

The Development of Microfinance in China

(Final Draft)

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I. Introduction

Microfinance provides financial services for low-income and poor customers through innovative organizations and systems, with the goal of poverty alleviation. Since the 1990s, the influence of international best practices popularized microfinance in the development field, and different models have developed in diverse political and economic contexts.

After ten years, microfinance in China has drawn from specific techniques and models, introducing a system suitable to the Chinese situation. This process was initiated in the mid 1990's by the Chinese government's poverty reduction goal, which highlighted a strategy for targeting poverty-stricken villages and households. This process began from a plan to improve effectiveness of poverty-alleviation subsidy loans in which relevant government regulations and decisions played a key role. Three organizational forms thus emerged: pilot practices of funding organizations, large-scale campaigns against poverty by the government, and rural financial services provided by formal financial institutions. The practices of different organizations have had a positive impact on the growth of Chinese microfinance, poverty reduction, and rural financial services. They have also contributed to testing the assumptions and suitability of microfinance in China while exposed to certain constraints.

The paper delineates a basic outline of microfinance growth in China through examining its organizations, systems, methodologies and fundamental assumptions. This study finds that the most critical constraint of China's microfinance development is its organizational structure, although weaknesses in new product development, delivery systems, and management also exist. This bottleneck in organizational structure makes restraints in techniques less salient than in other countries. It also results in a lack of effective supply channels in China, thus creating a supply-driven rather than demand-driven system.

II. Organizations and Systems

Microfinance in China has progressed from borrowing specific techniques to introducing a complete system. This process is a result of increased international microfinance activity, an increasing demand for more credit and poverty-reduction tools in a deepening marketing economy, and the necessity to improve rural financial services in less developed areas of China.

1. Funding from Donor Organizations: Pilot Practices

Accepting specific technology or certain organizational forms of microfinance first appeared in UNDP-funded projects in China in the 1980s¹. Through these projects fund management and organizational forms were improved, making contributions in at least two aspects: (1) changing simple grants to revolving funds and (2) adding locally- managed women's groups to government-established organizations. Policy-makers, donors, and researchers of poverty alleviation in China started to notice new development of microfinance in other countries in the mid 80's. In the early 90's, some international microfinance cases, especially on the practices of the Grameen Banks in Bangladesh, were translated into Chinese and included in collections of scholarly papers on poverty reduction².

From the early 1990s, many international aid projects in China were carried out as a response to the Chinese government Policy on Poverty Alleviation (PA). Clear goals of PA were articulated. A microfinance component was included in many of these PA programs with the World Bank, UNDP, UNICEF, UNFPA, and UNWFP/IFAD in the UN system, bilateral agencies such as AUSAID, CIDA, and GTZ, and international NGOs such as the Ford Foundation, World Vision International, and Oxfam Hong Kong.

New organizations were needed in order to launch microcredit programs in China. Four different types of organizational structures were used by these donor programs: NGOs, individual offices under a government department, connections with formal banks, and village banks.

(1)NGO: Funding the Poor Cooperative

Funding the Poor Cooperative (FPC) was initiated by the Rural Development Institute (RDI) of the Chinese Academy of Social Sciences (CASS) in 1993 and supported by the Ford Foundation and the Grameen Trust in Funds and Technology. FPC is an action-research project which replicates the Grameen Banks in Bangladesh,

¹ Susan Hulcome, <Paper Collection for Theory and Practice of Microfinance in China>, 1996,

² Zhou Pingping □□Paper Collections on poverty alleviation □□1991□

and as such was the first project in China to introduce microcredit as a means of poverty alleviation.

FPC wanted to eliminate inefficiencies in PA fund use at that time, as well as to provide a practical example for the Chinese government through a pilot practice of the Grameen model. The objective was to find solutions to problems of providing credit for the poor, to increase the low repayment rate among poor households, and to improve the sustainability of such poverty aid organizations.

After two years of hard work, improvement has been achieved on the first two issues of targeting the right households and achieving a 100% repayment rate. However, it has taken longer to realize the third goal. A common view in 1996 was that Grameen seemed to just approach the break-even point after 20 years of work. Microcredit programs in China, which had only started two years before, would undergo a long process of development. Interests were abundant and expectations were high (see Appendix 1).

