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IFAD’s Assistance to the Rural Finance Sector Reform in China

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Executive Summary

Over the past 25 years China has made remarkable progress in raising the living standards of its people and in achieving sustained economic growth. The number of rural poor people living under the official poverty line fell from 250 million in 1978 to 36 million in 1999, or from 31 percent to 4 percent of the rural population.

In China formal rural finance is provided by the Agricultural Bank of China, the Agricultural Development Bank, and Rural Credit Cooperatives (RCCs). RCCs were established in the 1950s as legally independent entities. Although created at the township level, their presence in villages through branches and offices makes them the financial institution with the widest outreach among rural populations. By the end of 2001 more than 40,500 RCCs were operating, accounting for 11 percent of the banking sector’s outstanding loans and 12 percent of deposits.

Improving the performance of RCCs and adding poverty alleviation–oriented financial products to their portfolios are crucial for developing sustainable rural financial services in China. Although ostensibly independent, RCCs served as arms of the Agricultural Bank until 1996, then were brought under the oversight of the People’s Bank of China. In 2003 the supervision function of the People’s Bank was transferred to the newly established China Banking Regulatory Commission.

Bank reform for the rural poor

In recent years the Chinese government has shown strong commitment to bank reform. The Banking Regulatory Commission is expected to introduce innovations in regulatory methodologies, systems, and technologies to modernize and upgrade financial supervision, while the People’s Bank will maintain its focus on monetary policymaking. Because many RCCs are weak, the People’s Bank has been implementing a national program for their capacity building and restructuring, culminating in recent guidelines for RCC operations and management. The International Fund for Agricultural Development (IFAD) has been collaborating with the bank to provide technical and managerial support to RCCs and to supervise and improve their performance.

In 1996, after the government decided to reform rural finance, the IFAD began funding projects that used RCCs to provide credit and other financial services to the rural poor. But whereas the People’s Bank welcomed this initiative, local governments were less enthusiastic—partly due to concerns about the solvency and governance structure of RCCs. Following the early experiences of IFAD and a group lending experience of DesJardins International Development, in 1999 the People’s Bank introduced a pilot scheme using RCCs as microfinance institutions. Combining these experiences and lessons from IFAD projects, the People’s Bank formulated guidelines for microlending by RCCs. A revised set of guidelines was issued in 2001.
IFAD's Rural Finance Sector Program

IFAD’s experience with RCCs and its longstanding dialogue with the People’s Bank led to the preparation of a Rural Finance Sector Program, financed with an IFAD loan of about $15 million. The program is in line with the IFAD’s main strategic objective—namely, enabling the rural poor to overcome poverty by increasing their access to financial services and markets. It will also enhance the IFAD’s catalytic impact by promoting institutions and policies that support the poor. The program will be part of ongoing RCC reforms and will provide opportunities to introduce good practices in microfinance—with a focus on the rural poor. Two major considerations drive the program:

- RCCs are an important source of financial services in rural areas and have the most extensive outreach capacity. But previous operations and current policies have jeopardized the sustainability of RCCs. Thus the government is developing policy reforms for RCCs, and some reforms are already being tested.
- A 2000 IFAD study on rural finance validated the Fund’s strategy of providing loans to the rural poor through RCCs. It also recognized that policy changes were needed for RCCs to play important roles in future IFAD projects.

Within the framework of the rural finance reform initiated by the China Banking Regulatory Commission in 2003, the IFAD program supports the government in defining RCC policies—taking into account their impact on both poverty reduction and institutional sustainability. It also aims to demonstrate the usefulness of microfinance for poverty reduction. In supporting policy reforms, the program will focus on lending policies that increase the rural poor’s access to RCC lending and on institutional and operational policies that enhance the efficiency of the cooperative bank system—contributing to their financial sustainability.

