistance they can get to cope with the necessary transformation/adjustment.

This Bulletin discusses the importance of agricultural finance policy in providing adequate credit to support policy-oriented agricultural development measures, in particular, and agricultural production, in general. It is based on a paper presented by the author during the International Seminar on Farm Credit Issues in Asia sponsored by FFTC and the National Agricultural Cooperative Federation (NACF), held in June 2004 in Seoul, Korea. The seminar served as a venue for the exchange and sharing of information and policy implications on improving agricultural finance systems among Asian countries.

We hope that this Bulletin serves as a useful reference material toward achieving improved agricultural finance system within the region.
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ABSTRACT

This Bulletin illustrates Taiwan’s agricultural finance policy which aims to provide adequate credit to support policy-oriented agricultural development measures, in particular, and agricultural production, in general. In Taiwan, the government designs loan programs to give credit support to farmers for policy-favored operations, such as farm mechanization. It also assists agricultural credit institutions, such as, credit departments of farmers’ and fishermen's associations and agricultural banks, so that farmers would have easy access to credit to finance their capital needs in production, consumption, or investment. Some structural problems of the agricultural finance system in Taiwan include: lack of economy of scale and limited area and scope of business operation of credit departments; privatization and commercialization of agricultural banks; lack of central agricultural bank to integrate the credit departments; and less competitive operation and inefficient internal auditing system of most credit departments compared to other financial institutions. Toward reforming the agricultural finance system in Taiwan, it is important to implement agricultural finance law and to establish a central agricultural bank for improving the structure and performance of the whole system.

INTRODUCTION

Agricultural development is considered as the foundation of industrial development and, consequently of a country’s overall economic development. Agricultural credit was one of the most important policies that facilitated agricultural development in Taiwan.

Agricultural finance policy is vital in terms of providing adequate credit to support agricultural production, in particular, and policy-oriented agricultural development, in general. The Taiwan government designs loan programs to give credit support to farmers for policy-favored operations, such as mechanization of farm operations. It also assists agricultural credit institutions, such as credit departments of farmers’ and fishermen's associations and agricultural banks, to provide farmers with easy access to ordinary credit to finance their capital needs in production, consumption or investment.

Although the agricultural finance in Taiwan played a very significant role in Taiwan's agricultural development, its agricultural finance system needs further improvement. So far, 36 poorly-operated credit departments of farmers' and fishermen's associations have been disbanded, while Taiwan's agricultural finance system continues to undergo reform.

This paper introduces Taiwan's agricultural finance system, discusses the problems and weaknesses of the system, and provides some recommendations for its improvement.

AGRICULTURAL FINANCE SYSTEM

The agricultural finance system of Taiwan is composed of agricultural credit institutions, agricultural credit programs, agricultural credit guarantee fund system, and the administrative system.

Keywords: agricultural finance system, credit departments, agricultural loans, agricultural finance law, agricultural bank
Agricultural credit institutions

Agricultural credit institutions in Taiwan include: agricultural banks (The Farmers Bank of China, The Land Bank of Taiwan, and The Cooperative Bank of Taiwan), and credit departments of farmers' and fishermen's associations.

Agricultural banks. The Taiwan Cooperative Bank, formerly known as the Cooperative Bank of Taiwan, was established in 1946. Besides commercial banking, the Taiwan Cooperative Bank also serves as a central banking institution for community financial institutions, including credit cooperatives and credit departments of farmers' and fishermen's associations. Currently, 60% of its capital is owned by the government, 23% by farmers' and fishermen's associations, 12% by credit cooperatives, and 5% by private banks.

The Farmers Bank of China was founded in mainland China in 1933 and was transferred to Taiwan in 1949. It resumed its full operation in 1967. Before its privatization in 2000, the bank was mainly owned by the government. The primary functions of the bank are to provide financial support to the farming and fishery industries, promote reconstruction of the rural economy, and improve agricultural marketing. The bank is moving toward the direction of commercialization.

The Lank Bank of Taiwan was established in 1946. It is still fully owned by the government and is specialized in land and agricultural financing.

The agricultural banks are obligated to accept deposits from the credit departments of farmers' and fishermen's associations, when there are excess funds in these basic agricultural credit institutions.

