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REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE

PEOPLE'S REPUBLIC OF CHINA

FOR THE

RURAL FINANCE SECTOR PROGRAMME

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CURRENCY EQUIVALENTS

Currency Unit	=	Yuan Renminbi (CNY)
USD 1.00	=	CNY 8.19
CNY 1.00	=	USD 0.12

WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 metre (m)	=	1.09 yards (yd)
1 square metre (m ²)	=	10.76 square feet (ft ²)
1 acre (ac)	=	0.405 ha
1 hectare (ha)	=	2.47 acres
1 ha	=	15 mu
1 mu	=	0.066 ha

ABBREVIATIONS AND ACRONYMS

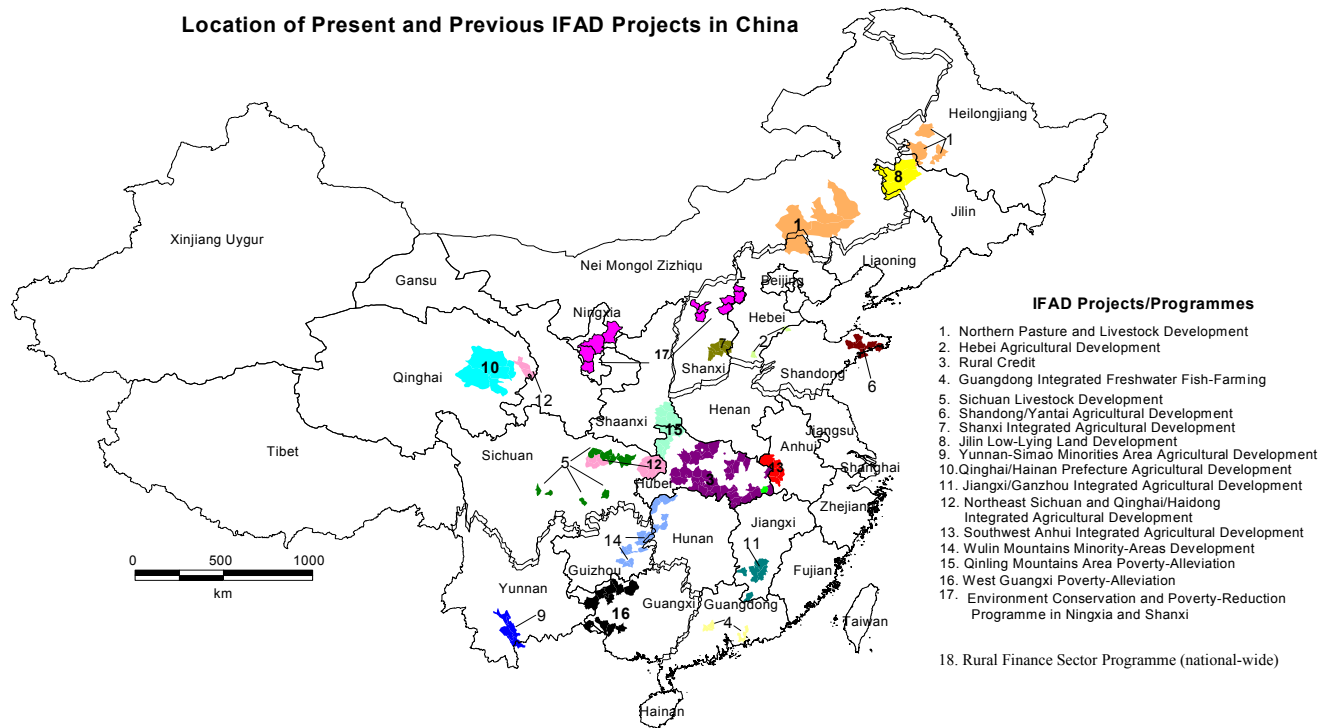
ABC	Agricultural Bank of China
CBRC	China Banking Regulatory Commission
CFSD	Cooperative Finance Supervision Department
COSOP	Country Strategic Opportunities Paper
CPMO	County Programme Management Office
NCMO	National Coordination and Monitoring Office
PBC	People's Bank of China
PMO	Project Management Office
PPMO	Provincial Programme Management Office
RCC	Rural Credit Cooperative
RCCU	Rural Credit Cooperatives Union
TVE	Township and Village Enterprise
UNOPS	United Nations Office for Project Services
WFP	World Food Programme

GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA**Fiscal Year**

1 January - 31 December

MAP OF THE PROGRAMME AREA

Location of Present and Previous IFAD Projects in China



WFP/IFAD China VAM Unit, March 2002



Source:

The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

PEOPLE'S REPUBLIC OF CHINA
RURAL FINANCE SECTOR PROGRAMME

LOAN SUMMARY

INITIATING INSTITUTION:	IFAD
BORROWER:	People's Republic of China
EXECUTING AGENCY:	Provincial Rural Credit Cooperatives Union (RCCU)
TOTAL PROGRAMME COST:	USD 21.3 million
AMOUNT OF IFAD LOAN:	SDR 9.95 million (equivalent to approximately USD 14.7 million)
TERMS OF IFAD LOAN:	40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum
COFINANCIERS:	<ul style="list-style-type: none">– Rural Credit Cooperatives (RCCs)– Rural Credit Cooperatives Unions (RCCUs)– CBRC
AMOUNT OF COFINANCING:	<ul style="list-style-type: none">– RCCs: USD 6.1 million– RCCUs: USD 97 000– CBRC: USD 24 000
TERMS OF COFINANCING:	<ul style="list-style-type: none">– RCCs: loan– RCCUs: grant– CBRC: grant
CONTRIBUTION OF BORROWER:	USD 406 000
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	United Nations Office for Project Services (UNOPS)

PROGRAMME BRIEF

Who are the beneficiaries?

Programme beneficiaries comprise about 120 000 poor rural households in four poverty stricken counties of two provinces. The programme will help implement pilot reforms in rural finance policies with a view to rendering them more poverty- and gender-oriented. Average rural household incomes range from USD 50 to USD 180, less than one quarter of the gross national income per capita of USD 840. Typical households are engaged in mixed dryland farming; and a significant proportion of their income is earned by migrating to other areas to work as seasonal or short-term labour.

Why are they poor?

Poverty stricken areas are usually remote and far from provincial and county-level economic centres. These areas are characterized by poor natural resources, limited investments in industry or services and inadequate social services and facilities. Overall, this has led to reduced economic activity and lagging social development. One of the major obstacles to eradicating poverty in these areas is the lack of investment resources and outflows of funds to more economically attractive urban areas.

What do the beneficiaries expect from the programme?

Rural households, particularly poor households, expect rural credit cooperatives (RCCs) to be able to provide them with needed investment resources and other financial services in line with their assets and capabilities. To this end, the programme will assist in implementing several policy reforms on a pilot basis. Should the results be positive, the reforms will be extended to other, ongoing, IFAD projects.

How will the beneficiaries participate in the programme?

Households will participate in the programme as borrowers and depositors using RCCs that are involved in applying policy reforms. Microfinance, group lending and lending programmes targeted at women will increase the outreach of RCCs and improve the access of poorer households to institutional financial services.

**REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD
TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE
PEOPLE'S REPUBLIC OF CHINA
FOR THE
RURAL FINANCE SECTOR PROGRAMME**

I submit the following Report and Recommendation on a proposed loan to the People's Republic of China for SDR 9.95 million (equivalent to approximately USD 14.7 million) on highly concessional terms to help finance the Rural Finance Sector Programme. The loan will have a term of 40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum. It will be administered by the United Nations Office for Project Services as IFAD's cooperating institution.

PART I – THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY

A. The Economy and the Rural Finance Sector

1. **Overall economic performance.** Covering an area of 9.6 million km² and with an estimated 1.25 billion people, China is the world's most heavily populated country. Despite the recent economic downturn in the region, China's economic performance over the last decades is unparalleled. During the period 1978-99, gross domestic product (GDP) increased by an average of 9.7%. Since 1978, real per capita income has increased by 525%, or 7.9% per year. In 2000, the average income per capita in the urban areas was USD 767; the corresponding figure in the rural areas was USD 275, of which USD 200 represented cash earnings.

2. The country's economic development in 2001 demonstrates that, although the international economy is important, the main driving force is growth in domestic demand. China has maintained a high growth rate of 7.3% thanks to the performance of industry and services. However, the value-added of agriculture has increased by only 2.8% following diversification to more remunerative activities. Budget revenues in 2001 rose by 22.2% as a result of better tax administration and strong enterprise performance reaching 18% of GDP. Total spending grew more slowly (18.6%), thereby reducing the budget deficit to 3.0% of GDP. Recent overall deflationary developments have helped China to maintain its international price competitiveness and have resulted in improved terms of trade in rural areas.