The implementation of the Rural Finance Sector Program will involve, as much as possible, national and international experts on microfinance. Frequent consultations, including bilateral and multilateral donors, will be held to benefit from available expertise and to disseminate positive results from pilot activities supported by the program. The program will support ongoing and planned policy adjustments, help refine implementation approaches, and address new policies with clear gender and poverty dimensions. In this respect, the program’s support will focus on interest rate liberalization, microfinance, group lending, and lending to women. Later, support will be given to develop other new products.

The program will improve households’ access to formal rural financial services—especially poor households—and increase the efficiency and sustainability of RCCs. The program will also provide the opportunity to test a number of institutional innovations, including changes in the legal structures of RCCs and RCC unions, and in incentives for staff.

Lessons

Influencing policy in China is an extremely challenging, complicated process. The most practical approach is to undertake pilot interventions that demonstrate good practices and trigger the
interests of local and central governments in innovative approaches. Long-term processes require exceptional patience to build up a reiterative approach, whereby experiences are reflected and included in new pilot activities. Finally, collaboration with like minded partners and networking with domestic stakeholders are critical to the success of any project.
Implementation Process

Based on earlier experiences and a joint poverty mapping with the World Food Programme (WFP), IFAD prepared a new Country Strategy during 1998 which was approved in February 1999. Under this strategy, two projects were approved and have started implementation, in the Qinling Mountains and West-Guangxi areas respectively. A third project, in Ningxia and Shanxi Provinces, has completed appraisal. A key aspect of all joint IFAD/WFP-funded projects in China is credit delivery to poor households, supplemented by advisory support services and social development.

The complementarity of IFAD and WFP mandates combining financial assistance and food aid reinforces the outreach of the two organizations to the rural poor, and the joint operation provides a more sustainable development approach to the poorest beneficiaries.

WFP Food-For-Training (FFT) and Food-For-Work (FFW) programmes provide for meeting the food gap of the hungry poor, building their productive capacity and increasing their creditworthiness. IFAD loan funds help improve the operational capacity of extension services and the rehabilitation of rural infrastructure, health and education facilities. Farmers can use credit for income-generating activities and build up assets for further development, thus enabling them to meet essential needs and to graduate from beneficiaries to creditworthy clients.

Three official financial services institutions operate in rural China, namely the Agricultural Bank of China (ABC); the Agricultural Development Bank of China (ADBC); and Rural Credit Cooperatives (RCCs). Non-official organizations include Rural Credit Foundations (RCFs), Mutual Savings Associations, the informal sector, and micro-credit projects that have developed recently aiming at poverty relief.

It is a long standing issue of IFAD/WFP-funded projects to enable existing financial intermediaries to deliver credit and other financial services to the target group. Up until 1996, however, the existing financial institutions were not included in the project design and implementation. The projects that were designed before 1996 under previous Country Strategies channeled credit through Project Management Offices (PMOs), while the financial offices at Township level were responsible for credit delivery.

From the purely credit disbursement perspective, the PMO model appears efficient where implemented. It is endowed with a relatively good geographical coverage compared to RCC operations and is effective in targeting the poorer rural households. As a model, however, it is a short-term measure, and not empowered to deliver sustainable financial services after project completion. Two important weaknesses manifested themselves during project implementation: i) inability to mobilize savings and recycle them from investment; and ii) inability to eliminate potential moral hazard, since borrowers may perceive that loans from government departments can simply be written off.

Gradually project designs have shifted from being entirely supply driven — with government offices deciding on credit delivery and with funds allocated after little consideration
of parameters such as loan appraisal, or repayment capacity client credit history — towards seeking to use local financial service institutions, the RCCs. In fact since 1996, when the Government of China (GOC) decided that RCCs would become the primary rural financial institution at township level, IFAD/WFP-funded projects have retreated from unsustainable financial services delivered by PMOs.

RCCs were established in the 1950s as legally independent cooperatives. Although they were created at the Township level, their presence in Villages through branch or representative offices renders them with the widest outreach into rural populations of the financial institutions. Despite their legal structure as independent entities, however, RCCs were absorbed by ABC and assumed a branch role for it.