The initial experience of the FPC played an important role in successful donor and government microfinance practices. Before FPC, microcredit was not an action or practice but only a concept and theory. Its significance lies in that for the first time, it introduced microcredit as a framework of poverty aid through financial means in China. It also proved that local organizations could cooperate with the Chinese government and donor organizations.

(2) UNDP-CICETE³ Microcredit Practice

The UNDP funded 16 PA projects combating absolute poverty. The projects targeted rural and urban areas in 48 counties in 16 provinces and six districts of the Tianjin municipality. The total fund input from the UNDP for the PA projects reached US\$19.32 million, among which US\$8.21 million was for the revolving fund.

The UNDP decided to use the Grameen methodology in their 48 project counties not because this model was a perfect match, but because no other alternatives were available at that time. Although the UNDP-CICETE microcredit program almost completely borrowed the Grameen group-liability lending technique, it was adjusted to suit the Chinese governmental structure. At the national level, CICETE, the Chinese partner of UNDP, set up a separate Supporting and Coordinating Office (SCO) for project coordination, supervision and management. At the county level, special operating offices were set up by different government departments in different counties.

In 2001 when old UNDP programs approached their end and new programs were ready to start, all 48 county offices were facing the decision of how to develop in the

³ CICETE: China International Center of Economic and Technology Exchange, the UNDP partner office in China.

future. Guided by the sustainability principle, UNDP supported refunding a new program focusing on capacity building for sustainable development. Four counties were selected from the 48 counties because they had shown the likelihood of achieving “win-win” results and had received intensive funding and technical support. (See Appendix 2).

(3) AusAID Qinghai Program

Microcredit is one of the four main components of the Qinghai Community Development Program of the China/Australia Technical Cooperation Program in the remotely western Qinghai province. AusAID provided Aus\$2.26 million (approx. US\$1.67 million) for the project. The Haidong Branch of the Agricultural Bank of China (ABC) and township offices managed credit services and operations, respectively. At the village level, CEIs (Coordinating Extension Intermediaries) were recruited from the local village and given incomes completely based on interest and loan principal collection. Credit officers at the township level were responsible for disbursing the loans. This structure enabled smooth turnover at project close. The Haidong Branch of ABC incorporated a microfinance office into its own organizational structure, resulting in local creditors could continue to distributing funds without the villagers feeling the change. This is the first microfinance project managed by a bank in China which has shown the advantage of breaking away from the “one size fits all” type of products. Loan sizes range from US\$50-\$250 with terms between 4 and 12 months with an average of 6 months. Because of the province’s plateau location, seasonal agriculture activities occur from April to October. As of the end of June 2002, 20,000 active clients have been served by the Haidong ABC microfinance programs.

(4) Caohai Community Trust Funds

In the Caohai Natural Reserves of Weining County in Guizhou Province, the International Crane Foundation and local environmental protection authorities initiated and funded a joint program to provide livelihoods for people making a living in protected wildlife areas. At the field level, the program was operated by the Community Trust Funds.

To operate a Village Community Fund (VCF), a special VCF management committee was established. Villagers formed a group of 10-15 people with a group leader. After management committee approval, a grant of US\$25 per person was required from each member to contribute to a group fund. In this model, the group is the fundamental entity that decides on how to use the group fund, such as delivery methods, loan terms, loan sizes, and interest rates.

The autonomy and wide participation make this model highly distinct from the

Grameen model, which was the most popular in China. This model is very close to the model that is referred to as Village Bank abroad.

2. Government Initiatives: Poverty Aid in Rural Areas and Assistance to Laid-Off Workers

(1) Review on Poverty Alleviation Policy

The development of microfinance in China is closely related to the governmental PA policy. It is helpful to briefly review policy changes in the policies in order to fully understand microfinance development in China. As of the end of 2000, the progress of rural poverty alleviation in China can be divided into the following three stages (Table1):

Table 1. Transformation of governmental policies on PA

	PA Mode	PA Measures
Stage 1 (Before 1985)	Relief	Providing relief for living and fiscal subsidies.
Stage 2 (1986-1993)	Regional development	Targeting regional poverty; improving development conditions; stabilizing agricultural productivity
Stage 3 (1994-2000)	Village & household focused	Targeting poor groups; developing human capital

Credit Against Poverty was one of the most significant microfinance approaches as it accounts for the largest percentage of PA funds in China. PA subsidy loans increased from RMB5 billion in 1994 to RMB15 billion in 2000. But low outreach rate to poor households and low repayment had long existed in PA fund management, partly because of the previous regional PA strategies and the Chinese financial system⁴. However, in 1994 new strategies started to target poor households, creating increased demand for new techniques.

