

## **Chapter 1 Introduction**

### 1.1 Characteristics of Agricultural Finance

Agriculture has the following characteristics:

- Agricultural production is largely affected by natural condition.
- Agriculture is unprofitable business.
- Capital equipment is high even though agriculture is one-man business.
- Revenue opportunities are low.
- Collateral on property is mainly agricultural land.
- It takes a long time to repay loans.

Therefore, agricultural finance used for loaning money for agricultural production is unfamiliar compared with ordinary financial institutions, such as bank.

## **Chapter 2 Current Situation of Agricultural and Rural Finances in Japan**

### 2.1 Agricultural Finance System in Japan

#### 2.1.1 Financial Institutions Providing Agricultural Finance

Agriculture finance in Japan can be divided into financing by agricultural cooperative-affiliated financial institutions and private financial institutions, such as ordinary commercial banks, and financing by government-affiliated financial institutions, such as Agriculture, Forestry and Fisheries Finance.

In view of the share of loan to agriculture and rural areas with outstanding loan (as of the end of March, 2004) for each financial industry, most of loans (96.1% in total) are from agricultural cooperative-affiliated financial institutions (87.5% of the total) and government-affiliated financial institutions, such as Agriculture, Forestry and Fisheries Finance Corporation (8.6% of the total).



Source: Ministry of Agriculture, Forestry and Fisheries, Management Improvement Bureau, Credit Control Department

(1) Agricultural cooperative-affiliated financial institutions

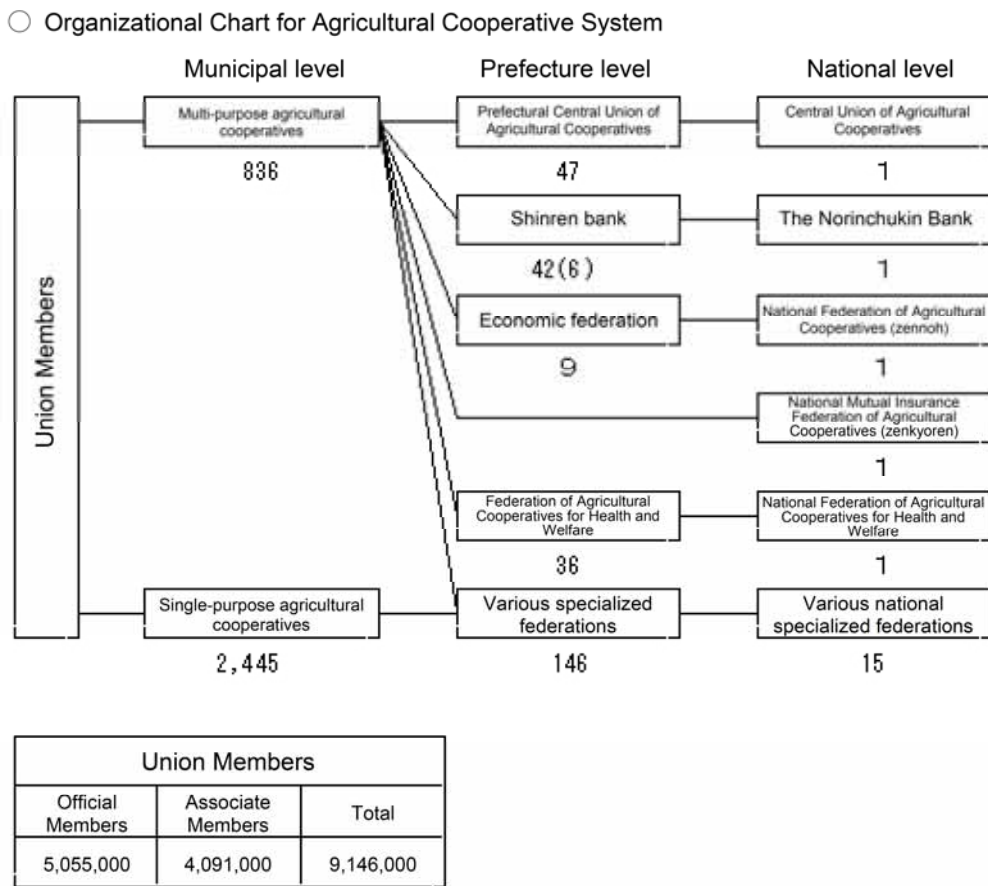
Agricultural cooperative-affiliated financial institutions consist of agricultural cooperatives (JA), Prefectural Federation of Agricultural Cooperative Associations and National Federation of Agricultural Cooperative Associations.