In 1996, RCCs were separated from ABC and found themselves in a national oversight and policy making vacuum. They were first brought under the oversight of the People’s Bank of China (PCB) and specifically of the Rural Finance Reform Office and the Cooperative Finance Department. As of 2003, the China Banking Regulatory Commission (CBRC) has taken over this role. By the end of 2001, over 40.500 RCCs were operating, with RMB 1200 billion in loans outstanding (11 percent of the total banking sector) and RMB 1700 billion in deposits (12 percent of total). Township and Village Enterprises (TVEs) lending constitutes about half of all loans outstanding, while household lending amounts to about a quarter, and private and household enterprises loans account for the remainder.

Since the mid 1990s, RCC Unions (RCCUs) with individual legal person status have also been established at the County level. Township level RCCs are members of the County level RCCU, which provides clearing facilities, plans and supports member RCCs’ staff training, and carries out inspections and annual audits of the latter.

The introduction of RCCs as credit delivery mechanism in IFAD projects has been growing over time while encountering a number of issues: i) PMOs regarded RCCs weak and risky in terms of recovery of IFAD project resources provided to them; ii) PMOs were very reluctant to transfer responsibilities to RCCs, as they were afraid of losing control; iii) RCCs were not given the autonomy of an independent bank as they mostly served clients that were proposed to them by the PMOs, increasing thus the risk; and iv) the aggregate of handling commissions and charges at Provincial, Prefecture and County level rendered IFAD funds unattractive and expensive to RCCs, until the end of 2001 when the Ministry of Finance (MOF) decided to extend IFAD loan funds to the Province at concessional terms.

In 2000, IFAD’s Office of Evaluation and Studies undertook a Thematic Study on Rural Finance which assessed both the project managed credit (through PMOs and the Finance Bureaux) and the RCC operations. Its conclusions were discussed in a meeting among the Ministry of Agriculture (MOA), MOF, PBC and IFAD, where the recommendation was adopted that RCCs would be the main channels for disbursement of IFAD funds allocated as credit and that IFAD would support GOC in restructuring RCCs to render them cost-effective and sustainable instruments, emphasizing their potential for poverty alleviation.
Subsequently, the Rural Finance Sector Programme (RFSP) was developed by IFAD in close collaboration with PBC, MOF and MOA. The RFSP proposal was prepared during 2002 for further consideration by MOF and PBC.

Two major considerations form the rationale for IFAD’s RFSP:

- RCCs constitute a very important source of financial services in rural areas and the most extensive network and outreach capacity with credit officers providing services at the farm gate. Previous operations and present policies, however, have jeopardized the sustainability of RCCs. GOC is therefore considering to define and implement a policy reform programme for RCCs and some reforms are already being tested on a pilot scale.

- IFAD’s 2000 Thematic Study on Rural Finance confirmed the Fund’s strategy to provide loans to rural poor through RCCs. It also recognized that policy changes were needed for RCCs to play important roles in future IFAD projects.

Within the framework of the Rural Finance Reform process guided by CBRC since 2003, RFSP aims to support GOC in defining RCCs policies taking into account their impact on both poverty reduction and institutional sustainability. It also aims to demonstrate the usefulness of micro-finance for poverty reduction. In supporting policy reforms, the focus of RFSP will be on lending policies that allow increased access of rural poor to RCC lending and on institutional and operational policies which will enhance the efficiency of the cooperative bank system. Hence it will contribute to their financial sustainability.

RFSP follows upon the strategy for policy dialogue as proposed under IFAD’s Country Strategy Document of 1999, and is in line with the strategic objective of IFAD, namely enabling the rural poor to overcome their poverty by increasing access to financial services and markets. RFSP will also enhance IFAD’s catalytic impact through “helping to establish institutional and policy frameworks in support of the poor.” Moreover, it materializes aspects of IFAD’s Strategy for Asia and the Pacific Region, which announced a shift in emphasis towards projects and programmes with the strategic potential to influence policies.