(2) Government Leads Large Scale Campaign Against Rural Poverty

Policies and regulations of the central government have played a critical role in microcredit poverty alleviation since 1996. PA funds were required not only to reach poor counties, but also poverty-stricken villages and households in accordance with the Anti-Poverty Conference of the Central Government in 1996. In the PA conferences held

⁴ Liu Wenpu, <Principle and Practice of Microfinance>, 2001.

respectively in February and September 1998, the PA Office of the central government and the State Council emphasized that microcredit should be started and gradually expanded in all provinces. In the Third Plenary Meeting of the 15th Session of the Central Communist Party held on October 14, 1998, “The Decisions of the Central Government and the Communist Party on Some Key Issues about Agricultural and Rural Work” advocated summarizing and extending effective PA fund microcredit operations to the poor. This was again emphasized in subsequent central government PA conferences.

There were many regulations and decisions on PA fund use. However, these regulations create labor-intensive conditions and require stronger financial network than banks could afford on their own. A suitable delivery approach and system was in great demand. It was under such conditions that the government PA program adopted the microcredit group-lending methodology and made it a PA policy. With the goal of improving PA fund efficiency, FPC performed tests to integrate microcredit into the PA system. This should not be overlooked in the progress of large-scale government-initiated microcredit campaigns for the poor, as it was a turning point for Chinese microfinance development. Projects evolved from donor-funded pilot programs mainly operated by NGOs, to government-funded, large-scale programs run by the government PA offices and government-appointed banks. Some provinces, such as Shanxi, Sichuan, Yunnan, Guangxi and Guizhou, where existing pilot donor-NGO programs and had already experienced faster development. The success of the pilot programs also helped the local governments adopt microcredit at an early stage (Liu Wenpu).

With the strengthening of PA microcredit policy, inconsistencies between financial regulations and PA subsidy loans became more apparent. When the government launched its large-scale microcredit program, the government PA offices credited the PA subsidy loans from rural banks. The management of the PA subsidy loans was shifted from ABDC (sic) to ABC in June, 1998, and government-led microcredit grew fast during the second half of 1998. Near the end of that year, officers from the central bank and the ABC headquarters surveyed some PA subsidy loan microcredit programs and raised questions of the lawfulness for government departments to directly disburse subsidy loans. They believed that non-financial institutions should not be allowed to operate microcredit businesses that are, in essence, a financial activity. Therefore, from 1999 the PA subsidy loans were delivered by the ABC directly to the poor. The government PA offices were responsible for identifying the targeted groups. The dilemma of the PA subsidy loans for the poor continued because of macro-policy and systemic issues.

The government-led programs contributed greatly to the large-scale aid to the poor by lending in a relatively short period of time. However, without a long-term goal of sustainable development, these programs could only aim to assist the government’s poverty-alleviation initiatives and improve the low rates of outreach and loan repayment. Seen from this point, it is more appropriate to treat these programs as

poverty reduction than standard microfinance.

(3) Microcredit Pilot Programs for Laid-Off Workers

Increased economic reform in China has stimulated rapid economic development. This, however, has been accompanied by increasingly serious problems of layoffs and unemployment in urban areas. Re-employment has therefore become one of the most important tasks for the Chinese government since the mid 1990s.

The capital for the pilot programs for laid-off workers usually comes from local governments instead of donors. Therefore, the projects are designed and implemented by the local departments. Urban microfinance projects rarely get support from outsiders except for the Tianjin urban project. Two reasons account for this. First, the Chinese government has emphasized re-hiring laid-off workers and has used re-employment funds from fiscal sources controlled by the labor department, women federations, and labor unions. Second, macroeconomic policies, especially financial regulations, are not liberalized enough to allow other institutions to provide financial services unless authorized by the central bank. Therefore, donors can not support MFIs (sic) in urban areas. In addition, the national banks seem to lack incentives to serve laid-off workers.

In terms of the number of clients and amount of funds, these programs are small in scale. They also progress in different ways: some grow slowly and some are discontinued after brief yet rapid development. The reason is that most programs use microcredit as a measure to achieve government goals without a long-term goal of strategy and sustainability (see Appendix 3).