Agricultural cooperatives (JA) consist of multi-purpose agricultural cooperatives conducting sales, mutual relief and instructions as well as credit business (savings and lending practice), and single-purpose agricultural cooperatives having special department.

Agricultural cooperatives (JA) plays a large part in agricultural finance by providing money to union members based on savings of farmers.

(Current situation of agricultural cooperative-affiliated organizations)

Figure 2-2 Current Situation of Agricultural Cooperatives-affiliated Organizations



Source: Ministry of Agriculture, Forestry and Fisheries, Management Improvement Bureau, Credit Control Department

(Note) 1 Current number of union members as of 1st January, 2007 (Numbers of single-purpose agricultural cooperatives, various federations and national federations are numbers as of the end of March, 2006 (Agriculture, Forestry and Fisheries Ministry: Statistics on Numbers of agricultural cooperatives in 2005))

2. Number of union members are taken from " Statistical Table of General Agricultural Cooperatives in 2005 (fiscal year)".

3. The number in parentheses indicates the number of Sinrens that performed partial business assignment to agricultural and forestry central bank.

4. Number of single-purpose agricultural cooperatives in local authority level includes agricultural cooperatives in more than 2 prefectures, but not national-level agricultural cooperatives, and national-level agricultural cooperatives.

Number of single-purpose agricultural cooperatives in prefecture level include cooperatives in more than 2 prefectures, but not prefecture-level agricultural cooperatives.

## (2) Agriculture, Forestry and Fisheries Finance Corporation

The Agriculture, Forestry and Fisheries Finance Corporation was established in 1953 as a wholly government-funded policy finance institution to provide long-term low-interest fund that is necessary to maintain and improve the productivity of agricultural, forestry and fishery.

Financing facility by the Agriculture, Forestry and Fisheries Finance Corporation has been restructured, developed and improved to quickly respond to the development of agriculture, forestry and fishing in accordance with the above purposes since its establishment.

Currently, the Agriculture, Forestry and Fisheries Finance Corporation has been conducting business with 22 branch offices and 280 subcontracting banking institutions (as of the end of March, 2004), and the balance of money loans of agriculture, forestry and fishery is approximately 3.4 trillion yen as of the end of March, 2004).

### 2.1.2 Outline of Government-program Loans for Agriculture

Generally, it is hard for ordinary financial institutions to provide money to farmers due to low profitability caused by special structure of agricultural production and risks caused by characteristics of agricultural technology.

Therefore, the government-program loans for agriculture has been established as a measure for complementing support for agricultural workers and promoting the business to respond to Government request. Agricultural finance system has the following funds corresponding to the purpose and characteristics of the business.

(1) Loan that local authorities subsidize interest to private financial institutions, such as agricultural cooperatives

#### (1) Agriculture Modernization Loans

This loan is used for medium-term facility investment and running cost necessary to acquire agricultural machines and facilities in order to improve farm management.

Maturity period: Within 15 years

Interest: Interest varies depending on the financial conditions when borrowing money

(Reference: As of 20th September, 2005: Approved farmer: 0.65 to 1.35%, other farmers: 1.5%)

Possibility for lending money: Approved farmer\*: 100%, other farmers: 80%)

\* Basic loan limit is 18 million yen (200,000,000 yen for corporations)

\* Approved farmer: A farmer who is willing to achieve the business objective set by the municipality and improve the management, and whose agricultural management improvement plan that was submitted to and approved by the municipality (based on the "Farm Management Base Strengthening Promoting Law" established in 1993).

(2) Fund for relieving the liability for redemption for farming

Necessary fund to relieve the liability for redemption for farmers who are struggling to redeem liability incurred to farming

Maturity period: Within 10 years (within 15 years if necessary (depending on the annual amount of redemption, etc.)  
Interest: Interest varies depending on the financial conditions when borrowing money  
(Reference: 1.5% as of 20th September, 2005)  
Loan limit: None

(2) Long-term and high finance that private financial institutions, such as agricultural cooperatives, cannot fully support.