The goal of RFSP is to render rural financial services capable of contributing effectively and in a sustainable manner to poverty reduction. Its specific objectives are:

- Rural households, including the poor, have a better access to financial services and effectively make use of them to improve their living standard;

- RCC policy reforms have been successfully tested and are being implemented in ongoing IFAD/WFP-funded projects as well as in future interventions;

- Improved institutional and operational management capacities in RFSP RCCs are applied on a larger scale and help improve cost effectiveness and profitability;

- Modalities for the solution of the non-performing loans issue have been tested and are applied on a wider scale.
RFSP will support the CBRC at central level, and RCCUs and RCCs in two pilot Provinces at County and Township level. It is structured in five components: policy development; institutional development; operational development; financing; and programme management.

The implementing agency of RFSP will be CBRC. The Department of Cooperative Finance in CBRC Head Office will establish a Coordination and Monitoring Unit and appoint a Director. In programming activities, County RCCUs and Provincial RCCU will ensure that coordination with PMOs of on-going IFAD/WFP-funded projects is maintained.

In the area of support to reforms in RCCs to render them more sustainable and efficient in poverty reduction, IFAD is nearly the sole external donor. In conjunction with the IFAD/WFP Wulin Mountains Minority Areas Development Project, GTZ has been providing technical assistance for training RCC staff, but this project is being terminated. Other GTZ interventions, e.g. in Jiangxi province, were of similar nature. The World Bank is providing technical assistance for the reform of the financial sector, focusing on state banks.

The implementation of RFSP will be the occasion to involve as much as possible national and international expertise from the micro-finance industry. Frequent consultations, to which also bilateral and multilateral donors will be invited, will be held to benefit from available expertise and to disseminate as widely as possible any positive results from the pilot activities supported by RFSP.

**Impact Analysis**

As many RCCs are still weak, PBC has been implementing a national programme for their capacity building and restructuring, culminating in the recent publication of definitive guidelines for RCC operations and management. IFAD has been successful in collaborating with PBC to provide for the technical and managerial support to RCCs, and to supervise and ensure their performance. Moreover, all IFAD-financed sub-loans to RCCs are administered in such a way as to minimize the impact from the old, non-performing parts of the RCC portfolio.

The approach of RFSP in support of policy reforms is to assist in on-going or already planned policy adjustments, help in refining implementation modalities and tending to that new policies have clear gender and poverty dimensions. In this respect, RFSP support will focus on the liberalization of the interest rate, micro-finance and group lending, and lending to women. At a later stage, support to the development of other new products will be provided.

RFSP will generate important benefits both in terms of improved access of households, especially poor households, to formal rural financial services, and in terms of strengthened efficiency and sustainability of RCCs. These two benefits will be closely monitored during RFSP implementation.

RFSP will be implemented at the national level as a programme allowing CBRC and the RCCUs/RCCs to test good practices for micro-finance with special emphasis on facilitating access of rural poor. In line with China’s incremental reform strategy, this will initially be undertaken in a selected, limited geographical area at county level. Once results are conclusive,
the reforms will be translated into policy and institutional reforms for application on a larger scale.

The main objective of the ongoing credit initiatives under IFAD projects has been to improve access of poor households to micro-finance, which included also group-lending and special loan programmes for women. Also support was provided for capacity building of RCCs to become sustainable financing institutions, which would benefit mostly the poor for which RCCs are the only source of formal deposits and loans in rural areas. RFSP however by virtue of being a sector programme, will benefit all potential clients of the RCCs and RCCUs by improving the policy environment and institutional and operational modalities of RCCs and RCCUs in the programme area.

