evaluation profile

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China at a glance

Population	1253.6 million
	69% rural
Population growth	1% (1993-1999)
GNP per capita	USD 780
Agriculture	25% of GDP
Inflation	-2.3%
Life expectancy	70
Poverty (% of population)	5%
Human Development Index	87/162

Source: World Development Indicators Database, World Bank 2001; Human Development Report, UNDP 2001

Total lending	USD 380m (1981-2000)
Total loans	15 (16 provinces)
Projects visited	Jianxi/Ganzhou, Anhui, Wuling, Sichuan

IFAD's thematic study on rural finance in China

Double-edged sword?

Efficiency vs equity in lending to the poor

Demand for credit is high in rural China, even at higher interest rates. Many resource-poor households are constrained not by limited capacity to borrow but by insufficient supply and availability of credit. The poorest, survey data suggest, are able to borrow amounts equal to the average borrowings of the richest households. Rural Credit Co-operatives (RCCs) are the mainstay of the rural financial sector; their savings mobilisation is impressive. Yet their lending or contribution to rural development is limited; they only reach 20% of the poorest households.

How can RCCs develop into fully-fledged poverty-focused rural financial institutions? To tap the potential for broad-based economic growth, that includes rural resource-poor households, a re-structured RCC network is essential. RCCs need to be able to design products that meet the requirements of resource-poor households whilst generating enough income to cover the higher costs involved in supplying credit to rural areas.

Key challenges identified by IFAD's thematic evaluation include:

- **Flexible lending** rates that reflect the RCC's perception of the credit risk and costs of reaching dispersed rural households: for poorer people, access is more important than low interest rates.
- **Greater independence**: funding needs to be routed to RCCs directly from the Ministry of Finance so that RCCs can act independently, select clients on their own terms, and shoulder credit risk rather than rely on local government. →

Main achievements

IFAD projects provided loans to between 20 and 66 percent of rural households in the project areas. The main project activities promoted through micro credit were grain production, horticulture, livestock rearing, and women's income generation. The average loan size was 2,000 yuan (approximately USD 240) and it is estimated that projects reached 42% of households. Almost 90% of those who took out a loan received training related to the activity for which the credit was advanced. Survey findings suggest that poverty fell between 8 and 20% between 1995 and 1999 but analysis shows that IFAD had difficulties in reaching the poorest Chinese. Most households receiving project loans were in the better–off strata of society: RCC and PMO loan officials prefer to lend to better-off households, being more concerned with clients' ability to repay than with finding ways to achieve poverty alleviation.

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Open air market in Kunming. The Yunnan-Simao Minorities Area Agricultural Development Project supports an estimated 100,000 households in the area.

IFAD photo by Martine Zaugg

IFAD photo by Louis Dematteis

A Hani minority worker picks lichee fruit in Jiangcheng County. The project is financing the development of 7,200 hectares of diverse permanent crops grown mainly on sloping land used for rotation cropping or wasteland.

IFAD's experience

IFAD is the first international finance institution to search for solutions to mainstream RCC financial services in China. Responsibility for credit delivery in IFAD projects has begun to shift from government-run Project Management Offices (PMOs) to RCCs, regulated and managed by the People's Bank of China (PBC). Unmet demand for rural credit in China is huge and will only be satisfied through strengthening the capabilities of the RCC-based financial infrastructure. Although PMOs have been instrumental in infusing much-needed capital into the rural economy, they are supply-driven and cannot provide longer term sustainable solutions for rural financial services. Unable to mobilise and recycle savings for investment, there is also the danger that borrowers will think that loans from government departments can simply be written off.

Can RCCs meet demand?

RCCs, on the other hand, supply the majority of formal loans to rural areas and account for two thirds of household deposits. They have already established a large network and are the only formally authorised financial institution to serve rural households. Yet, they shy away from lending to poorer farmers – not least in isolated mountainous areas – which is costly, preferring to lend to better-off households – in their view more likely to repay loans. The study provides new data that demonstrate that the perception that the poor cannot repay is unfounded. According to 1997 data, poor households can service amounts equal to the average borrowing of the richest households. Indeed, 42% of the most resource-poor households took formal loans in 1997 – mainly from RCCs – and around half those borrowing formally also borrowed informally. Resource poor households are constrained by supply limitations and loan requirements rather than ability to repay. Employing village agents would help broaden RCC credit outreach to remote areas, but incentives such as flexible interest rates are crucial to achieving this goal.

For institutional sustainability to become a reality, the flow of funds to RCCs needs to be redefined so that local government cannot influence loan approval decisions. RCCs should have independence to select and fund clients using their own criteria and risk assessments. Allowing RCCs to charge higher interest rates would give them a competitive edge against other rural financial institutions: interest rates on lending from pilot civil society organisations are flexible, varying between 12% and 20%. Indeed, the lending rate at the successful Grameen pilot project in Yixuan County, Hebei Province is 16%. RCCs also need to develop credit histories for their clients, enabling them to graduate to progressively larger loans. In addition, incentives for prompt repayment such as easy immediate access to larger subsequent loans would help clients understand the importance and advantages of repaying loans on time.

Reaching the unreachable?

Reaching areas without financial infrastructure and households unable to access formal financial institutions is not easy: better access to credit through RCCs might improve efficiency but will not necessarily improve equity. Pro-poor lending activities could include modifying collateral and guarantee requirements by permitting joint liability, credit-history based lending, and structured repayment plans. Yet, without a credit history or a demonstrated ability to use credit effectively, poorer households will still be excluded. Some areas in China have no form of local financial infrastructure: very different strategies would be needed for such situations. For the RCC network to develop into a fully poverty-focused institution will take a long time.

Based on: *Rural Financial Services in China Thematic Study*, Report #1147-CN, International Fund for Agricultural Development (IFAD) Office of Evaluation and Studies, December 2001. Please contact Mark Keating for more information: M.Keating@ifad.org or see www.ifad.org/evaluation/index.htm