(1) Agriculture, Forestry and Fisheries Finance Corporation

Long-term facility investment that private financial institutions cannot provide money and used to acquire agricultural lands, facilities and a large-size fishing boat and plant trees in order to improve the management of works engaging in agriculture, forestry and fisheries.

Approved farmer: Super L fund  
Other farmers: Management entity cultivation strengthening fund  
Maturity period: Within 25 years  
Interest: Interest varies depending on the financial conditions when borrowing money  
(Reference: As of 20th September, 2005 Approved farmer: 0.65 to 1.5%, other agricultural workers: 1.5%)  
Possibility for lending money: Approved farmer\*: 100%, other farmers: 80%)  
\* Standard loan limit is 150,000,000 yen (500,000,000 yen for corporations)

(3) Interest-free fund for challenging a new business provided by prefectural and city governments and private financial institutions

(1) Agriculture Improvement Loans

Fund for acquiring agricultural machines and facilities to start growing a new crop

Maturity period: Within 10 years  
Interest: Interest-free  
Possibility for lending money: Approved farmer\*: 100%, other farmers: 80%)  
\* Standard loan limit is 18 million yen (50 million yen for corporations)

(2) Provident fund to start farming

Fund required for paying for training and preparing facilities helping the young to start farming (when the young starts farming, the farming goal and the proposal on trainings to achieve the goal must be approved by governors.)

i) Training fund to start farming (the fund required for the training to learn agricultural technique and management)

Interest: Interest-free

Loan limit: Agricultural college, etc. → 50,000 yen/ month

Advanced farmers, etc. → 150,000 yen/ month

Directive training (the young) → 2 million yen

Maturity period: Within 12 years if the applicant is young (15 years-old or older and younger than 30 years-old) (within 20 years if the agricultural land is disadvantaged area.)

Within 7 years if the applicant is middle-aged (younger than 55 years-old) (within 12 years if the agricultural land is disadvantaged area.)

ii) Provident fund to start farming (the fund required for relocating, obtaining the qualification, and searching the place to start farming)

Interest: Interest-free

Loan limit: 2 million yen

Maturity period: Within 12 years if the applicant is young (15 years-old or older and younger than 30 years-old) (within 20 years if the agricultural land is disadvantaged area.)

Within 7 years if the applicant is middle-aged (younger than 55 years-old) (within 12 years if the agricultural land is disadvantaged area.)

iii) Fund for facilities to start farming (the fund required to purchase machines and facilities, etc.)

Interest: Interest-free

Loan limit: For the young (15 years-old or older and younger than 30 years):

As for 2.8 million yen and over, either 9 million yen or 1/2 of necessary funds (smaller one) provided (5 years after farming has started).

For the middle-aged (younger than 55 years-old):

As for 1.8 million yen and over, either 9 million yen or 1/2 of necessary funds (smaller one) provided

Maturity period: Within 12 year

(4) Fund based on financial funds and money from private financial institutions

(1) Agriculture Management Promotion Fund (Super S fund)