At the household level, credit delivery remains a strong instrument to improve year-around food-security and increase the income of poor rural households. Individual households will benefit from collateral-free loans provided under new policies. The strategy of combining FFT with credit for productive on- and off-farm activities exhibited significant positive results. Those households that were not able to access formal credit became eligible through technical and business training. Furthermore, project reports reveal an increase of agricultural production, establishment of various off-farm activities, such as grocery shops and restaurants, as well as an increase of agriculture production livestock rearing, fruit tree plantation and greenhouse-based, intensive vegetable production. According to the Thematic Study, in 1999 some 50-80 percent of RCC loans drawn by households were used for investments in crop and livestock production. Return on such investments is high as evidenced in the project impact analysis, which are presented in each Project Completion Report.

Considerable progress in credit-awareness has been achieved. Women especially have demonstrated a high degree of confidence in their ability to use external borrowed funds productively. In the Wuling Mountains Minority-Areas Development Project, for instance, about 50 percent of credit allocation was explicitly directed to women. In reality, however, 90 percent of all credit funds was actually used by women. Most of the loans for productive activities by women are medium and short-term credit of up to 2000 yuan.

Nevertheless, as RFSP is a sector programme, benefits will transcend RCCs and RCCUs directly involved in implementation as positive results will disseminate to RCCs and RCCUs in the same provinces or beyond for implementation. Where necessary, on-going IFAD/WFP-funded project resources will be allocated to implement the proven, new policies.

**Driving Factors**

A suitable political and economic environment is a critical precondition to test and implement innovative approaches. The decision to move away from the PMO-based credit system to private financial rural providers was triggered through the successful tests in a step-wise approach embedded in the Integrated Rural Development Strategy that IFAD has been pursuing in China.
The close collaboration with and strong support by governmental institutions to participate effectively in rural financial sector reform culminated in IFAD’s participation in China’s National Reform Programme that would ensure the inclusion of experience as obtained through IFAD/WFP-funded projects.

**Commitment and Political Economy for Change**

China has made remarkable achievements in improving the standard of living of its people, and in realizing sustained economic growth in the past two decades. Especially praiseworthy is the sustained economic growth, combined with a sharp reduction in the proportion of its population defined as poor. The rural poor population – using the official poverty line definition – fell from 250 million in 1978 to 36 million in 1999; or from 30.7 percent to 4.2 percent of the total rural population.

The *Baqi (8-7) Poverty Reduction Plan* was instituted by GOC in 1994 with the objective of lifting 80 million rural poor out of poverty by the year 2000. Having missed the deadline the Chinese government has been confronted with the urgent issue on how to transform current unsustainable credit delivery methods into a sustainable footing. The Government has realized the importance of integrating credit services with those of the local financial infrastructure as practiced in IFAD/WFP-funded projects, and views the reform of RCCs as critical for improving the sustainable financial services to poor and low-income households.

The ability of RCCs as a whole to serve rural production, smooth household consumption and poverty alleviation has been negatively affected by their deteriorating financial situation. Efforts are now afoot to slowly and steadily re-structure the RCCs. These efforts depend on the speed with which the restructuring is undertaken of the Township- and Village-owned enterprises to which RCCs have granted substantial loan amounts in the past.

Some loss-making RCCs in small Townships (mainly in poor areas of China) have been closed, or merged, putting at a disadvantage rural poorer households. Many RCCs provide loans only to those who can provide certificates of deposits as collateral for loans over yuan 1000 (US$ 120). RCCs are the only financial institutions with the outreach required to serve rural households. Improving their performance and incorporating poverty alleviation-oriented financial products into their portfolio remains the key for developing sustainable rural financial services in China.

The IFAD/WFP-funded projects have been integrating project-based-financial-services delivery into the regular activities of RCCs. Despite the favourable environment, however, the use of RCCs was hampered by the interest margins de facto imposed by MOF. As a result RCCs have a small margin, and have witnessed their creditworthiness suffer.