3. Formal micro-loan banking system of rural credit cooperatives

Rural credit cooperatives (RCCs) have the best network in rural China and can be found in almost every rural township. Since established, farmers have been their major clients for decades. Each individual RCC, although small in terms of their deposits, loan portfolios and client volume, is a legal entity and profit center. While RCC's operate on the township level, RCC unions are set up at the county level. Many RCCs also have savings and credit stations at the village level. In 2000, there were 37,624 RCCs, 2,517 RCC Unions, 14,040 Saving Stations, 169,092 Credit Stations, and 645,889 employees⁵.

In rural China, savings service is more successful than credit service. The Agricultural Bank of China (ABC), RCCs and Postal Savings are the three main rural savings providers. Table 2 provides the information on RCC savings. Postal savings have been growing recently, accounting for 2.46% of the total deposits in 2001, up from 1.02% in 1995. Postal savings is therefore a major competitor to RCC's in rural

⁵ Dr. Xie Ping, "Reforms of China's Rural Credit C12.2 cooperatives and Policy Options", Paper prepared for DRC/ World Bank Workshop on Rural Financial Reforms in China 18-19 September 2002, Beijing

areas.

Table 2. RCC's Deposits in China (1995-2001)

Year	Total Deposits of RCCs (Billion \$)	% RCCs/Total Deposits by Financial Institutions in China	% of savings from Rural Household
1995	87	13.3	86.4
1996	107	12.8	87.2
1997	130	12.9	86.0
1998	149	12.7	85.6
1999	163	12.3	84.0
2000	184	12.2	81.7
2001	210	12.0	80.1

The RCC micro-loan program was introduced in 1999 but became active at the end of 2001. The program aimed to improve loan portfolio management and to better serving farming households and agricultural activities, and was closely related to agricultural on-lending support. The PBC demanded that agricultural on-lending support be distributed to farmers as micro-loans. Therefore the fund source of micro-loans of RCCs was mainly PBC agricultural on-lending support. At a low interest rate (2-3% per annum), on-lending from the PBC was regarded as an RCC subsidy.

The PBC disseminated their "Temporary Provisions for Management of RCC's Micro-loan Program" in 1999, and the "Guidance for the Management of RCC's Liability-group Loan" in 2000. These two documents are related to the practice and assumptions of microfinance movements both home and abroad, and promoted the RCC micro-loan program. In December 2001, the PBC issued the "Guidance for the Management of RCC's Micro-loan Program" asking all RCCs to open micro-loan

businesses to initiate credit in villages and townships.

Moreover, RCCs also provided fund transfer services in townships, particularly in poor areas. They were the only institutions to provide transfer services when ABC withdrew their branches for profit reasons. As a result, most donor funding and some government-led microcredit programs transferred their funds through RCCs.

II. Methodology

1. Grameen model and China's practice

(1) Flagship's impact and lack of alternatives

As an international flagship, The Grameen bank (GB) has greatly influenced microcredit development in China. Before 1997, most people involved in pilot microcredit programs for the poor thought the GB was synonymous with microfinance to some degree. Therefore, when the Grameen model was replicated in China, Chinese practitioners did not understand the whole picture of the international microfinance movement.

The UNDP-CICETE program is an example. In the early 1990's the UNDP-CICETE incorporated a microfinance component in its poverty alleviation program. There was no intention of applying the Grameen model at the beginning. Due to the lack of applicable technical support, the microcredit program could not be fully developed. UNDP-CICETE decided to adopt the Grameen methodology after the FPC successfully replicated the Grameen model in 1994. From 1993 to 2000, all UNDP-supported poverty alleviation programs in China covering 48 counties in 16 provinces adopted some component of the Grameen group lending microcredit program. The programs were carried out in metropolitan and remote mountainous areas, ecologically sensitive zones, as well as areas with scarce population and minimal market transaction activities.

(2) Group Lending Delivery Skill

Although the Grameen model was widely adopted in the Chinese microcredit program, only group lending delivery skills were actually put into practice. This methodology was approved by the MFI's managers, government PA officers and professionals from banks. Dependence on the Grameen group lending methodology was due to its impact as a flagship, the experiences of FPCs at the initial stages, and a lack of other feasible alternatives at later stages. Traces of the Grameen model could be found in many microcredit projects in China. However, the Grameen model's

popularity resulted in the misunderstanding that only the GB was the standard form of microfinance. Although there were many other successful microfinance models in other countries, they were not as well known in China (Liu Wenpu).