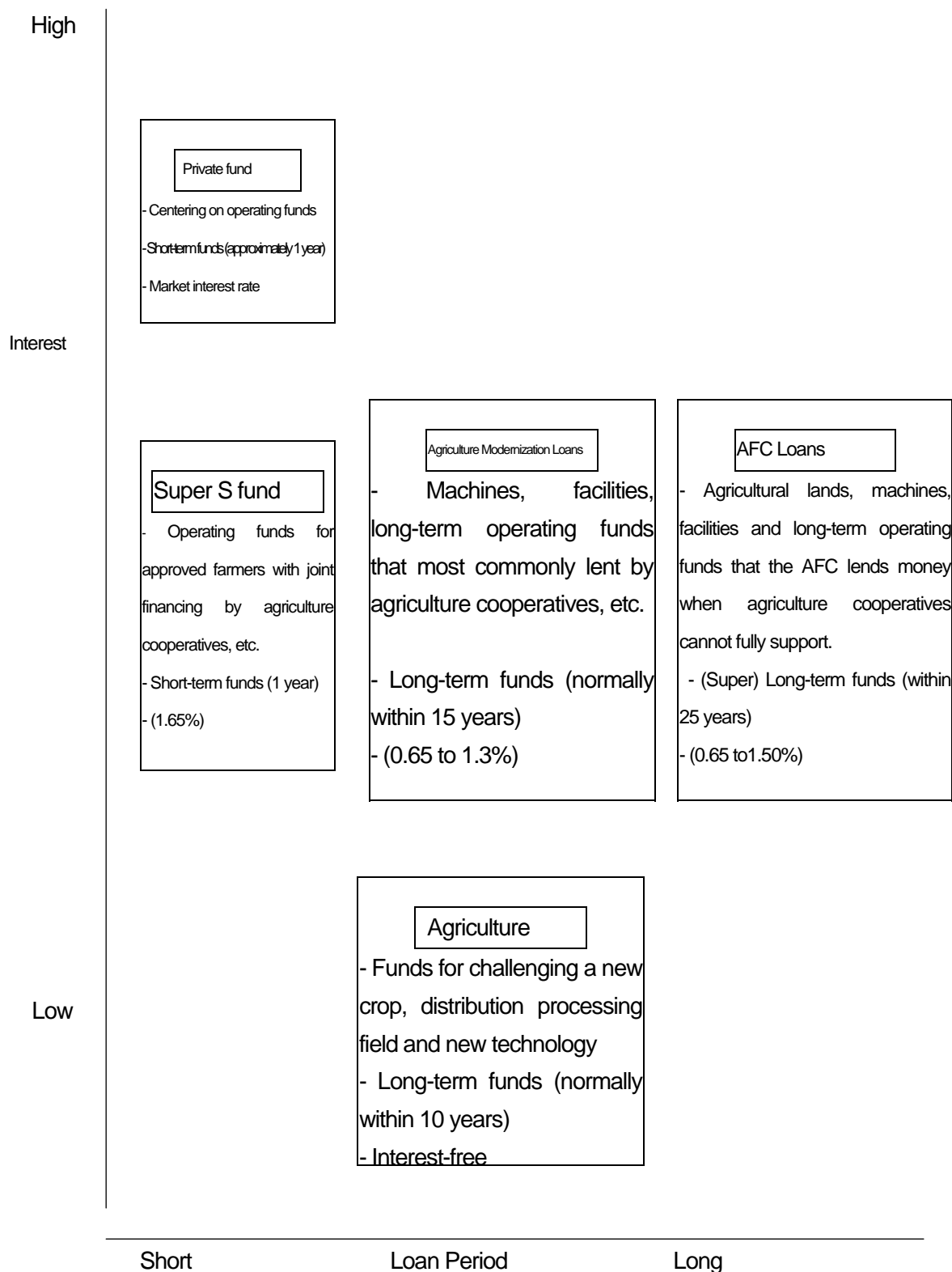
Short-term and low interest working capital necessary for approved farmers to expand the scale

Maturity period: Within 1 year

Interest: 1.65%

\* Standard loan limit is 5 million yen (20 million yen for corporation).

Figure 2.3 Positional Relation of System Fund



Note: The positional relation of interest is based on the current interest (as of 20th September, 2005).

Source: Ministry of Agriculture, Forestry and Fisheries, Management Improvement Bureau, Credit Control Department

### 2.1.3 Trend of Main Finances related to Agriculture

The finance record of the agricultural system fund, such as AFC fund and agriculture modernization fund, in recent years shows that the trend of agricultural system fund has been on a declining or stagnating trend. It may be caused by unfavorable business conditions.

The loan trend of main agricultural system funds is as follows.

#### (1) Fund by the Agriculture, Forestry and Fisheries Finance Corporation

The loan for the agricultural sector makes up 52.0% (as of the end of March, 2004) of the performance of APC fund.

The breakdown of the performance of loans for the agricultural sector by fund shows that the agriculture management promotion fund for local farmers (approved farmers) accounts for 22.5%, the agricultural production infrastructure development fund accounts for 36.4% including land improvement, etc., and the AFC facility fund, such as agricultural facilities and shared facilities, accounts for 15.6%.

#### (2) Agriculture Modernization Loans

The performance of agriculture modernization loans has been on a downward trend after peaking in 1977.

The breakdown of the performance of agriculture modernization loans by personal facility and shared facilities, personal facilities account for 52% and shared facilities account for 42%.