3. **Rural financial institutions.** China's financial sector is headed by the People's Bank of China (PBC), which was established in December 1948 and is governed by the Central Bank Law of 1995. Under the leadership of the State Council, PBC formulates and implements monetary policies to maintain the stability of the national currency and promote economic growth. PBC's Cooperative Finance Department has been responsible for overseeing the Rural Credit Cooperatives (RCCs) but has been transformed recently into the China Banking Regulatory Commission (CBRC). Formal rural finance services are provided by the Agricultural Bank of China (ABC), the Agricultural Development Bank of China (ADBC) and the RCCs. ABC and the RCCs had a long history of closing, reopening, merger integration and separation until the RCCs were separated from ABC in

1996 and came under the direct supervision and management of PBC and then CBRC since 2003. From then on, ABC has operated as a commercial bank focusing on crop procurement, industrial processing and rural industries, but not excluding individual households and township and village enterprises (TVEs). ADBC was set up as a policy bank in 1995, when it took over responsibility for crop procurement from ABC, which, however, retained responsibility for subsidized poverty-reduction lending.

4. By the end of 2001, more than 40 500 RCCs were operational, accounting for a total of CNY 1 200 billion (USD 146.5 billion) in loans outstanding (11% of the total banking sector) and CNY 1 700 billion (USD 207.6 billion) in deposits (12% of total). RCC's outstanding loans are dominated by TVEs, which account for about 50% of all loans. Loans to households amount to approximately 25% (USD 53.9 billion), and the remainder are provided to private and household enterprises. A recent PBC policy decision restricts further lending to TVEs. A more detailed presentation of typical RCC Unions (RCCUs) and RCCs appears in Appendix III.

5. **Policy reforms.** PBC and later on CBRC have been instrumental in introducing many innovations that are now being tested on a pilot basis. In the rural finance sector, these include: liberalization of the lending interest rate; introduction of micro-lending and joint-liability group lending; incentive schemes for staff; and a review of the legal status of RCCs. For each of these innovations, pilot counties are now being selected for application of the new policies. The outcome of the tests will determine whether or not they are to be applied on a larger scale. A critical step was taken in June 2003, when China's banking regulatory body, the China Banking Regulatory Commission was established and took over the regulatory functions from PBC.

B. Lessons Learned From Previous IFAD Experience

6. Since 1980, IFAD has financed 17 loans to China for a total of approximately USD 429 million. Project performance has been good: objectives are normally achieved ahead of time, and poor households obtain effective access to project investments and support. IFAD/World Food Programme (WFP) joint operations, which commenced in 1996, have created strong synergies between food-driven actions supported by WFP and production-oriented investments through IFAD resources. WFP food aid helps the subsistence farmers to become almost self-sufficient in food. This allows them to make better use of credit for cash-generating activities and to build up assets for further development, thereby increasing prospects for sustainability.

7. In the projects designed under previous country strategies, credit delivery was normally project-based with little involvement of existing financial institutions. While this is an effective way of targeting project activities, the institutional set-up involved is not sustainable after project completion. Therefore, since 1996, IFAD projects have provided for the delivery of credit through the RCCs. This approach has led to some difficulties, which have been overcome gradually over time. With some justification, project management offices (PMOs) have seen RCCs as risky in terms of recovering the IFAD project resources provided to them. Moreover, RCCs do not have the autonomy of independent banks as they mostly serve clients proposed to them by the PMOs, thus increasing risks. The handling of commissions and charges at the provincial, prefecture and county levels have made IFAD funds unattractive and expensive to RCCs.

8. IFAD's Thematic Study on Rural Finance, undertaken in 2000, analysed both project-managed credit and RCC operations. The findings of the study were discussed at a meeting attended by representatives of the Ministries of Agriculture and Finance, PBC and IFAD, when it was decided that RCCs would be the main channels for the disbursement of IFAD loan funds. It was also agreed that IFAD would support the Government in restructuring RCCs to render them cost-effective and sustainable, and realize their potential in terms of reducing poverty. The present programme has been designed on the basis of these objectives.

C. IFAD's Strategy for Collaboration with China

9. **China's policy for poverty reduction.** According to official statistics quoted by many international organizations, China has built up an impressive record in terms of reducing poverty. In 1978, the country had approximately 250 million poor, corresponding to about 30% of the rural population, but by 1998 this number had been reduced to 42 million or less than 5%. It is obvious that the incidence of poverty depends on the poverty lines used; those of the Government have been rather conservative, defined as covering minimum food and clothing needs. If the arbitrary USD 1 per capita/day poverty line is used and poverty is measured in terms of consumption expenditures rather than estimated income, one finds that rural poverty rose by 27% in 1996-99. However, if income is used as the yardstick, the incidence of poverty would appear to have reached only 11% in 1999. It is likely that rural poverty fell in 2000-2001 thanks to improved terms of trade and higher rural incomes. However, the rural-urban poverty gap widened during the same period as the result of faster growth in urban incomes. The incidence of urban poverty declined to 7.7% in 1996-99.

10. **IFAD's strategy in China.** IFAD's Country Strategic Opportunities Paper (COSOP) for China, approved in February 1999, builds on the 1998 joint IFAD/WFP strategy. Since then, three projects have been approved: the Qinling Mountain Area Poverty-Alleviation Project; the West Guangxi Poverty-Alleviation Project; and the Environment Conservation and Poverty-Reduction Programme in Ningxia and Shanxi. A key aspect of all IFAD projects in China is delivery of credit to poor households, supplemented by advisory support services and social development.

Programme Rationale

11. The proposed Rural Finance Sector Programme corresponds to one of IFAD's strategic objectives: enabling the rural poor to escape poverty by increasing their access to financial services and markets. The programme will help to strengthen IFAD's catalytic impact through the establishment of institutional and policy frameworks in support of the poor. This is in line with the Fund's regional strategy for the Asia and the Pacific region, under which greater efforts are to be made to identify projects and programmes with potential for influencing policies and generating a 'ripple effect'. The COSOP emphasized the need for support to the rural finance sector to turn RCCs into sustainable microfinance institutions with a poverty- and gender-sensitive approach to facilitating the access of poor rural people to credit and other financial services. The COSOP also recommended that a policy dialogue should be undertaken with the PBC, now CBRC, and RCCs with a view to better supporting the RCC reform process.

12. The rationale of the programme is based on two major considerations. First, RCCs play an important role in the provision of financial services in rural areas in view of their extensive network and outreach capacity, with credit officers providing services at the farm gate. However, both past operations and present policies have put RCCs into situations where their sustainability was at risk. To address this problem, the Government is currently in the process of defining a programme of policy reforms for RCCs, some of which are already being tested on a pilot basis. Second, the aforementioned Thematic Study on Rural Finance confirmed the validity of IFAD's strategy to provide loan funds to poor households through RCCs. Once a proper policy environment is in place, the RCCs will be able to play an important role in future IFAD projects.

13. The CBRC and RCCs have already launched a reform process which will create an enabling environment for the programme to provide support in defining RCC policies so as to improve their impact on both poverty reduction and institutional sustainability. Another programme objective is to provide loan funds for implementation of the new policies, especially in microfinance. In supporting such policy reforms, emphasis will be placed on lending policies to provide better access to RCC loans,

especially for poor households and women, and on institutional and operational policies that increase the efficiency of the institutions and contribute to their financial sustainability.

PART II – THE PROGRAMME

A. Programme Area and Target Group

14. **Programme area.** The programme will be implemented at the national level to support CBRC and RCCUs in testing a number of policy and institutional reforms. In line with China's current reform strategy, these tests will be initially undertaken in selected geographical areas. Should the results of the tests be conclusive, the reforms will be applied at national scale.

15. Since rural finance is only one – albeit crucial – component of rural development, pilot activities will be undertaken in the project areas of IFAD-funded interventions. This will ensure that microfinance policies are applied in the IFAD projects and that credit operations are complemented by both agricultural and social support services and infrastructure development. Such an approach will also ensure that households receive appropriate training to enable them to carry forward income-generating activities funded by loans. The programme will be implemented in four counties of two provinces that are among the provinces selected by CBRC for pilot activities.

16. **Target group.** The programme is expected to benefit about 120 000 poor rural households. Several of the above-mentioned policy reforms will improve the access of poor households to loans, especially in terms of micro and group lending and loans for women. Other policies will help to transform the RCCs into sustainable financing institutions, which is in the interests of all their clients but especially the poor for whom the RCCs constitute the only source of formal deposits and loans.