(3) Incompatibility Between Grameen Organizations and the Chinese

Context

The political, economic, and social structure of China made it impossible to fully adopt the Grameen model from the very beginning. If a five-person group could be identified as a delivery group and a 30-person group could be taken as the grassroots organizational form of the Grameen model, then China would face no difficulty applying group lending skills. However, it was extremely difficult to apply the structure of Grameen centers. There is strong government organizational structure and resource availability in the rural areas of China, where villages are the fundamental organizational unit. As a result, microcredit activities were carried out on the level of administrative villages or natural villages. Weekly Center meetings were soon attended by the whole village, where village leaders had to play some leadership role in this process. As a contrast, in urban areas the fundamental organizations are enterprise labor unions or street-level offices. It is very hard to set up a Center across multiple fundamental organizations. No persistent system of holding weekly meetings at the Center level could be found in the Chinese Grameen model due to organizational barriers.

Microfinance operations are either directly administered by the program office at the county level or by a separate office. If at the county level, the program office is usually supported by a government department with a program coordinator from that department. If it is a separate office, the office is registered with the local civil affairs department as a fully legal individual organization. The chairman of the organization is usually the deputy chief of the county and local officers serve as board members. Although in principle the government's function is to support rather than interfere, it is always very important that the roles of MFIs and the local government are balanced.

2. Credit Ratings of RCC Micro-loan Programs

The credit ratings for rural households were introduced in the RCC micro-loan programs. Usually an RCC would first set up files for each household containing information about the family size, basic financial data and major income generating activities undertaken by the household. Then the RCC would send a credit rating taskforce to villages to assess, with the help of village leaders, loan repayment capabilities and credit-worthiness of each household. Finally, qualified households would be offered a Credit Certificate with a specific credit limit based upon the

assessment. Households with a Credit Certificate would be able to borrow from RCCs up to their credit limit at any time.

There are currently two types of loan products. The first is the individual micro-loan, which is based on the established credit limit on the household's Credit Certificate, varying from US\$125 to \$6,000 depending upon the region. No collateral is required for this type of loan. The second type is the group-liability loan for farming households. This targets clients whose loan needs exceed their individual credit limits or who lack sufficient collateral. In this case, a liability group can be formed by 3-5 similar households. The loan terms of these two products are determined based on the activities undertaken with the working capital loan not exceeding one year. Interest rates are determined by the PBC, which is able to make rate adjustments in special cases as appropriate.

III. Assumptions

Microfinance development in China has evolved from the assumptions of policy makers and scholars on the functions of microfinance. These assumptions are based on judgments of international microfinance development with considerations of the Chinese social-economic situation and the need for policy.

1. Microfinance, an Effective Tool Against Poverty

Since replicating the Grameen model, most practitioners have accepted the assumption that microfinance is an effective credit instrument against poverty. The Grameen model is most effective at targeting the poorest people, especially in the initial program stages. An important monitoring factor, therefore, was to see if the truly poor people had been reached early in the program, and in fact, they had been. But with further development of the projects, issues of low repayment and high cost emerged. Some started to doubt whether the Grameen model was a right choice for the poorest communities and whether the welfare of these people could be really improved. It then became obvious that to improve the lives and operations of the poorest households cooperation was needed between the credit services and other types of services. Should microfinance programs only provide credit services or other technical and social services needed by these households as well? Practitioners, researchers and policy makers were confronted with these questions. At the same time, with the expansion of the projects, the high cost of reaching the poorest households became increasingly serious. Therefore, the succeeding projects mainly targeted low and middle-income households in poverty stricken areas.

Under the assumption that microcredit is an effective credit instrument against poverty, most projects at that time were carried out in the poorest areas or served the poorest households in moderately poor areas. Microcredit was thus considered a tool to

improve efficiency of public goods provided by public sectors.

2. Microfinance as a Means to Achieving Sustainable Development

By 1997, with the expansion and success of several pilot projects, it seemed likely that these projects would soon have to become accountable for their own profits and losses. At the same time, some donor organizations such as CGAP and UNDP published series of case studies on microfinance “best practices.” More knowledge of the microfinance movement beyond the GB also became available in China. Operational sustainability of the projects and organizations became an important success factor of microfinance programs. It became a well-accepted assumption that MFI’s could achieve sustainable development while engaging in poverty outreach. When this “win-win” idea became accepted in China, ensuing pilot projects started to target “best practices.” For example, FPCs led efforts to provide valuable experiences and lessons in balancing sustainability, efficiency, portfolio quality and targeting the poor.