The breakdown of purpose for funds of private facility shows that loans for buildings, structures and agricultural instruments account for approximately 60% of total funds.

#### (3) Agriculture Improvement Loans

The performance of agriculture improvement loans has been on a downward trend after peaking in 1991.

#### (4) Agriculture Management Promotion Fund

The total amount of the agriculture management promotion fund is 14,100,000,000 yen (contract price) as of the end of March, 2004.

Table 2.2 Loan Trend of Agricultural System Fund

(Unit: hundred million yen)

|   | 2002.3 | 2003.3 | 2004.3 | 2005.3 | 2006.3 |
|---|--------|--------|--------|--------|--------|
| Fund by Agriculture, Forestry and Fisheries Finance Corporation (Agriculture) | 2,028  | 1,922  | 1,672  | 1,493  | 1,418  |
| Agriculture Modernization Loans   | 800    | 529    | 611    | 562    | 510    |
| Agriculture Improvement Loans   | 75     | 39     | 31     | 33     | 26     |
| Agriculture Management Promotion Fund   | 143    | 136    | 141    | 149    | 151    |

Source: Ministry of Agriculture, Forestry and Fisheries, Management Improvement Bureau, Credit Control Department

#### 2.1.4 Instructions to Agriculture System Finance

##### (1) Administrative Organization

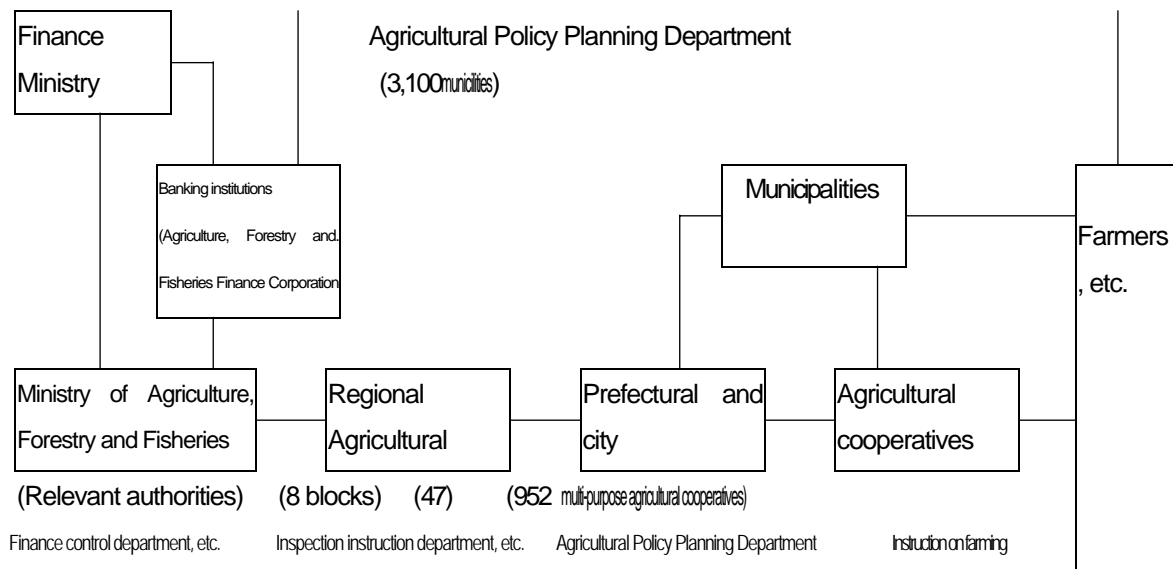
Instructions to the agriculture system finance are performed by the Ministry of Agriculture, Forestry and Fisheries that is the center of the agriculture system finance, the Regional Agricultural Administration Office controlling local blocks, prefectural governments and municipal governments.

The Ministry of Agriculture, Forestry and Fisheries plans various system finances, presents bills to the Diet, enforces, controls, and reviews systems. The Regional Agricultural Administration Office enforces and controls the system funds in local jurisdiction, instruct and make communications and adjustment with prefectural governments, and delivers subsidies.

The prefectural government gives general instructions regarding agricultural administration to municipal governments, provides detailed information regarding the community-based production measure, management and techniques to agriculture cooperatives and farmers, instructs various system funds and agricultural systems finances to agriculture cooperatives, and delivers subsidies to agriculture cooperatives.