The practice of ‘dictated’ interest rates has now been suspended and these new circumstances should allow for the widespread introduction of micro financial institutions. This also offers the opportunity to gradually change the composition of the RCCs portfolios to include a larger share of longer term lending in addition to the seasonal components which, however, remain dominant.
In the recent years, GOC has repeatedly shown strong signs of a political commitment for the reform process in the banking sector. A major impetus for reform was given in April 2003, when the banking supervision function of PBC was handed over officially to a new banking regulatory body: the CBRC. CBRC is expected to introduce innovations in the areas of regulatory methodology, systems and technologies to modernize financial supervision and upgrade it to professional status, while PBC will maintain its focus on monetary policy making.

PBC has actually been instrumental in many innovations which are currently tested on a pilot case. In the rural finance sector these include: the liberalization of the lending interest rate, the introduction of an incentive scheme for staff, and the re-consideration of the legal status of RCCs. In addition, the introduction of micro-lending and joint-liability group lending have been tested on the basis of micro-credit experiences in IFAD/WFP-funded projects. For each of these innovations, pilot Counties were selected where to test these policies. The first outcomes seem to be positive and are under application on a larger scale.

The second impetus for reform occurred in June 2003 when GOC issued the “Pilot Scheme for RCC Reform,” and then on 18 August 2003 formulated a pilot programme in eight Provinces. Through the relevant governmental institutions, i.e. MOF, PBC and CBRC, GOC has exhibited strong commitment in the development of RFSP as a response to the challenges of the ambitious reform process in the country. In light of IFAD’s continuous and successful support to the RCC system in the past, it is reasonable to assume that IFAD-funded operations have been instrumental in triggering GOC’s pilot scheme. As previously mentioned, RFSP will be implemented as part of the pilot scheme in two Counties in each of the eight pilot Provinces. It is expected that the outcome of the activities will trigger the up-scaling of the experience at a national scale, if deemed successful.

**Institutional Innovation**

The first institutional innovation already mentioned above is the establishment of a specialized regulatory commission, CBRC. The commission will be responsible for the introduction of innovation that would modernize the financial sector and render it more professional and efficient. The Department of Cooperative Finance (DCF), which is formally under PBC, but was transferred to CBRC, continues to play a leading role in the RCC reform, and to ensure the supervision function of the CBRC for the RCCs. DCF will be responsible for all cooperative institutions in rural and urban areas. Its functions include the standardization of management structures; drafting of regulations for supervision; risk control; quality of assets; and interest rate for loans and savings. It will also carry out investigations and take up necessary actions in case of delinquencies. DCF will also be the implementation agency of RFSP.

RFSP will provide the opportunity to test a number of institutional innovations. These include the change of the legal structure of RCCs and RCCUs, and of the incentive scheme for staff.

Legal structure: RCCs have been isolated entities at Township level and as such cannot access higher level support in terms of technical support, product development, and staff training.
Moreover, they lack the benefits of economies of scale that would enable them to continue expanding its operations and overcome eventual crisis. The RFSP will foster the present pilot consolidation of RCCs as branches into RCCUs at the County level. National and international technical expertise will guide the process to analyze and offer guidance in terms of strategy development and the operational and institutional implications inherent in changing legal structures. It is expected that the new legal structure will stimulate further development at the RCCU level above core functions and assist RCCs in evolving into strong institutions.

Staff incentive system: As indicated above, RCCs and RCCUs have recently introduced a staff incentive system that has been applied by the ABC since the mid 1980s. The scheme is simply a distinction total salary with about 60 percent of the income consisting of a fixed, minimum salary and the remaining 40 percent of bonuses. Regular staff meetings intend to maintain and improve staff qualifications. RFSP aims to assist the effectiveness of the scheme through analyzing the incentive effects, the impact on cost effectiveness of operations and overall financial results and on staff motivation and morale. Further application will be analyzed and proposed for implementation.

Although the impact of these innovations cannot be predicted at this stage, a positive effect on efficiency and outreach is widely expected to occur.