17. The programme's ultimate target group consists of poor households with an average per capita income of USD 113 (in 2001) and a rural poverty incidence of about 50%, based on the official poverty line of USD 122 per capita. However, by its very nature, a sector programme should help to improve the policy environment and institutional and operational modalities of RCCs and RCCUs in the programme area. This will not only benefit poor households but all other RCC/RCCU clients. The choice of the pilot counties as provincial poverty-stricken counties, however, ensures that programme benefits will flow to a population which, to a large extent, qualifies as poor, while the 'better-off' in such poverty areas still have incomes that are less than half the average national per capita income.

B. Objectives and Scope

18. The overall aim of the programme is to ensure that rural financial services contribute effectively and sustainably to reducing poverty. Its specific objectives are to ensure that: (i) rural households, including poor households, have better access to financial services and effectively make use of them to improve their living standards; (ii) RCC policy reforms have been successfully tested in the programme area and are being implemented in IFAD-financed interventions elsewhere; (iii) improved institutional and operational management capacity in programme RCCs is applied on a larger scale and contributes to improving cost-effectiveness and profitability; and (iv) modalities to resolve the problem of non-performing loans have been tested and applied on a wider scale.

C. Components

19. The programme is structured around five components: policy development; institutional development; operational development; financing; and programme management.

Policy Development

20. The programme approach in support of policy reforms is to assist in ongoing or planned policy adjustments; help in refining implementation modalities; and ensure that new policies have clear gender and poverty dimensions. In this respect, programme support will focus on liberalizing the interest rate, on microfinance and group lending, and on lending to women. At a later stage, support will be provided for the development of other new products.

21. **Interest rate liberalization.** PBC has allowed RCCs to apply ceiling interest rates, typically with a 50% margin above the PBC base rate. Recently, PBC has allowed a number of RCC pilot operations to increase their margins on interest rates to 100% of PBC rates. The programme will provide support to RCCUs to determine market-derived lending interest rates.

22. **Microfinance** approaches presently being introduced include a number of positive innovations, such as the possibility of borrowing without collateral or guarantees; guaranteed access to loans once households have been certified as creditworthy; and the possibility of disbursing loans at the farm gate. County-level RCCUs have prepared detailed regulations in various ways. The programme will make periodic analyses of current rules and regulations and their impact on borrower selection, types of activities funded, portfolio quality, loan risk and participation by poor households. Based on these analyses, the programme will assist RCCUs in adjusting regulations to improve the programme's effectiveness and impact in terms of reducing poverty.

23. **Group lending** policies have not been explicitly developed but form part of the microfinance regulations for cases where a loan request exceeds the individual loan ceiling. The programme will support RCCUs to further develop the concept of group lending and to carry out pilot schemes.

24. **Women's window.** Experience has shown that women tend to be better borrowers than men, and thus represent less of a risk for financing institutions. Nonetheless, most lending goes to men, even when the funds are used for activities carried forward by women. Based on experience in Anhui Province, the programme will support the establishment of a 'women's window' in collaboration with representatives of the Women's Federation. By means of this window, women will be able to take out individual or group loans in their own names. As required, the programme will provide funds for functional literacy training and women will be given their own signature seals. Representatives of the Women's Federation at the village and township levels will, if so requested, help women to establish groups and to fill out application forms and submit them to the RCCs.

25. **New products.** During the second half of its implementation period, the programme will help to develop new and diversified financial products. One area of possible interest is a variation in repayment modalities to replace the present bullet repayments.

Institutional Development

26. **Infrastructure and equipment.** In view of the precarious financial situation of many RCCs, essential equipment has not been procured or replaced and no building maintenance has taken place, with the result that working conditions in several RCCs have become hazardous. The programme will allocate funds to each RCC to carry out the most urgent repairs and maintenance work, and, where required, to strengthen their security facilities. It will also ensure that each RCC has at least two computers and a printer, and, wherever necessary, computer training and specific software will be provided. Electronic mail connections that permit direct communications with the RCCUs will be promoted. In addition, each of the four RCCUs will be equipped with at least one vehicle, which will be used for transporting money as well as for support and supervision work in RCCs.

27. **Staff training.** The levels of staff education and training in the RCCs and RCCUs vary between areas, although the poorest and most remote areas tend to have less qualified staff. Staff training is rather scarce within the system. The programme will therefore support a staff training programme for RCC, RCCU and CBRC provincial staff. Training on modules will be provided for RCC managers, credit officers, accountants and administrative staff.

28. **Legal structure.** Once they have reached a certain volume of business, rural finance institutions are required to fulfil a number of functions and tasks that are usually performed at the headquarters level, including internal control, settlements, technical support to branches, product development, fraud prevention and staff training. This enables institutions to continue expanding their operations and to overcome the crises that inevitably occur throughout their growth cycles. Isolated RCCs that have no access to higher-level support will not be able to internalize these functions due to their lack of economy of scale. The present pilot transformation of RCCs into branches of county-level RCCUs offers very promising prospects in this regard as it will make it possible to further develop the above-mentioned core functions at the RCCU level and help support the growth and strengthening of individual RCCs. The programme will therefore help to change the legal status of township RCCs into RCCU branches in each pilot county.

Operational Development

29. **Accounting system and policies.** The current accounting systems and practices followed by RCCs and RCCUs involve the provision of detailed accounts of their respective financial situations. The programme will provide support to bring these systems more into line with international practices while continuing to use present inputs. A computerized accounting system may need to be designed for this purpose. Computer software would make it possible to integrate important policy issues, such as a provisioning policy, based on a loan-ageing analysis. Moreover, support will be provided to review policies on accruing interest incomes, loan rescheduling and the writing-off of non-performing assets.

30. **Staff incentive system.** Several RCCs and RCCUs recently introduced incentive schemes whereby about 60% of staff income consists of a fixed, minimum salary and 40% is earned through bonuses. ABC has followed this type of system since the mid-1980s. In addition, RCCs undertake staff screenings through bi-annual examinations with a view to maintaining or improving staff qualifications. The programme will assist in analysing the incentive effects of the system, its impact on the cost-effectiveness of operations and overall financial results, and on staff morale and motivation. Further applications, in terms of individual performance indicators and categories of staff under a similar system, will be analysed and proposed for implementation. Constant monitoring of effects and the drawing up of guidelines for replication are also foreseen.

Financing

31. **Credit lines.** RCC lending resources consist of deposits and refinancing from PBC. Average loan/deposit rates are about 80%, the remaining 20% being kept in reserve at the PBC. Refinancing is relatively expensive: for instance, in February 2002 the interest rate was 3.2%. In this situation, the introduction of new products such as microfinance, group lending and lending to women is constrained by lack of resources. Following introduction of the microfinance programme and the provision of certificates to about 25% of households, further certification was halted as the RCCs were unable to honour their commitment to provide loans to certificate holders at any time. The programme will therefore provide additional credit lines in order to expand microfinance, group lending and lending to women, matching RCC contributions on a 50:50 basis.

Programme Management

32. A county programme management office (CPMO) will be established in each county RCCU covered by the programme. The CPMOs will be responsible for the planning and implementation of activities, monitoring implementation in the RCCs, reporting, disseminating results through workshops and providing support to ongoing IFAD projects in adopting successful approaches followed by the pilot programmes. CPMO directors will be appointed by the RCCUs, and the programme will finance the services of additional professional staff members, accountants, secretarial support, office equipment and vehicles in each of the units. Separate funding will be available for ad hoc studies on different implementation aspects. This will also cover semi-annual reviews and planning meetings with RCC managers and the provincial PMO.

33. A provincial programme management office (PPMO) will be set up at the RCCU of each programme province. The PPMOs will be headed by directors and comprise professional staff members, accountants and secretarial staff funded by the programme. Each PPMO will be provided with a vehicle and operating costs plus a budget allocation for ad hoc studies and consultant support, workshops and meetings, and will be responsible for planning activities in consultation with the RCCUs, monitoring implementation and consolidating reports.

34. **National coordination and monitoring office.** The national coordination and monitoring office (NCMO) will be located at the CBRC head office. The Cooperative Finance Supervision Department (CFSD) will appoint the director and the NCMO will be composed of representatives of the Ministry of Finance and CBRC. The NCMO will be responsible for providing policy guidance, and for ensuring that policy reforms undertaken in different RCCUs are both coherent and in line with national policy considerations. For that purpose, NCMO will supervise the implementation of programme activities through frequent field visits.