Figure 2.4 Structure of Instruction

(As of the end of March, 2004, the number of municipalities is as of April, 2004.)



- Presentation of bills to the Diet session
- Securing of financing
- Supervising banking institutions
- Evaluation and review of the system
- Providing instructions to the Regional Agricultural Administration Office and prefectural governments
- Enforcement of the system
- Enforcement of financing
- Providing instructions to agriculture cooperatives
- Enforcement of the system
- Securing of financing
- Providing instructions to agriculture cooperatives

## (2) Budget for Government-program Loans for Agriculture

Government-program loans for agriculture provides favorable conditions for farmers with loan rate and redemption period since it is designed for providing secure financing to farmers with weak management foundation and who cannot get good financing from ordinary financial institutions, and providing incentives to projects that are necessary to promote agricultural policies.

The government must take certain budgetary steps to provide asset for keeping the interest rate low and interest subsidy for lowering the interest rate.

Therefore, budget needed for lowering the threshold for providing necessary funds and the interest rate is requested to the Ministry of Finance every year, and budget allocation is determined at the Diet.

Budgetary steps are taken for guarantee insurance institutions that guarantee liabilities of farmers to expand the financial ground for the guarantee insurance.

Similar budgetary steps are taken for fair enforcement of government-program loans for agriculture by the national government and prefectural governments, administrative cost for appropriate administration, and expense for promoting the government-program loans for agriculture.

## **Chapter 3      Current Situation of Agricultural and Rural Finances in Japan**

### **3.1 Before World War II**

The Japanese government has politically promoted the economic development by setting up special banks for each category as a measure to rapidly approach the economic level of advanced countries in Europe since Japan has opened up to the world and transition to capitalist economy has started after the restoration of Imperial power in 1868. The agricultural finance institution was also established as a special bank.

After 1896, Hypothec Bank (Nippon-Kangyo Ginko) and Bank of Agriculture and Manufacture (Nohko Ginko) established mainly for agriculture. Nippon-Kangyo Ginko was established to provide the long-term investment fund contributing to the increase of agricultural production, such as land improvement and road construction, to mainly landlords in rural areas by receiving real property as security. On the other hand, Nohko Ginko was established in each prefecture to lend small amount of money to farmers by receiving real property as security.

However, industrialization and urbanization have been advanced at the time, so that landlords that were initially expected to expand the agricultural productivity based on agricultural investment became landlords receiving rent rather than farmers. Banks also raised profits by providing loans to non-agriculture sectors since commerce and industry developed much faster than agriculture. Therefore, loans for the agriculture sector by Nippon-Kangyo Ginko and Nohko Ginko accounted for approximately 34% and 42% of total, respectively, and they lost their character as farm loan banks and became mortgage bankers. Then, agricultural and industrial banks started competing with other private financial institutions and Nippon-Kangyo Ginko, so that ailing agricultural and industrial banks increased and all agricultural and industrial banks merged with Nippon-Kangyo Ginko. Then, Nippon-Kangyo Ginko was also converted into ordinary banks in 1950 (after world war II).

At the time, most of farmers were minute independent farmers and tenant farmers, not landlords and larger than medium-scale farmers. In 1908, 50% of paddy area and 40% of field area were tenanted lands, and the percentage of independent farmers, tenanted farmers and small tenant framers were 33%, 28% and 39%, respectively. 72% of landlords were minute landlords having the land less than 1ha and landlords having the land more than 3ha were only 9% of all landlords. It was almost impossible to increase agricultural production by providing funds to landlords and medium-size and large-size farmers only on security of lands. Therefore, the necessity of the government-program loans for agriculture providing relatively short-term working capital without security to many minute farmers including tenanted farmers arose. Thus, industrial cooperative financing (current financing by agriculture cooperatives) was established ("Cooperative Society Law" was established in 1900.)

However, the industrial cooperatives have small financial power and their role as a banking institution was small. Farmers mainly borrowed money from informal moneylenders, such as loan sharks (advance money from consolidating stations). Therefore, farmers were caught in the debt spiral and became insolvent when bad harvest or price drop occurred.