However, no “win-win” case emerged from China’s microfinance practice. The importance of setting sustainability as a goal was obvious given the longer-term, wider scale projects. But at the same time, challenges in management and operations became more and more critical. A 100% repayment rate could not be realized, some loans were more risky than others, repayment delay became widespread, and the performance of some organizations deteriorated. Strengthening control and improving the system resulted in higher costs. Organizational capacity became closely related to the survival of the projects. The goal of sustainability, therefore, became more distant and the “win-win” idea was questioned.

Currently, pilot programs require external technical support, training, and financing resources. Increasing income and reducing costs seems easy under sustainability, but achieving these goals is restrained by the following two factors: First, interest rate and macroeconomic policies determine that there are no other channels to increase revenue. Second, there is a tradeoff between reducing costs and ensuring loan quality. If external variables remain the same, there is limited room left for balancing returns, efficiency and quality internally.

3. The “win-win” proposition as a long term strategy

Most microfinance programs in China were started under the assumption that microcredit would be the single-most effective poverty-alleviation instrument. When pursuing the two goals of targeting the poorest and achieving sustainability, some projects were faced with a lack of proper strategies. The questions that need to be answered have become: What is the relationship among helping the poorest, cost and efficiency, clients’ return and MFI returns? How to break down the strategic, “win-

win” goal into shorter-term goals? What kind of incentive mechanisms should be adopted to realize the “win-win” goals?

Although with some confusion, microfinance practice in China became more widespread and diverse through the pursuit of sustainability. These practices also played a critical role in making the project offices and governmental agencies realize the importance of improving efficiency and reducing costs.

In the process of pursuing the “win-win” goals, some shortages were revealed. These could be caused by limited project management capabilities, misunderstanding of the microfinance system, or the socio-economic context and policy framework in China. Some of these issues were commonly found internationally while others were unique to China. At the same time, people also realized that microfinance could be used to achieve economic, social, and development goals by providing direct financial services to targeted groups. Some of these development goals included poverty alleviation and women’s empowerment. These financial services were scarce to poor people yet extremely important to improving their welfare.

Pursuing this goal also made it easier to understand the goals of achieving financial sustainability and serving the poorest people. Financial sustainability aims to improve the integrity of financial services, to follow market rules, and to effectively provide customized products. Serving the poorest is a goal of social equality and needs support from the public and private sectors. The two goals both share the efficiency principle.

IV. Contribution

1. Progress of China’s Practice

Donor-funded programs began disbursing loans in 1994 while the government program started in 1997. The RCC program was introduced in 1999 and fully launched at the end of 2001. According to data from the Poverty Alleviation Office of the State Council⁶, the total fund input reached RMB600 million at the end of 1998. As of 2001, the government has disbursed subsidy poverty alleviation loans of RMB3.784 billion, covering 2.342 million poor households. For the RCC micro-loan projects, according to relevant reports⁷, 90% of RCCs offered microloans with outstanding loans reaching RMB69.5 billion as of September 2002. The progress of these three programs is summarized as follows (Table 3):

⁶ China National Women Federation: “Work progress in carrying out microcredit against poverty”, the material for Summit Meeting 5+, November 2002 (in Chinese).

⁷ Xu Zhong “Evaluation of the RCC-based micro-credit practices”, International Workshop on Rural Finance, September 18-19, 2002, Beijing.

Table 3. Summary of Microfinance Programs in China

	DONOR	GOVERNMENT	RCC'S
Starting time	1994	1997	2001
Size (US\$) (1998)	20M	75M	---
Credit limit (US\$)	125-800	125-800	125-6,000
Credit Methodology	5-person groups and village-based credit funds	5-person groups and collateral in urban areas	Individuals; Liability groups
Savings	Compulsory savings among members	Compulsory savings among members or non-savings	Voluntary savings
Interest rate	8% (flat) or based on rates of the bank	3% (flat)	Based on bank rates (6-7%)
Targeted customer	Poor households	Poor households	All households in rural areas

2. Exploring Applicability and Fundamental Principles

The group-lending methodology used in large-scale government PA subsidy loan programs has had a positive impact on poverty reduction, but not without some incompatibility between new instruments and the old system.