It is envisioned that an "Agricultural Bank of Taiwan" will be established in 2005 to replace the three agricultural banks.

Credit departments. The credit departments of farmers' and fishermen's associations are grassroots financial institutions which serve as the base of agricultural credit in Taiwan. They are authorized to accept deposits from and extend loans to members, handle remittances, and serve as agents for agricultural banks and other government agencies in supplying farm credits. However, the scope that the credit department's business operation allows is much narrower than those of the banks.

The credit departments frequently make collections, and keep custody and account for the township treasury. The credit department is also allowed to provide short-term credit to other departments of the same farmers' association. However, the credit department must, for accounting purpose, be kept separate from other departments in the same farmers' association.

The distinct characteristics of the credit program of farmers' associations are: a) It differs from commercial credits in the sense that collateral requirements are relaxed to broaden availability to majority of small borrowers; b) A package of service activities is coordinated with credit supply; and c) The credit program of farmers' association is closely linked to agricultural extension activities and marketing function, since the activities are carried out annually with funds from the net earnings of these associations. The credit department is the major source of earnings for most farmers' associations (60% of the net profits of each credit department must go to the farmers' association).

There are, at present, 304 farmers' associations and 40 fishermen's associations in Taiwan. Of these, 253 farmers' associations and 25 fishermen's associations have credit departments, with a total of 839 annexes.

The credit department is the only banking facility within 93 of the 309 townships in Taiwan. Apparently, most credit departments serve as small rural community banks.

The credit departments of township farmers' associations make loans solely to their members (regular and associate members), as well as to their family dependents for farming and non-farming uses. Farm loans constitute the majority of their lending operations. Meanwhile, the main source of their lending funds is the deposits of their members and their family dependents.

The market shares of the total loans and deposits of the credit departments in Taiwan were limited, only 3.0% and 6.0%, respectively, in the financial market in 2004. However, roughly 48% of the total agricultural loans in Taiwan were provided by the credit departments.
Although some of the credit departments have serious operating problems, most of the credit departments within the system still made profits despite of recent deterioration in operating performances. According to the statistics, 211 out of the 253 credit departments of farmers' associations made total profits of 2.83 billion N.T. dollars, while 38 had total deficits of 2.78 billion N.T. dollars by the end of 2003.

Agricultural loan programs

A number of key agricultural loan programs were initiated by the Council of Agriculture (COA) of Taiwan to facilitate the achievement of agricultural policy objectives. Four of the most important ones are:

1) Farm Mechanization Loans: Loan interest subsidies are provided by the Agricultural Development Fund (ADF) to speed up agricultural mechanization with a view of enhancing efficiency in agricultural production and lowering farm costs.

2) Land Purchase Loans: Low interest long-term loans are also provided by the ADF to expand farming scale for better land utilization and to encourage agricultural land investment.

3) Accelerated Rural Development Loans: The loans began in 1973 in coordination with the government's various agricultural development measures. Items extended under these low-interest loans include those for crops, animal husbandry, fisheries, infrastructure, and improvement of agricultural marketing, village development, rural youth guidance, pollution prevention, soil and water resource conservation, and reconstruction after disasters. Interest subsidies are provided for these loans by ADF.

4) Repairing Farmers' Housing Loans: The low-interest loans began in 1991 to assist farmers and fishermen to repair their residences, speed up improvement of farm and fishing village environments, and promote overall development in the rural areas. Also, interest subsidies are provided for these loans by ADF.

Agricultural Credit Guarantee Fund

In order to assist farmers and fishermen who are lacking adequate security in acquiring necessary working capital, the Agricultural Credit Guarantee Fund (ACGF) was established in 1984 as a juridical person to provide guarantees for the borrowers.

By the end of 2003, the total fund raised for the ACGF was 3.14 billion N.T. dollars (the initial amount was 0.3 billion N.T. dollars). The ACGF was contributed by the government, the agricultural banks, and a few farmers' and fishermen's associations.