Then, boom period lasted for a certain period immediately after World War I, but financial crisis occurred in 1920. The price of rice and silk sharply decreased and farm household economy was deeply hurt. Therefore, the industrial cooperative central bank (current "Norinchukin Bank") was established in 1923 and

it adjusted financial surplus or deficit among industrial cooperatives in Japan, and raised funds by helping non-agricultural sectors migrate from the standard financial market to industrial cooperative financial institutions. Due to credit capability of the Norinchukin Bank at the time, the government took relatively low-interest loans (Chukin loan) issued by the Norinchukin Bank, so that the Norinchukin Bank was strictly controlled by the government as a semi-private banking institution.

After the Great Depression in 1929, rural areas were impoverished and liabilities of farmers largely increased since the price of silk and rice sharply decreased and cold-weather damage occurred several times in 1930's. At that time, miserable things, such as selling daughters, frequently occurred. To cope with the situation, the "Self-reconstruction Campaign of Rural Economy" started. This campaign encouraged self-help efforts to reduce debts. With the campaign, the debt reduction cooperatives were established to negotiate with creditors. When the conditions to relieve repayment were decided, the government supported farmers by lending money at low interest.

However, agriculture in Japan was involved in wartime economy without seeing the achievement of this campaign. In 1938, the National Mobilization Law was established and all resources were used for the war. The Food Control Law was established in 1942 and distribution of rice, oats and potato were under the control of the government.

### 3.2 Post-War High Economic Growth and Agricultural Finance

After the end of World War II in 1945, Japanese social economy was in serious turmoil and people were on the verge of starvation. Therefore, the government carried out the temporal financing for procuring fertilizer by requesting assistance from the central bank to increase food production. On the other hand, various systems were developed to secure long-term development and the agricultural land reform was carried out during 1947 to 1950. In 4 years, 80% of tenanted lands were forcibly bought out and they were sold to tenant farmers. Therefore, incentives to increase the food production were significantly improved. The Agricultural Cooperative Association Law of Japan was established in 1947 and the Land Reform Act was established in 1949 while carrying out the agricultural land reform. In 1953, the Agriculture, Forestry and Fisheries Finance Corporation was established providing financial assistance to small-size independent farmers that were created by the agricultural land reform, and the land reform was promoted mainly by irrigation. The agriculture improvement loans for introducing new technology were established in 1956 and agriculture modernization loans to subsidize interest to medium- and long-term operating funds by using private financial institutions, such as banking institutions related to agricultural cooperatives, were established in 1961.

In the late 1950s, high economic growth started in Japan and the income gap between agriculture and industry became apparent. Economical development should have gradually closed the gap between agriculture and industry by reducing the number of farmers, enlarging the farm scale and increasing the productivity. Under the circumstances, the basic law on agriculture was established in 1961 and it represented the scenario that closes the income gap by expanding the management scale, improving the productivity, and focusing on growing agricultural crops having high demand. The Agriculture, Forestry and Fisheries Finance Corporation played a large role for supporting the agricultural structural reform.

Although this scenario was partially realized in capital intensive farming (chicken farming, pig farming

and protected horticulture), agriculture in remote area where people could not get nonagricultural work, and agricultural works that cannot do as the on-the-side job, such as diary, many farmers continued farming as weekend farmers (mainly wet paddy rice growing) after getting secure jobs.

Although rich and varied diet is realized, the food self-sufficiency sharply decreased. In Japan, domestic food supply has been lowering since the number of farmers has been falling while abandoned, unused or little-used agricultural lands have been increasing. Aging of the population and depopulation have been apparent in rural areas and some areas cannot maintain the communality due to outflow of rural population.

Therefore, agricultural finance must play an important role for comprehensively supporting innovative governmental efforts by smoothly providing loans to farmers with weak and reducing the interest-rate in order to steadily promote various policies.

#### **Chapter 4 Conclusion - Problems in Development of Agricultural Finance**

Due to internationalization of the economy, import liberalization of agricultural products has been promoted and Japan is being the world's leading importer of agricultural products. Many agriculture lands are abandoned since many weekend farmers do not have successors and farmers are aging. Medium-size farmers that should take over agricultural work must pay back the debt caused by expanding the farm scale with their agricultural revenue, so that they are financially weak. Agricultural finance must financially contribute to realize the agricultural structure that core farmers occupy most of production and survive under the WTO system by centralizing agricultural resources to core farmers.

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