This methodology also explores the feasibility of some fundamental principles recommended by the international microfinance movement, which include long-term service, coverage, outreach, and financial self-sufficiency. Some donor-funded projects have made efforts to balance these goals while providing information about the Chinese situation. Thus far relevance and viability of microfinance in China has been achieved. As for the applicability of microfinance, CGAP pointed out recently that microfinance is just one of the many tools to fight poverty. It would be helpful to those who already have businesses as well as the capabilities to manage them. To others, microfinance might not be as helpful and could drag people into debt. Other limitations also could restrict the success of the delivery mechanism and the methodology. Microfinance practice in China has provided rich information in the following aspects: (1) The UNDP-CICETE project in Tibet has been carried out in an area with poor natural conditions, minimum infrastructure and market, and scarce population. It has demonstrated that a project needed inputs and the Grameen model involved a high cost. (2) The UNICEF SPPA (Social Development Program in Poor Areas) has shown that including a social development component was essential to improving poor women's confidence and skills. It also has proven that different results are possible depending on the goals of the local government and subsequent actions taken. (3) The legal system and rules have become a key external constraint for the rural and urban practices.

V. Challenges

Microfinance practice in China has demonstrated its viability while facing multiple challenges. Choosing a correct strategy is key to future development. The major challenges are: (1) Creating successful transitions from pilot projects to institutions; (2) formulating strategies for poverty alleviation subsidy loans; (3) fostering NGOs and MFIs in order to meet the diverse demands of poor people; (4) strengthening RCCs to turn them into the main force of microfinance; (5) preparing MFIs to enter the market and deciding which organization(s) should take responsibility for regulating and supervising the microfinance in China.

In the process of expanding microfinance practices, incompatibility between the new system and the current organizational structure has emerged. Inconsistencies between the government credit PA subsidy loans and the current financial regulations have appeared as well.

The government's attempt at leading the subsidy PA loan programs ended with

many lessons, a major one being obstacles in organization and structure. The government needed to lead the effort due to its strong existing organization as compared to extremely weak NGOs. Furthermore, some governmental functions could not be performed via non-governmental means. Cooperation between the government and NGOs could effectively help achieve poverty alleviation goals. It was also necessary to foster and establish a framework to enable NGOs to operate independently the governmental structure.

Although the donor funding pilot projects have achieved some success, progress has been slow on the organizational and system levels. These relatively independent microfinance offices are challenged by registration restrictions in becoming legal organizations within the current financial policy and management framework of NGOs. The consequences of this legal obstacle have been very limited resources for the projects, including restricted financing channels and insufficient human resources.

If RCC micro-loan programs could grow smoothly, they would rejuvenate the microfinance industry in China. But the programs are new and are facing certain key constraints. First, the availability of on-lending from the PBC at the current low rates may give rise to moral hazard problems. On-lending credit risks would be ultimately carried by the PBC if there were no fundamental reforms in ownership structure and corporate governance of RCCs. The RCC micro-loan program would become another short-term policy. RCCs should therefore advocate more deposits to promote long-term program operation. Second, the purpose of micro-loan programs is to help farmers get access to financial services. Achieving this goal depends on other policies and rules. RCCs face some key constraints in the process of operating micro-loan projects such as chronically bad debts, management incapacity and interest rate ceilings too low to cover costs. However, it is perhaps too early to make any judgements.

Microfinance in China began as foreign donor funded pilot projects and grew to include government initiatives. Formal financial institutions are now actively involved, and microfinance programs will become even more diverse in the future. Only diverse offerings can meet the demand for financial products and services of most low-income and poor customers. There is no doubt that current supply-driven microfinance cannot meet such demands. Diverse demands require multiple supply sources in terms of organization, products, and instruments. The challenge is how to foster collaboration among financial institutions, non-bank financial institutions, cooperatives or community organizations, and NGOs. This course of action is often referred to as liberalization of financial policies. If there were no policy framework or approaches for non-bank financial institutions and MFIs to enter the market, it would be hard to develop a regulated and supervised microfinance industry. Meanwhile, competitors and cooperators would benefit from the healthy development of RCC micro-loan programs and microfinance in China.

Seen from this point of view, the microfinance challenges in China are organizational rather than technical in nature.