35. Monitoring of programme implementation will be based on a set of agreed indicators. Consultant studies and regular reporting by RCCUs and provincial CBRCs will provide the required information for this purpose. The NCMO will organize national-level workshops to discuss results and to pursue policy discussions with practitioners in the rural finance sector. It will also be responsible for reporting to the Ministry of Finance and IFAD on a semi-annual basis, in accordance with an agreed proforma.

D. Costs and Financing

36. Cost estimates have been based on a modular approach for a typical province. This approach will involve two counties, within which 30 RCCs will operate. Total costs include two such province modules, which provide a high degree of autonomy to the PPMOs in terms of the programming of resources.

37. The total costs of the four-year programme have been estimated at CNY 174.3 million, or USD 21.3 million. Underlying assumptions are a domestic inflation rate of 1.5%, a foreign inflation rate of 2.5% and an exchange rate of USD 1=CNY 8.194. Physical contingencies of 10% have been applied on all items, except for credit and salaries. Summaries of programme costs and financing are given in Tables 1 and 2, respectively.

TABLE 1: SUMMARY OF PROGRAMME COSTS^a
(USD '000)

Components	Local	Foreign	Total	% of Foreign Exchange	% of Base Costs
Policy development	1 584	573	2 156	27	11
Institutional development	3 307	605	3 913	15	19
Operational development	660	227	887	26	4
Financing	11 994	0	11 994	0	60
Programme management	1 075	101	1 176	9	6
Total base costs	18 620	1 506	20 126	7	100
Physical contingencies	630	150	780	19	4
Price contingencies	339	39	378	10	2
Total programme costs	19 589	1 696	21 285	8	106

^a Discrepancies in totals are due to rounding up.

TABLE 2: FINANCING PLAN^a
(USD '000)

Components	IFAD		CBRC		RCCU		RCCs		Government		Total		Foreign Exchange	Local (Excl. Taxes)	Duties and Taxes
	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%			
Policy development	2 440	99.9							2	0.1	2 442	11.5	649	1 791	2
Institutional development	4 029	92.2							341	7.8	4 370	20.5	678	3 351	341
Operational development	988	99.2							7	0.8	995	4.7	254	733	7
Financing	6 090	50.0					6 090	50.0	-	-	12 180	57.2	-	12 180	-
Programme management	1 120	86.4	24	1.8	97	7.5	-	-	56	4.3	1 296	6.1	114	1 127	56
Total disbursement	14 669	68.9	24	0.1	97	0.5	6 090	28.6	406	1.9	21 285	100	1 696	19 183	406

^a Discrepancies in totals are due to rounding up.

38. The programme will be financed by an IFAD loan of USD 14.7 million, or 69% of total costs. From the loan, the programme will match RCC credit funds for microfinance, group lending and women's loans, providing USD 6.1 million or 29% of total programme costs to the RCCUs as a subsidiary loan. CBRC and RCCUs will, from their own resources, cover the salaries of the directors of CPMOs, PPMOs and the NCMO. The Government will cover all taxes, for a total of USD 406 000, or 2% of total costs.

E. Procurement, Disbursement, Accounts and Audit

39. **Procurement** will be undertaken by the programme implementation units of RCCUs and other programme units. Training and consultancy services represent the most important group of items for procurement. All international consultants will be recruited on the basis of international shopping procedures, with bids requested from at least three reputable suppliers. Contracts for national consultants, training and studies costing more than USD 10 000 equivalent will be based on local shopping procedures, with bids from at least three suppliers. Contracts exceeding the equivalent of USD 50 000 will require the prior approval of the cooperating institution, United Nations Office for Project Services (UNOPS). Contracts for civil works, vehicles and equipment estimated to cost more than USD 50 000 equivalent will be awarded on the basis of local competitive bidding. Contracts for the same items estimated to cost USD 50 000 equivalent or less may be awarded on the basis of local shopping procedures, with bids invited from at least three reputable suppliers. Contracts for USD 10 000 equivalent or less for national consultancy contracts, training and studies will be procured using direct contracting under terms of reference acceptable to IFAD. Loans will be provided to borrowers on the basis of loan contracts signed with RCCs.

40. **Disbursement.** The IFAD loan will be disbursed over a period of four years. A special account will be opened in each province by the Provincial Department of Finance into which IFAD will make an initial deposit of USD 1.9 million to cover expenditures for the first six months. All programme expenditures are eligible to be covered by the special account, which will be replenished against statements of expenditure (SOEs) for categories determined by the Borrower, IFAD and UNOPS. The originals of justification documents will be kept in the respective programme units and made available for inspection by supervision missions and auditors. RCC loans to eligible farmers and groups and under the special programme for women will be partly financed from annual contributions for the establishment of revolving funds in each county. Monthly summaries of credits disbursed and recovered will be maintained on a gender-differentiated basis for review by supervision missions.

41. **Accounts and audit.** Each CPMO will maintain consolidated accounts. The financial reporting and accounting practices followed by the Finance Bureaux are acceptable to IFAD. The accounting sections will be adequately staffed and fully capable of handling the accounting requirements of the programme. Independent auditors will be responsible for auditing all accounts including the review of the withdrawals on the basis of SOEs and provide an opinion on whether such expenditures fully comply with expenditures eligible for IFAD disbursement. The independent auditors will also review the management aspects of the credit operation, and comment on disbursements and recoveries and on provisions for bad debts. Certified copies of the audit reports will be provided to IFAD and the cooperating institution not later than six months after the end of each financial year.

F. Organization and Management

42. The Ministry of Finance shall delegate implementation to the PPMOs and the CBRC will be responsible for establishing national policies of rural finance and supervising their implementation.

43. The planning of all activities will be undertaken by the managers of the concerned RCCUs and the director of the CPMO, who will draw up annual action plans for review and endorsement by the PPMO. At the planning stage, account will be taken of the need to coordinate activities between

provinces. Action plans will be accompanied by annual budgets and financing plans, drawn up in line with detailed cost estimates presented in the cost tables. To allow for flexibility and adjustment to local conditions, the directors of the PPMOs and CPMOs will be authorized to reallocate all funds other than the credit lines between activities up to a cumulative total of 25% of the total annual budget.

44. Funds for the credit lines will be on-lent to the RCCUs in accordance with the terms of a subsidiary loan agreement acceptable to IFAD. Terms will include an on-lending rate of 0.75% per annum, a grace period of ten years and a maturity of twenty-five years. During the grace period, funds will constitute a revolving fund in the RCCU for the purpose of financing microfinance, group loans and loans to women.

45. In a programme such as this, which will pilot policy reforms, monitoring assumes an even greater importance. The PPMOs and the NCMO will coordinate their respective monitoring activities and review programme progress twice-yearly. The units will be also responsible for the dissemination of results to RCCs, RCCUs and other parties such as IFAD, Cooperating Institution, the NCMO and other IFAD supported projects.

G. Economic Justification

46. The programme will generate important benefits both in terms of improving the access of households, and especially poor households, to formal rural financial services and in strengthening the efficiency and sustainability of RCC institutions. Individual households will benefit from collateral-free loans provided under new policies. According to IFAD's Thematic Study on Rural Finance, in 1999, some 50-80% of all RCC loans drawn by households have been used for investments in crop and livestock production, 10-20% for services and about 10% for processing activities. Average household loan sizes for crop and livestock activities varied between CNY 700 and CNY 1 500, while loans for services and processing averaged about CNY 3 500.

47. The return on such investments is high, as witnessed by the crop and livestock activity models presented in each IFAD project document. The economic analysis of investments in livestock production shows returns before labour that range between 83% and 151%. For investments in crop production, the incremental revenues range between USD 15 and 58 per *mu*, whereby land levelling has the highest incremental return, underlined by a benefit-cost ratio of 4.8. Loan activities will thus yield significant returns and be effective instruments for reducing poverty.

48. About one third of total programme costs will be spent on policy development and for improving the institutional and operational capacity of the RCCUs/RCCs. A large proportion of such funds will be used for technical assistance and staff training. For these, it would be highly speculative to quantify financial or economic benefits. Therefore, no economic rate of return for the programme has been estimated as it would be largely dependent on non-directly verifiable assumptions, such as the relationship between the liberalization of the interest rate and the volume of loans outstanding or between the volume of staff training and the profitability of RCCs.

49. The credit lines provided under the programme will match the RCCs' own resources for microfinance, group lending and women's windows. These funds will constitute revolving funds for eight years at the RCCs. With an estimated loan volume for this purpose of about USD 3 million per year in each province, the total loans provided to poor households during the eight-year period will amount to about USD 96 million. The programme is expected to reach about 120 000 poor rural households.