**Learning and Experimentation**

**Microfinance:** The learning and experimentation process has started with the inclusion of the RCCs as financial service providers in IFAD/WFP-funded operations. The provision of technical skills and functional literacy training financed either with IFAD cash funds or WFP FFT together enhanced the skills of the target group, consisting of the poor and very poor rural households. In turn, RCCs considered the advanced skills of trained project beneficiaries as collateral for good loan performance and hence, provided small loans for productive activities to also those that could not access formal credit previously. This strategy has been tested and gradually refined in five projects since 1996.

**Women Window:** IFAD has supported its projects to provide specific assistance to economic activities of women. Experience elsewhere has demonstrated that women tend to be better quality borrowers rather than men, and thus represent a lower risk level for financing institutions. In spite of this, most lending is administered to men, even when the funds are used for investments operated by women. Moreover, men, who are traditionally viewed as the head of the household responsible for signing any legal document including loan contracts, have migrated to urban centers, while spouses have been left to tend to on- and off-farm activities and the family. Therefore it is only logical that RCCs recognize women as loan contractors.

In addition to the RCC services, the recent IFAD/WFP-funded project included a special women window which has been entrusted to the local branch of the Women Federation. The special women window provides small loans for productive activities, in conjunction with functional literacy training, to very poor disadvantaged rural women. This programme has successfully upgraded women to access formal credit channels like RCCs.
Experience up to now shows that women have been successful in establishing micro-enterprises that provide sustainable income to the household. Moreover, a recent Gender Assessment study has demonstrated that setting up a successful business in rural areas reduces out-migration of husbands – a finding which constitutes a significant indication of a positive impact on rural poverty. Building on this positive experience, the women window will be further developed under RFSP. Women will contract individual or group loans from RCCs in their own names. Where required, RFSP will provide funds for functional literacy training and allow for women to sign with their own seals.

**Interest rates**: RCCs have been facing serious difficulties in obtaining enough returns from their operations, while covering risk and operational and fixed costs given the weak economic basis in the rural areas of the Western Provinces. External credit lines aimed to assist RCCs in extending loans to poor rural households. When the level of the interest rate ceiling was reduced, however, external credit lines as provided by donors like IFAD became too costly. It was only in 1999, when MOF reduced the on-lending interest rates that external credit lines were deemed interesting for RCCs to on-lend to poor rural households.

RCCs have been applying a ceiling in their interest rates determined by PBC, typically within a 50 percent margin above the PBC base rate. Recently some RCCs pilot cases have been given the flexibility by PBC to increase their margin on interest rates to 100 percent of the PBC rates. Although this flexibility is welcome, it does not address the core challenge of interest rate setting for RCCs operations which is the need to retreat from administered interest rate settings towards a system of loan pricing based on actual costs for delivering services to rural poor households.

**External Catalysts**

Most of the credit schemes of international donors and NGOs have been project-based, and hence unsustainable. Some international agencies and donors began recently to operate pilot projects to explore possible ways of transforming the project-based credit support to sustainable institutional capacity building.

Following the initial experiments of the Chinese Academy of Sciences (CASS) in 1994, a series of international institutions, including the Ford Foundation, GTZ, and OXFAM, and domestic institutions have introduced micro-finance models, mostly based on the Grameen Bank model. Dissatisfied with the subsidized poverty lending and eager to meet poverty alleviation targets, local governments undertook the initiative to establish micro-finance programmes. The striking results include an improved performance of non-governmental programmes in targeting poor households and in achieving a high repayment rate.

In 1994, the experimentation of PBC/RCC micro-credit in Hebei Province led to the formulation of policy guidelines for micro-lending by RCCs. In December 2001, these guidelines were issued including lessons learned from IFAD/WFP-supported projects.
Lessons Learned

Influencing policy in China is an extremely challenging exercise and a very complicated process. The most practical approach has been to undertake pilot interventions to demonstrate good practices and to attempt to trigger the interest of local and central governments for innovative approaches. Long-term processes require exceptional patience to build-up a reiterative approach, whereby experiences are cumulatively included in pilot activities. Lastly, the collaboration with like minded partners and networking with resource people in the country are critical to the success of any project.
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