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THEMATIC STUDY ON RURAL FINANCIAL SERVICES IN CHINA
AGREEMENT AT COMPLETION POINT



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I. CORE LEARNING PARTNERS

1. The Core Learning Partnership (CLP) in China extended from the central agencies in Beijing to the Provinces. In Beijing, the CLP comprised representatives of the Ministry of Agriculture, the People's Bank of China (PBC) and the Ministry of Finance (MOF). Representatives of the Provincial Governments of Hunan, Jiangxi, An'Hui and Sichuan, their project management offices (PMOs) and the rural credit cooperative (RCCs) unions, were also consulted. Researchers from the Chinese Academy of Social Sciences participated in the study. The World Food Programme (WFP) also took part in the learning partnership.

II. STUDY CONTEXT

2. The thematic study examined the institutional context and effectiveness of the credit components of IFAD loans provided to the People's Republic of China since 1987, and covered four diverse project areas.

3. Under IFAD projects, methods for delivering credit to rural resource-poor households have changed. At the outset, projects delivered these services through PMO, but more recently RCCs have been used in the expectation of credit components being integrated into local rural financial infrastructures. The study examined the advantages and disadvantages of the two approaches, and made an empirical analysis of credit demand and supply based on data gathered from both rural financial institutions and households. The aforementioned analysis suggests that a large proportion of resource-poor households are constrained by limited availability of formal credit rather than by poor capacity to absorb it. Furthermore, such households are not constrained by formal institutions' lending rates, even though such rates may be higher in real terms.

4. The above findings confirm that the RCC network has the potential to become a fully-fledged, poverty-focused rural financial institution, and point up the wide scope for an evolving RCC system of financial services in China. Nevertheless, unless resolved, outstanding issues relating to governance, non-performing loans and policy constraints will prevent RCCs from playing their full role in delivering sustainable financial services in rural areas.

5. The thematic study made a comparison of two models: project-funded credit delivered by PMOs, versus the new system under which it is delivered by RCCs. It is true, if viewed in isolation, that the PMO model supported by IFAD projects is an efficient credit-delivery model. PMOs provide loans in accordance with prescribed plans, with limited appraisal of repayment capacity and of the activities for which the loans are provided. In contrast, RCCs provide fewer needs-related loans to borrowers that have the capacity to repay loans.

6. The study shows that the IFAD project-propagated RCC model is, in reality, a modified PMO model: funds flow through RCCs while the PMOs continue to bear the credit risk. While project design gives the RCCs the authority to accept or reject loan applications, in fact, this power remains with the PMOs and local governments.



7. If the potential for dynamic growth in the income of rural resource-poor households is to be exploited, a restructured and vibrant RCC network is essential. Macro constraints, such as governance, a stock of historical bad debt and other operational difficulties will need to be addressed through a well structured reform programme. In the final analysis, RCCs will need to adopt a more flexible approach to loan criteria and procedures.

III. LESSONS LEARNED

8. Lessons learned with regard to the provision of financial services across many countries confirm that the most successful credit projects are those where only one financial service provider is involved and when, in addition, that provider's independent status is assured.

9. In China, a two-pronged approach is warranted for the purpose of reaching resource-poor households under the umbrella of IFAD projects. The thematic study concludes that unless MOF routes funding directly to the RCCs through their supervisory bodies, it is unlikely that the RCCs will be in a position to act independently or to bear the credit risk.

10. The procedure for providing funds to RCCs needs to be redefined in order that the use of such funds is not influenced by local government decision-making. Grant funding should be provided to RCCs for capacity building in such a way that the positive evolving features of microfinance strategies are incorporated into their lending strategies. Employing village agents would increase outreach. RCCs should be fully authorized to select and fund clients, and encouraged to expand their lending operations financed under IFAD projects by using funds from the savings they mobilize. RCCs facing liquidity constraints should be given greater access to the PBC refinancing window.

11. With regard to PMOs, measures should be taken to avoid that they compete with RCCs on favoured terms. The current financial situation of many RCCs may not allow them to participate actively in medium- and long-term credit provision. In these cases, for projects already funded, the involvement of PMOs in providing non-seasonal credit will need to be decided on a case-by-case basis. Moreover, the rate of interest on loans should be equal to that charged by RCCs on an annual basis. PMOs will be allowed to provide only one loan per person so as to ensure that once the client has repaid the loan, he/she will approach the RCCs for subsequent credit. Record-keeping, loan account monitoring and maintenance of revolving funds will need to be substantially improved so as to improve transparency.

12. PMO staff, who comprise representatives of all line agencies, effectively provide technical services to households. In collaboration with the PMOs, WFP has provided training to improve credit use. Further grant funding, to enable PMOs to provide training, is warranted.

13. It is true that the previous system, whereby formal financial institutions such as RCCs were fully responsible for providing poverty-alleviation loans, may have been less than satisfactory. Whereas that system has improved efficiency and ensured institutional sustainability, it might well exclude households that neither possess the necessary credit history nor have demonstrated ability to effectively use credit. It stands to reason that even with well-intentioned microfinance product design and delivery systems, considerable time would be needed to develop RCCs to expand their outreach and become fully poverty-focused institutions. In addition, for areas with no local financial infrastructure, a PMO-led self-help group strategy is a valid proposition.



IV. AGREEMENTS REACHED

14. A meeting, chaired by Mr Tang Zheng Ping, Director General of the Department of International Co-operation, was held at the Ministry of Agriculture in Beijing on 6 July 2001 (see Executive Summary for findings and recommendations). Representatives of PBC, MOF, and the PMOs in Hunan, Jiangxi, An'Hui and Sichuan Provinces attended the meeting, as well as Messrs Per Eklund, Roy and Martens of IFAD. The Chinese Government representatives welcomed the report, its analysis and recommendations, and considered it to be a useful starting point for restructuring the RCCs.

15. The Chinese Government expressed its desire to initiate discussions with IFAD on the possibility of obtaining an IFAD policy loan to initiate this restructuring process and invited the Fund to participate in the restructuring exercise.

V. SUMMARY OF RECOMMENDATIONS

16. Agreement was reached on the importance of restructuring the loan products provided to farmers served under current IFAD loans and on the benefits to be accrued from better outreach of microfinance to rural development in China. Restructuring of the RCCs would ensure that a larger share of the savings mobilized by them is transformed into productive investments.

17. Representatives of PBC and MOF confirmed the Chinese Government's interest in the RCCs becoming independent financial institutions with a transparent ownership and equity structure. The Government would welcome both capital infusion from donors and a cooperative relationship with IFAD in the necessary restructuring exercise.

18. In line with the recommendations of the thematic study, in order for the RCCs to develop into fully viable financial institutions they would need to:

- be made accountable and responsible for their actions;
- be endowed with a qualified management structure;
- become creditworthy; and
- serve not just the farmers but the poor farmers.

19. In line with the recommendations of the thematic study, RCC loan products and services will need to be made more flexible to better respond to user demand; PBC is presently exploring how this may be achieved.

VI. CONCLUSION

20. In closing the meeting of evaluation partners, the Chairman summarized the agreements reached.

- (i) The Chinese Government would welcome a cooperative endeavour with IFAD in the restructuring of the RCCs;
- (ii) RCC operations and performance are extremely mixed. It is not foreseen that the use of a uniform model would be suitable in terms of RCC restructuring; and
- (iii) a pilot approach is called for. Such an approach would translate into adopting eligibility and selection criteria with regard to RCCs qualifying for assistance.