H. Risks

50. The programme will introduce crucial policy reforms on a pilot basis. Since it is essential that these pilots be carried out in a professional manner, applying proper policies and procedures, the programme will provide for international and national consultants. The risk that the pilot activities fail for reasons inherent to the programme, rather than for objective reasons in the implementation environment, should be minimized if not eliminated. Factors such as delays in fund transfers, recruitment of consultants who do not meet high-quality standards, and problems in communications should be avoided. Close monitoring and supervision may help to avoid these problems.

I. Environmental Impact

51. The programme will focus on financial policy reforms and on improving access for rural households, including the poor, to formal financial services. As a result of the programme, households that could not previously borrow from RCCs will now be able to do so, which will allow them to undertake economic activities to improve their incomes. Based on the aforementioned studies and experience, it can be expected that a large proportion of these incremental loans will be used to purchase agro-chemicals and for the most popular livestock activity, pig-raising. This will provide manure, which will in turn increase crop productivity and reduce the need for fertilizer. On balance, while the environmental impact of the programme is difficult to assess, it will undoubtedly increase the use of chemical inputs. However, the proportion of the increase within the total consumption is minimal and will have a negligible impact on the environment and public health. Therefore, the programme has been classified as Category B.

J. Innovative Features

52. The programme will include the following main features:

- support for pilot implementation of policy reforms in microfinance, group lending and lending to women. These policies represent major innovations in the rural finance framework and support will be based on best practices drawn from both international and national experience;
- support for reforms in the legal status of RCCs and introduction of staff incentives and accountability schemes. Under the latter, staff would earn a base salary of not more than 50-60% of their previous salaries and the remainder would be earned on the basis of performance and periodic skills tests. As such, the scheme represents an interesting innovation for national or international public institutions; and
- the programme is the first policy-support programme implemented by IFAD in China.

PART III – LEGAL INSTRUMENTS AND AUTHORITY

53. A loan agreement between the People's Republic of China and IFAD constitutes the legal instrument for extending the proposed loan to the borrower. A summary of the important supplementary assurances included in the negotiated loan agreement is attached as an annex.

54. The People's Republic of China is empowered under its laws to borrow from IFAD.

55. I am satisfied that the proposed loan will comply with the Agreement Establishing IFAD.

PART IV – RECOMMENDATION

56. I recommend that the Executive Board approve the proposed loan in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the People’s Republic of China in various currencies in an amount equivalent to nine million nine hundred and fifty thousand Special Drawing Rights (SDR 9 950 000) to mature on or prior to 15 April 2044 and to bear a service charge of three fourths of one per cent (0.75%) per annum, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.

Lennart Båge
President

**SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES
INCLUDED IN THE NEGOTIATED LOAN AGREEMENT
(Negotiations concluded in Rome on 19 April 2004)**

1. **Counterpart contribution.** The Government of the People's Republic of China ("the Government") will ensure that each province provides adequate counterpart funds from its own resources to cover taxes under the programme in accordance with its customary national procedures.
2. **Availability of loan proceeds.** The Government will make the proceeds of the loan available to each provincial and county Rural Credit Cooperatives Union (RCCU) in accordance with the annual work plan and budgets (AWP/Bs) and the respective subsidiary agreements to carry out the programme, and will ensure that each county RCCU makes the loan proceeds available to each Rural Credit Cooperative (RCC) in accordance with the AWP/Bs. The Government will ensure that the RCCs make available from their own resources the amount of no less than USD 6 000 000 for the provision of credit to the target group.
3. **Programme area.** The programme will be initially implemented in four (4) counties, of which two will be located in Shaanxi province and the other two will be located in Chongqing province. The Government and IFAD may agree to implement the programme in any other county within the context of the National Banking Reform Programme of the Government.
4. **Subsidiary agreements.** The Government will enter into an agreement with each provincial government for the transfer of available loan proceeds as a loan. The Department of Finance will enter into an agreement with each provincial RCCU participating in the programme for the transfer of available loan proceeds as a loan. The provincial RCCU will enter into an agreement with each county RCCU participating in the programme for the transfer of available loan proceeds as a loan.
5. **Additional events of suspension.** IFAD may suspend, in whole or in part, the right of the Government to request withdrawals from the loan account if: (i) the audit report has not been satisfactorily concluded within 12 months of the financial reporting date; (ii) any of the subsidiary agreements or any provision thereof, have been violated or have been waived, suspended, terminated, amended or otherwise modified without the prior consent of IFAD, and IFAD has determined that such violation or waiver, suspension, termination, amendment or other modification has had, or is likely to have, a material adverse effect on any portion of the programme; (iii) IFAD has determined that the material benefits of the programme are not adequately reaching the target group, or are benefiting persons outside the target group to the detriment of target group members; (iv) in consultation with the Government, a repeal, invalidation, suspension, amendment or other change to any national law may result in detriment of any of the terms and conditions of the programme loan agreement; and (v) procurement has not been carried out in accordance with the programme loan agreement.
6. **Conditions precedent to the effectiveness of the programme loan agreement.** The following are the additional conditions precedent to the effectiveness of the programme loan agreement:
 - (a) the draft AWP/B for the first programme year will have been submitted to IFAD for its no objection;
 - (b) a copy of each signed subsidiary agreement will have been delivered to IFAD;
 - (c) the programme loan agreement will have been duly signed, and the signature and performance by the Government will have been duly authorized and ratified by all necessary administrative and governmental action; and
 - (d) a legal opinion, issued by the Department of Treaty and Law of the Ministry of Foreign Affairs in form and substance acceptable to IFAD, will have been delivered to IFAD.

APPENDIX I

COUNTRY DATA

CHINA

Land area (km² thousand), 2000 1/	9 327	GNI per capita (USD), 2000 1/	840
Total population (million), 2000 1/	1 261.1	GNP per capita growth (annual %), 2000 1/	6.1 a/
Population density (people per km²), 2000 1/	135	Inflation, consumer prices (annual %), 2000 1/	0.3
Local currency	Yuan Renminbi (CNY)	Exchange rate: USD 1 =	CNY 8.19
Social Indicators		Economic Indicators	
Population (average annual population growth rate), 1980-99 2/	1.3	GDP (USD million), 2000 1/	1 079 954
Crude birth rate (per thousand people), 2000 1/	16 a/	Average annual rate of growth of GDP 2/, 1980-90	10.1
Crude death rate (per thousand people), 2000 1/	7 a/	1990-99	10.7
Infant mortality rate (per thousand live births), 2000 1/	30 a/	Sectoral distribution of GDP, 2000 1/	
Life expectancy at birth (years), 2000 1/	70 a/	% agriculture	16
Number of rural poor (million) (approximate) 1/	39.3	% industry	49
Poor as % of total rural population 2/	5	% manufacturing	38
Total labour force (million), 2000 1/	759.1	% services	34
Female labour force as % of total, 2000 1/	45	Consumption, 2000 1/	
Education		General government final consumption expenditure (as % of GDP)	11
School enrolment, primary (% gross), 2000 1/	123 a/	Household final consumption expenditure, etc. (as % of GDP)	49
Adult illiteracy rate (% age 15 and above), 2000 1/	16	Gross domestic savings (as % of GDP)	40
Nutrition		Balance of Payments (USD million)	
Daily calorie supply per capita, 1997 3/	2 897	Merchandise exports, 2000 1/	249 212
Malnutrition prevalence, height for age (% of children under 5) 2000 1/	16 a/	Merchandise imports, 2000 1/	225 097
Malnutrition prevalence, weight for age (% of children under 5), 2000 1/	9 a/	Balance of merchandise trade	24 115
Health		Current account balances (USD million)	
Health expenditure, total (as % of GDP), 2000 1/	4.5 a/	before official transfers, 1999 1/	10 723
Physicians (per thousand people), 1999 1/	1.4	after official transfers, 1999 1/	15 667
Population using improved water sources (%), 1999 4/	75	Foreign direct investment, net 1999 1/	36 978
Population with access to essential drugs (%), 1999 4/	85	Government Finance	
Population using adequate sanitation facilities (%), 1999 4/	38	Overall budget deficit (including grants) (as % of GDP), 1999 1/	-2.2 a/
Agriculture and Food		Total expenditure (% of GDP), 1999 1/	9.3 a/
Food imports (% of merchandise imports), 1999 1/	4	Total external debt (USD million), 1999 1/	154 223
Fertilizer consumption (hundreds of grams per ha of arable land), 1998 1/	2 826	Present value of debt (as % of GNI), 1999 1/	14
Food production index (1989-91=100), 2000 1/	171.9	Total debt service (% of exports of goods and services), 1999 1/	9.0
Cereal yield (kg per ha), 2000 1/	4 735	Lending interest rate (%), 2000 1/	5.9
Land Use		Deposit interest rate (%), 2000 1/	2.3
Arable land as % of land area, 1998 1/	13.3		
Forest area (km ² thousand), 2000 2/	1 635		
Forest area as % of total land area, 2000 2/	17.5		
Irrigated land as % of cropland, 1998 1/	38.8		

a/ Data are for years or periods other than those specified.