A ceiling of 90% for policy-oriented agricultural loans and 80% for general agricultural loans are covered by the ACGF. Every farmer or fisherman is eligible for almost all kinds of loans under this guarantee fund system. By the end of 2003, over 115,000 cases had been guaranteed.

This financial service reduces risks for the agricultural credit institutions and thus to some extent increases the lending amounts of agricultural loans.

Supervision and administration

The COA is in charge of the supervision and administration of farmers' and fishermen's associations. It used to be the Ministry of Internal Affairs, before the Farmers' Association Law was amended in 1999. The Ministry of Finance was responsible for the establishment, supervision, and performance evaluation of the credit departments of farmers' and fishermen's associations, as well as of agricultural banks before 2004. Since the Agricultural Finance Law was put into practice in January 2004, the administration authority of the credit departments had been transferred to COA. Therefore, credit departments and farmers' associations are now administrated by COA.

In order to safeguard the benefits of depositors, promote savings, maintain an orderly credit system, and enhance the sound development of financial operations, the Central Deposit Insurance Corporation (CDIC) was established by the end of 1985. It is the only government agency that conducts deposit insurance business in Taiwan. The CDIC also performs examinations of insured financial
institutions (including credit departments of farmers' and fishermen's associations) subject to
the approval of the Ministry of Finance in consultation with the Central Bank. In order to
monitor operations of financial institutions at any time, identify problem of financial
institutions, and serve as complementary tool for on-site examinations, the CDIC designed a
nationwide financial early warning system which started to operate in 1992.

An independent financial inspection
agency, the Financial Supervisory Commission
(FSC), has been established in July 2004 to
inspect all financial institutions, including credit
departments, in Taiwan.

ISSUES AND CHALLENGES

Operating problems
of credit departments

Market shares of deposits and loans of the
credit departments have been decreasing, e.g.
from 11% and 7.7% in 1996 to 6.0% and 3.0%
in 2004, respectively. Profits have also been
decreasing significantly, e.g. the rate of return
on capital dropped from 0.8% in 1996 to 0.3%
in 2004. In addition, non-performing loan rates
have been increasing rapidly, e.g. from 8.6% in
1996 to 15.5% in 2004. In general, the financial
structure of the credit departments has been
deteriorating in recent years, and some even
showed negative net worth.

Structural problems of the system

Most of the individual credit departments are
small scale. Lacking of economy of scale makes
the credit departments less efficient and
competitive in the financial market. Besides, the
area and scope of business operation of the
credit departments are limited, making them less
competitive. On the other hand, agricultural
banks are moving toward the direction of
privatization and commercialization, therefore,
the functions of agricultural financing provided
by these agricultural banks are diminishing.

The agricultural banks are not performing
the expected role of integrating the credit
departments well. In other words, a "central
agricultural bank" of the credit departments is
needed to integrate them and to improve the
structure of agricultural finance system in
Taiwan.

Furthermore, the internal auditing system
in most credit departments is not sound
even to prevent corrupt practices from
happening. Credit departments are not
independent financing institutions, and farmers'
associations could interfere in their operation
easily. In addition, most profits of the credit
departments are required to be allocated to
support other activities of the associations,
which makes the improvement of the credit
departments' financial structure very difficult.

Since the "share capital system" was
abolished in 1974, the ownership of farmers' associations became vague, and associations
could be easily manipulated by few administrators owing to the lack of concerns
and supervision from the members.

Compared with banks, most credit
departments are located in rural/remote areas,
and the salary level they offer their employees
is not competitive with other financial
institutions. Therefore, it is not easy for credit
departments to compete with banks in
attracting well-qualified personnel in the
professional job market, which in turn makes
the operation of the credit departments less
efficient and competitive.

Administrative problems

Before the Agricultural Finance Law took effect
in January 2004, the supervision and
administration of credit departments (Ministry
of Finance) and farmers' associations (Council
of Agriculture) were not unified, and this
hindered the efficiency of identifying and
solving problems in the early stage. Therefore,
it was argued whether a credit department
should be regarded as an inseparable part of a
farmers' association or not, and should be
administered by the same authority. Is it the
Ministry of Finance or the Council of
Agriculture which is responsible for its
administration?