1/ World Bank, *World Development Indicators* database

2/ World Bank, *World Development Indicators*, 2001

3/ United Nations Development Programme (UNDP), *Human Development Report*, 2000

4/ UNDP, *Human Development Report*, 2001

PREVIOUS IFAD FINANCING TO CHINA

Project Name	Initiating Institution	Cooperating Institution	Lending Terms	Board Approval	Loan Effectiveness	Current Closing Date	Loan/Grant Acronym	Currency	Approved Loan/Grant Amount	Disbursement (as % of approved Amount)
Northern Pasture and Livestock Dev. Project	IFAD	UNOPS	HC	22 Apr 81	20 Jul 81	31 Dec 88	L - I - 62 - CH	SDR	28 700 000	100%
Hebei Agricultural Development Project	IFAD	WB: IBRD	I	15 Sep 82	14 Jan 83	31 Dec 88	L - I - 107 - CH	SDR	22 900 000	100%
Rural Credit Project	IFAD	WB: IDA	HC	11 Sep 84	22 Jan 85	30 Jun 89	L - I - 153 - CH	SDR	24 250 000	100%
Guangdong Integr. Freshwater Fish-Farming Proj.	IFAD	WB: IBRD	I	03 Dec 86	24 Mar 87	31 Dec 92	L - I - 195 - CH	SDR	10 150 000	96%
Sichuan Livestock Development Project	IFAD	UNOPS	HC	30 Nov 88	16 May 89	30 Jun 95	L - I - 233 - CH	SDR	13 400 000	100%
Shandong/Yantai Agric. Dev. Proj.	IFAD	UNOPS	HC	07 Dec 89	10 Jul 90	31 Dec 96	L - I - 254 - CH	SDR	16 800 000	100%
Shanxi Integrated Agric. Dev. Proj.	IFAD	UNOPS	HC	04 Apr 91	26 Jul 91	30 Jun 98	L - I - 281 - CH	SDR	17 850 000	100%
Jilin Low-lying Land Development Project	IFAD	UNOPS	HC	14 Apr 92	15 Jun 92	30 Jun 98	L - I - 300 - CH	SDR	20 000 000	100%
Yunnan-Simao Minorities Area Agric. Dev. Proj.	IFAD	UNOPS	HC	15 Sep 93	10 Dec 93	31 Dec 00	L - I - 335 - CN	SDR	18 400 000	99%
Qinghai/Hainan Prefecture Agric. Dev. Proj.	IFAD	UNOPS	HC	05 Dec 94	08 Jun 95	30 Jun 01	L - I - 364 - CN	SDR	13 500 000	100%
Jiangxi/Ganzhou Integrated Agric. Dev. Proj.	IFAD	UNOPS	HC	06 Dec 95	10 May 96	31 Dec 01	L - I - 395 - CN	SDR	15 950 000	100%
Northeast Sichuan & Qinghai/Haidong Integr. Agric. Dev. Proj.	IFAD	UNOPS	HC	11 Sep 96	14 May 97	30 Jun 03	L - I - 424 - CN	SDR	19 100 000	93%
Southwest Anhui Integr. Agric. Dev. Proj.	IFAD	UNOPS	HC	11 Sep 97	12 Dec 97	30 Jun 04	L - I - 451 - CN	SDR	19 100 000	100%
Wulin Mountains Minority-Areas Dev. Proj.	IFAD	UNOPS	HC	10 Sep 98	21 Apr 99	31 Dec 04	L - I - 483 - CN	SDR	21 100 000	27%
Qinling Mountain Area Poverty-Alleviation Proj.	IFAD	UNOPS	HC	08 Dec 99	14 Aug 01	31 Mar 08	L - I - 517 - CN	SDR	21 000 000	10%
West Guangxi Poverty-Alleviation Proj.	IFAD	UNOPS	HC	07 Dec 00	21 Mar 02	30 Sep 08	L - I - 552 - CN	SDR	23 800 000	8%
Environment Conserv. & Pov.-Red. Progr. in Ningxia & Shanxi	IFAD	UNOPS	HC	11 Dec 02			L - I - 600 - CN	SDR	21 950 000	

BASIC INFORMATION ON SELECTED RCCUS AND RCCS

1. This appendix provides basic information on RCCUs in two counties of two provinces, which may be included in the programme. It also provides information on selected township RCCs in each county.

A. Example 1

2. **Structure and staffing.** An administrative reform reduced the number of townships in the county from 15 to 10, but 15 RCCs are operating to maintain the same coverage. Together with a business office directly managed by the RCCU, this accounts for 16 independent legal units. The business office, which is situated in the county capital, is responsible for settlements between RCCs, for supporting RCC cash management and for providing deposit and loan services. There are also 196 representative offices operated by agents on a commission basis, which can only receive deposits – their authority to disburse loans having been cancelled by PBC.

3. The total staff of the RCCs and RCCU amounts to 172 in all, of whom 78 (45%) are women. PBC regulations stipulate that RCCs should have a minimum staff of four, while the largest RCC has 18 staff members. The single urban credit cooperative had 22 staff but it merged with the RCCU, whose staff numbers 46, of whom 25 are women. Of these, 15 are administrative staff; the other 31 deal with commercial matters.

4. Of the total staff, 18 hold university degrees, 39 have diplomas from professional banking high schools and 101 have certificates of ordinary high school education. Among these, 17 have middle-level professional certificates and 71 primary-level professional certificates. The rest of the staff are technicians. ABC issues professional certificates on the basis of examinations. The minimum required qualifications for RCC managers and RCCU managers are primary-level certificates and middle-level certificates, respectively.

5. A typical RCC is located in a simple building in a varying state of maintenance, sometimes lacking basic amenities and running water. Security facilities are often rather rudimentary. Only nine out of the 15 RCCs use computers. Vehicles are not provided; some credit officers use their own bicycles to visit villages, but most travel by public transport. Some RCCs use vehicles that date back to the 1970s. The RCCU has a number of heavily-used vehicles for transporting cash. The remotest RCC, located at a distance of 50 km, takes two hours to reach, largely over unpaved roads.

6. **Deposits.** By the end of June 2002, the RCCU and RCCs held more than CNY 307.4 million in deposits. Of this, CNY 276.6 million (90%) came from households, the remainder coming from public institutions and local government. At the same date, a total of CNY 301.2 million in loans was outstanding, of which CNY 91 million had been financed through PBC refinancing. The loan/deposit ratio was thus 68%. Loans to agriculture amounted to CNY 157.2 million, or 52% of the total.

7. **Loans.** At end-June 2002, the breakdown of loans outstanding by types of borrowers was as follows:

Type of borrower	Amount (CNY million)	%
Individual households	124.92	41
Groups of households	11.08	4
Household microfinance	7.21	2
Agricultural economic organizations	13.96	5
Rural enterprises, incl. TVEs	97.69	32
Other enterprises	46.36	15
Total	301.22	100

Source: RCCU

Note: Agricultural economic organizations include collective service providers.
Other enterprises include private and household enterprises.

8. **Microfinance.** Lending started in 1999, when PBC drew up regulations that were further defined by the RCCU. An information campaign was organized among the population, but people sometimes found it difficult to distinguish loans from grants. Effective lending began in three pilot townships in 2000. Group lending involves groups of three-to-five households that accept joint responsibility for repayment. A deposit of 3-5% of the total loan amount must be pledged and loans are based on individual loan contracts. The repayment capacity of each member household is assessed by the RCC.

9. Microfinance certificates were provided to 2 440 households, of which 25% were in Level 1¹; 10% in Level 2; and 65% in Level 3. About 50% of rural households did not qualify for such certificates. Re-evaluation of household eligibility is undertaken every two years. The loan interest rate was 0.6% per month, with a maturity not exceeding 12 months. Loan ceilings were set at CNY 20.000 for Level 1; CNY 15.000 for Level 2; and CNY 10.000 for Level 3.