According to the Agricultural Finance
Law passed in July 2003, the administrative
authority of the credit departments and the
farmers' associations should be unified, and the
Council of Agriculture is responsible for the
administration of the agricultural finance
system.
RECOMMENDATIONS AND PROSPECTS

1) Problems do exist within the agricultural finance system in Taiwan. Since these problems continue to persist, reform measures must be adopted to prevent further deterioration of the system and to avoid drastic resistance from all stakeholders.

2) The basic principle of reform in agricultural finance is to maintain and repair the agricultural finance system instead of destroying or taking apart the whole system. Agricultural finance is a very useful tool in facilitating the achievement of agricultural policy objectives, and should not be regarded and treated as a general finance system. The general finance system can hardly replace agricultural finance system, and cannot assume the roles which the credit departments and agricultural banks play. This is especially true during this era of agricultural trade liberalization when the agricultural sector, the rural society, and the farmers need all the help and assistance they can get from the agricultural finance system to proceed with the necessary transformation/adjustment.

3) The agricultural finance system in Taiwan is not as complete and sound as those in many other countries such as Japan, Korea, or European countries. To improve the system, a "central agricultural bank" should be established to replace the existing agricultural banks and to integrate the individual credit departments, provide a better environment of operation for the credit departments, and raise the efficiency and competitiveness of the credit departments in the financial market. A vision of the agricultural finance system in Taiwan is illustrated in Fig. 1.

4) The establishment of the Agricultural Finance Law ensured the role and function of the agricultural finance system in Taiwan. The law provides guidance for the sustainable development of the agricultural finance system, as distinguished from the general finance system, and defines clearly the functions and roles of the agricultural credit institutions within the system toward its sound development.

5) Unifying the administrative authority of credit departments and farmers' associations is a good move, since a credit department is an essential part of a farmer's association but is not an independent entity. Moreover, since agricultural finance is an agricultural policy tool, and since farmers' associations are agricultural organizations formed by farmers, it is but appropriate that the Council of Agriculture be the one to administer the whole system instead of the Ministry of Finance. However, the inspection and examination jobs of the credit departments could be carried out by the independent national financing inspection agency.

6) Deposit insurance operation could be handled by the CDIC, and a separate deposit insurance system for agricultural finance, as suggested by others, is not anymore necessary.

7) It is crucial to reconstruct the whole system of farmers' associations so that the problems of the credit departments could be solved fundamentally. The Farmers' Association Law must also be amended to improve the qualifications of general managers and board members, modify the election practices, restore the "share capital system", and establish a central farmers' association. These are some of the key measures for preventing corruption and enhancing the sustainable development of the farmers' associations.

CONCLUSIONS

Farmers' associations and their credit departments have played a very important role in facilitating the development of the agricultural sector and the whole economy in Taiwan. However, if the farmers' associations or the credit departments could not adapt themselves to the rapidly changing environment, the said institutions may eventually be abolished. If that were the case, it would be a significant loss to the farmers, the agricultural sector and the whole society.

The problem of credit departments of farmers' associations is part of the problem of
the whole financial system. Nevertheless, it is not a purely financial or economic problem since it is entangled with problems of the farmers, farmers' associations, the rural society, and the agricultural sector. Likewise, it is very much a political issue.

In choosing the right direction and selecting the proper measures for the agricultural finance reform process, it is crucial to answer the following questions first: How important is agriculture to the society? How much are we willing and are able to pay for it? Is an agricultural finance system really needed? What is the role we expect the agricultural finance system to play in agricultural development?

Toward solving part of the agricultural finance problem of Taiwan, there is a need to adopt an agricultural finance law and to establish a central agricultural bank to improve the structure and the performance of the whole agricultural finance system. While these will not solve all the problems of farmers' associations, these measures will definitely be critical in improving the structure and the performance of the whole agricultural finance system.

While the Agricultural Finance Law has already been passed and implemented, an "Agricultural Bank of Taiwan" has yet to be established in the future. Agricultural finance reform in Taiwan is moving toward the right direction, but problems still exist and efforts must be intensified to reconstruct the system.
Fig. 1. A vision of Taiwan’s agricultural finance system
NOTE

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www.fftc.agnet.org

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