10. **Staff incentive system.** Since the beginning of 2002, a province-wide staff incentive system has been applied under which staff receive 60% of their previous salary level plus a bonus, the size of which is determined by RCC revenue. It is still too early to judge the effectiveness of the system. However, RCC performance improved during the first six months of 2001: interest income rose to CNY 7.9 million compared with CNY 4.7 million in the corresponding period of 2000. Whether this can be wholly attributed to the incentive system has not yet been decided, but there appears to be a certain correlation. A decision is still to be taken on how to deal with RCCs that are incurring losses.

11. In addition to the above-mentioned salary/bonus system, all RCC and RCCU staff are obliged to sit an examination every two years. The staff with the lowest examination marks are laid off and offered the job of recovering non-performing loans on a commission basis. Good performance over the course of a year entitles such staff to re-employment.

Selected Township RCC

12. **Staffing.** The staff of the RCC consists of a woman director, an accountant and two credit officers. The director has a college diploma and is a certified accountant; two staff members have a

¹ The criteria for each level are as follows:

Level 1: very good repayment capacity; high income.

Level 2: sufficient repayment capacity; good income with stable sources.

Level 3: has a loan outstanding for more than five years; is willing to repay but unable to because of poverty; low income.

APPENDIX III

high school education and one went to a professional high school. The RCC office is located in a badly dilapidated building; and it has one computer and a telephone that works on a hand-generator.

13. **Deposits and loans.** By the end of June 2002, total deposits amounted to CNY 3.53 million, of which CNY 3.4 million (97%) came from households. Total loans outstanding amounted to CNY 3.06 million, of which CNY 1.5 million was refinanced by PBC. The loans/deposit ratio was thus 44%. Microlending involved CNY 0.37 million. Average loan sizes were CNY 3000-5000 for individual loans, CNY 5 000 for microlending and CNY 2000-3000 for group loans, the latter representing 20% of the total outstanding. About 70-80% of all loans due are usually repaid on time. The RCC is running at a loss.

14. During the first six months of 2002, some CNY 60 000 in outstanding loans was recovered, despite these loans having been classified as non-performing. Of this, about CNY 40 000 had been outstanding for more than ten years. One main reason for these recoveries was that road construction investments created new employment opportunities in the area and households used their increased incomes to repay the loans.

B. Example 2

15. **Staffing.** The RCCU covers 33 RCCs with 29 branches. The RCCs have 381 staff, of which 130 work on temporary contracts. The 121 women staff members represent 32% of the total. Some 85 staff have diplomas from professional high schools or high schools, and 296 have junior or primary school diplomas. The RCCU has a staff of 22, including one woman. The business office attached to the RCCU employs nine staff, including six women.

16. **Deposits.** By the end of June 2002, total deposits amounted to CNY 463.12 million, representing an increase of 15% over 1999. Household savings accounted for 91% of the total, the other 9% being deposits by institutions and organizations. Of the CNY 420.6 million in household deposits, 90% are made by rural households. A major source of these deposits is income from labour migration. Most deposits are for a 12-month term.

17. **Loans.** Outstanding loans reached CNY 311.85 million by end-June 2002, an increase of 18% over the previous 12 months. Of this, 77%, or CNY 240 million, was outstanding to 70 076 households (48%), corresponding to an average of CNY 3 425 per household. The remaining CNY 71 million in outstanding loans was lent to private enterprises, construction firms and TVEs.

18. **Microfinance.** The RCCU initiated microfinance operations before the PBC regulations were issued, and provided household loans for a maximum of CNY 4 000-5 000 depending on the repayment capacity of individual households. Once the PBC had regulated the system, 30 000 households were evaluated and all qualified for certificates. Loan ceilings by level differ between townships. In the mountainous areas, these are: Level 1: CNY 2 000; Level 2: CNY 1 000; and Level 3: CNY 500. In more prosperous townships, the ceilings are, respectively, CNY 5 000; CNY 3 000; and CNY 2 000. The certificate is issued to the household and put in the name of the husband, but married women are allowed to use the same certificates.

19. **Women's window.** Discussions between the Provincial PBC and the Women's Federation led to the draft formulation of a 'women's window'. Representatives of the federation will help women to submit applications and describe the purpose of the loans so requested. The RCCs evaluate the proposals and, if they are found acceptable, provide loans on an individual basis. No loan ceilings are applied and no collateral or guarantees are required.

20. **Audit.** The RCCU has a team of seven professional inspectors who carry out ad hoc inspections of RCC operations and accounts. In addition, annual audits are made of all RCCs, including audits of

loan activities. Individual RCC accounts are not consolidated at the RCCU level. About 40% of RCCs are profitable, but overall losses are significant.

21. Issues raised by the RCCU are as follows:

- staff training is needed at all levels;
- infrastructure and equipment should be upgraded so as to encourage customer confidence; and
- additional funding resources are required.

Selected Township RCC

22. **Staffing.** The RCC occupies a badly dilapidated rented building and is equipped with only an interest calculator and a telephone. All accounting is done by hand². The RCC has a staff of nine, of which two are women, including a director and deputy director; accountant, credit accountant (female); treasury manager (female) and four credit officers. Five of these staff members have high school diplomas, and the rest had a junior school education. Over the last four years, all staff have been trained once by the RCCU. Once a year, the director and accountant attend a three-day training session at the RCCU. Each credit officer is responsible for three villages. The remotest administrative village is 7 km away.

23. **Deposits.** Total deposits by end-June 2002 stood at CNY 11 million, an increase of 5% per annum but less than the township growth rate of 6%. About CNY 10 million in deposits is held by one third of all households for terms exceeding 12 months. The remaining CNY 1 million is held by organizations and institutions. Average household deposits amount to CNY 6 000. However, average deposits are CNY 500-600, illustrating the marked disparity in incomes.

24. **Loans.** Total loans outstanding as of end-June 2002 amounted to CNY 6.9 million, of which 80% were for agriculture, 15% for private and township enterprises and 5% for consumption. Some CNY 1.8 million was obtained from PBC through refinancing. The RCC is running at a loss. Two major issues are involved: non-reimbursement by PBC of interest-rate subsidies applied on deposits during the high-inflation period 1989–94, as instructed by the Government; and the non-performing loan portfolio.

25. **Microfinance.** The evaluation of households for the purpose of certification led to 532 households being classified as Level 1; 895 households as Level 2; and 123 households as Level 3.

26. Loans ceilings for the three levels are, respectively, CNY 2 000, CNY 1 000 and CNY 500. Level 3 is an innovative product inasmuch as it does not permanently rule out genuine cases of poverty and inability to pay, but gives such borrowers the chance to start afresh. Repayment obligations under this scheme initially concern only the new, small loan. It is expected that this will 'prime the pump' for later recovery of the initial loan. Certification has come to a halt due to the shortage of funds to meet expected demand: the RCC should be able to provide loans to certificate holders at any time.

27. Before the present system was implemented, the RCC provided micro loans for labour migration, 'ticket loans' to buy transportation tickets of CNY 400 and agricultural input loans of CNY 400–500. Such loans were approved by the credit officer during visits to villages. She/he was authorized to approve loans of up to CNY 1 000.

² For purposes of comparison, the post office in the same town has its own building, operates two computers, has proper security facilities and runs a vehicle for transporting cash.

28. **Legal structure.** The RCC was set up as a cooperative in the 1950s with initial members holding shares. However, the boards of directors and supervision boards were never established and, in practice, the RCC operated as a branch of the ABC and subsequently of the RCCU. The legal reform that transformed the RCC into a branch office only provided formal confirmation of a situation that already existed. This applies for RCCs in about one third of the poverty-stricken counties, or one sixth of all RCCs.

LOGICAL FRAMEWORK

	Narrative Summary	Verifiable Indicators	Means of verification	Risks
Goal	Rural financial services contribute effectively, and in a sustainable manner, to poverty reduction	Reduction of poverty incidence attributed to improved rural financial services	<ul style="list-style-type: none"> • Household surveys • RCC and RCCU annual reports • Impact studies 	IFAD continues to support policy reforms after completion of the programme. Other dimensions of poverty continue to be addressed by Government and donors.
Objectives	<ol style="list-style-type: none"> 1.Rural poor improve their living standards through better access to financial services 2.RCC policy reforms are disseminated and implemented 3.RCCs have improved profitability and cost-effectiveness 	<ul style="list-style-type: none"> • Living standard indicators, lending volumes, repayment rates, RCC profitability, income and expenditures. 	<ul style="list-style-type: none"> • Household surveys, • RCC and RCCU financial statements • Impact studies 	<ul style="list-style-type: none"> • Rural households, particularly the men of such households, use improved incomes to raise their standards of living. • Other fiscal and monetary policies do not oblige RCCs to improve their performance
Outputs	<ol style="list-style-type: none"> 1.RCCs and RCCUs implementing pilot policy reforms 2.RCCs and RCCUs strengthened, both institutionally and operationally 3.Incremental microfinance and women's loans being disbursed and repaid 4.Programme properly managed; results disseminated 	<ul style="list-style-type: none"> • Policy reforms for RCC lending, staff and operational policies, legal status • Incremental lending volumes of microfinance, group lending and women's window. High repayment rates • Few, if any, delays in IFAD disbursements; suitable consultants recruited; workshops held 	<ul style="list-style-type: none"> • CBRC, RCCU and RCC programme implementation reports • RCC and RCCU accounts • Progress reports • Supervision reports 	<ul style="list-style-type: none"> • Positive reform environment maintained • No external calamities upset pilot experiences • Repayment performance improving
Activities	<ul style="list-style-type: none"> • Consultancies • Staff training • Exchange visits • Civil works • Provision of equipment • Microfinance, group lending and lending to women and recovery • Monitoring studies and dissemination workshops 	<ul style="list-style-type: none"> • No. of consultancy contracts • No. of staff trained; subjects of training; results of training • Exchange visits undertaken • Loan and repayment volumes • No. of studies, workshops 	<ul style="list-style-type: none"> • CBRC, RCCU and RCC programme implementation reports • RCC and RCCU accounts • Progress reports • Supervision reports 	<ul style="list-style-type: none"> • No major price changes • Timely availability of all resources

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COSTS AND FINANCING

**Table 1: Expenditure Accounts by Financiers
(USD '000)**

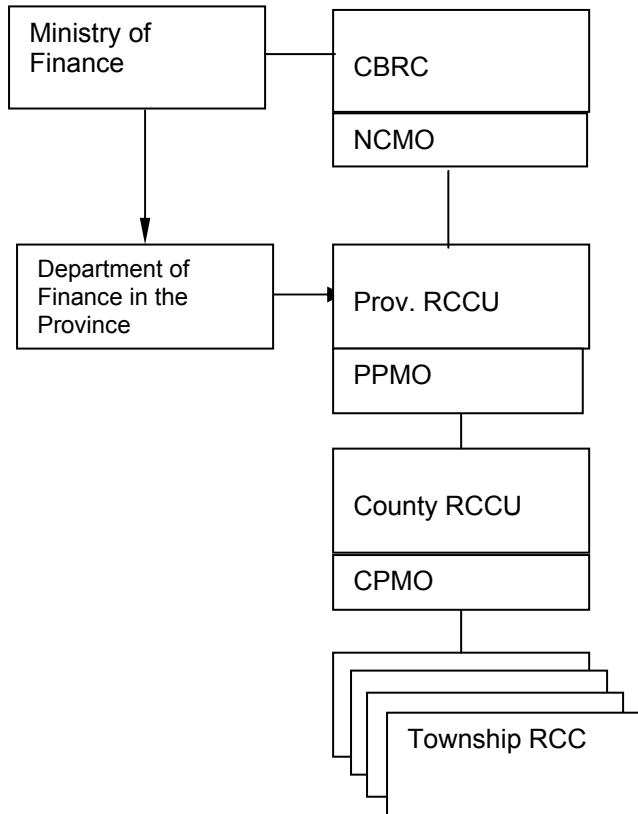
	IFAD Amount	%	CBRC Amount	%	RCCUs Amount	%	RCCs Amount	%	GOV. Amount	%	TOTAL Amount	%	For. Exch.	Local (Excl. Taxes)	Duties and Taxes
I. Investment Costs															
A. Civil works	843	95.0	-	-	-	-	-	-	44	5.0	888	4.2	156	687	44
B. Equipment, materials	1 463	89.1	-	-	-	-	-	-	179	10.9	1 642	7.7	242	1 220	179
C. Vehicles	218	82.0	-	-	-	-	-	-	47	18.0	266	1.3	106	111	47
D. Studies	662	98.4	-	-	-	-	-	-	10	1.6	673	3.2	68	594	10
E. Training, technical assistance	4 963	97.8	-	-	-	-	-	-	110	2.2	5 073	23.8	1 121	3 841	110
F. Credit, financing	6 090	50	-	-	-	-	6 090	50.0	-	-	12 180	57.2	-	12 180	-
Total Investment Costs	14 242	68.7	-	-	-	-	6 090	29.4	392	1.9	20 724	97.4	1 696	18 636	392
II. Recurrent Costs															
A. Staffing	217	64.4	24	7.0	97	28.6	-	-	-	-	337	1.6	-	337	-
B. Other operating costs	209	94.0	-	-	-	-	-	-	13	6.0	222	1.0	-	209	13
Total Recurrent Costs	426	76.1	24	4.2	97	17.2	-	-	13	2.4	560	2.6	-	546	13
Total PROGRAMME COSTS	14 669	68.9	24	0.1	97	0.5	6 090	28.6	406	1.9	21 285	100.0	1 696	19 183	406

**Table 2: Expenditure Accounts by Components
(USD '000)**

	Policy Development	Institutional Development	Operational Development	Financing	Programme Management	Total
I. Investment Costs						
A. Civil works	-	888	-	-	-	888
B. Equipment, materials	-	1 615	-	-	27	1 642
C. Vehicles	-	89	-	-	177	266
D. Studies	309	-	-	-	363	673
E. Training, technical assistance	2 132	1 777	995	-	167	5 073
F. Credit, financing	-	-	-	12 180	-	12 180
Total Investment Costs	2 442	4 370	995	12 180	735	20 724
II. Recurrent Costs						
A. Staffing	-	-	-	-	337	337
B. Other operating costs	-	-	-	-	222	222
Total Recurrent Costs	-	-	-	-	560	560
Total PROGRAMME COSTS	2 442	4 370	995	12 180	1 296	21 285
Taxes	1	340	7	-	55	406
Foreign exchange	649	678	254	-	113	1 696

ORGANIZATION AND MANAGEMENT

(one Province module)



FINANCIAL AND ECONOMIC ANALYSIS

1. Individual households will benefit from collateral-free loans provided under new policies. According to the 1999 Thematic Study on Rural Finance, some 50-80% of RCC loans to households were used for investments in crop and livestock production; 10-20% for services; and about 10% for processing activities. Average household loan sizes for crop and livestock activities varied between CNY 700 and CNY 1 500, while loans for services and processing averaged about CNY 3 500.

2. As mentioned above, the majority of loans provided to rural poor households were used for crop and livestock production. The financial analysis, as presented in each IFAD project document, is based on a series of crop models that are combined into foodcrop and livestock models. The models were combined to construct a 'whole farm' development model. The assumptions are that the household will modernize its annual crops in line with the average model; and agree to intensive management of a small fattening operation.

3. Return on such investments is high, as witnessed by the crop and livestock activity models presented in each IFAD project document. Illustrations have been drawn from the most recent report¹. The change in the economic performance of farming will be substantial at full deployment of activities. Compared with the 'without project' situation, net income will increase by about 83-151% from livestock production alone. Improved land and labour productivity will increase returns from crop production by 122-475%. Loan activities will yield significant returns and constitute an effective instrument for reducing poverty.

Financial Returns on Selected Activities

Activity	Investment Costs	Recurrent Costs	Income After Labour	Return on Invest. After Labour (%)	Income Before Labour	Return on Invest. Before Labour (%)
Livestock activities						
Pig-raising	2700	1458	1332	49	2232	83
Cattle-raising	1300	700	619	48	919	71
Goat-raising	2100	2325	756	36	931	44
Sheep-raising	940	614	1371	146	1421	151
Activity	Incremental Costs/mu		Incremental Revenue/mu		Incr. Benefit/Cost Ratio	
Crop Activities						
Wheat	86		122		1.42	
Potatoes	113		240		2.12	
Upland maize	103		237		2.30	
Land levelling	99		475		4.80	

4. In such a sector programme, the benefits of policy reforms will go beyond the immediate impact of credit to poor households, as illustrated above, because results will be also disseminated to RCCs and RCCUs outside the programme area.

5. Moreover, about one third of all programme funds will be allocated for policy development and institutional support, and a large proportion will be spent on technical assistance. For these, it would

¹ Environmental Conservation and Poverty Reduction Project in Ningxia and Shanxi: Appraisal Report, Working Paper 7, June 2002.

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APPENDIX VII

be highly speculative to quantify financial or economic benefits. Therefore, no economic rate of return for the programme has been estimated as it would, for the most part, be dependent on non-directly verifiable assumptions, such as the relationship between liberalization of the interest rate and the volume of loans outstanding or between the volume of staff training and the profitability of RCCs.