Appendix 1. Funding the Poor Cooperative (FPC)

Funding the Poor Cooperative (FPC) microfinance project was an action-research program launched in 1993 by the Rural Development Institute (RDI) of the Chinese Academy of Social Sciences (CASS). It was modeled after the Grameen Bank solidarity group methodology to provide loans to the rural poor. Since 1994, FPC of CASS has set up 15 sub-branches within 3 county level branches in Yixian County of Hebei Province, and Yucheng and Nanzhao Counties of Henan Province.

The FPC mission is to improve the economic conditions as well as social status of poor households, especially for poor women. This is effectively achieved through providing microcredit services, providing experiences for the field of microfinance in China, and gradually strengthening the MFI capacity for successful transition it into sustainable institutions.

FPC has made significant progress in improving its operation methods. It has improved methods of focusing on loan disbursement to the poor and maintaining high repayment rates; of setting up rules and standards to improving accounting and reporting systems; of pursuing cost-effectiveness in achieving operational self-sufficiency at the branch level. FPC currently is working on the challenges of improving portfolio quality, building staff and institutional capacity, increasing internal control, and producing an operating manual.

The work is more challenging on the institutional level. FPC holds legal status as a pilot microfinance project conducted by the RDI of CASS with the approval of the State Council, the People's Bank of China and the State Poverty Alleviation Office. In the local Chinese context, it is very important for FPC to have the official approval of these government institutions in order to operate and charge interest rates above legally mandated levels for poverty-oriented programs and institutions. FPC is expecting to make the transition from a pilot program to an institution.

TABLE 4 Summary of FPC's Progress

Data	12/98	12/99	12/00
No. of branches	3	3	3
No. of sub-branches	3	6	9

No. of active loans at end of period	7,515	12,266	14,032
Total outstanding loan balance (US\$)	548,996	1,112,150	1,466,500
Percentage of female clients	97%	98%	98%
Number of staff	54	68	78
Portfolios in arrears	0.7%	2%	2%
Portfolios at risk	0.4%	3%	3%
Average loan balance (US\$)	73	91	99
Average balance per loan as %of per capita GDP	10%	11%	11%

Appendix 2. UNDP-CICETE Microcredit Program

The UNDP-CICETE Microcredit Program has addressed rural and urban poverty in 48 counties of 16 provinces and six districts in the Tianjin municipality. Revolving loans total US\$8.21 million. According to CICETE statistics, as of the end of 2000, 42 counties were covered by 12 projects. The accumulated loan disbursement was US\$14.77 million with 93,110 members benefiting from the loan, 70% of which were women. At the same time, the amount of the loan outstanding was US\$5.97 million with 51,667 active borrowers. The repayment rate was 89% (see table 5). Among these projects, four counties belonged to the sustainable development program: Chifeng County in Inner Mongolia, Dingxi County in Gansu Province, Xiren County in Guizhou Province, and Yilong County in Sichuan Province.

Table 5. Progress of UNDP/CICETE Microcredit Program (As of the end of 2000)

	Accumulated amount loan Disbursed	Accumulated No. of clients	Women %	Outstanding Balance	Active Clients	Repayment Rate
1. GUIZHOU:						
ZiYun	386,037	1,895	83%	118,111	1,455	90%
PuDing	208,805	1,505	52%	28,928	421	98%

GuanLin	274,000	1,933	40%	110,009	1,033	93%
XinRen	465,488	2,659	93%	163,832	1,621	100%
2.QINGHAI:						
TongRen	174,390	1,430	53%	75,577	780	58%
GuiDe	152,439	1,250	53%	72,554	1,350	77%
HuangYuan	295,671	2,343	53%	182,121	2,410	54%
3.SICHUAN:						
MaiXian	221,957	1,978	95%	61,330	1,525	100%
HeiShui	164,634	1,500	57%	68,440	824	91%
SongPan	104,817	842	63%	37,847	747	99%
BaTang	134,171	930	64%	70,411	1,306	98%
4.YUNNAN:						
JinPing	375,244	2,473	86%	119,593	1,228	93%
MaLiBo	641,451	5,181	65%	220,892	1,795	95%
5.Inner MONGOL:						
ChiFeng	496,707	4,019	100%	167,405	2,639	100%
6.TIANJIN:	141,707	307	100%	101,045	307	100%
7.HUNAN:						
Xiangxi	659,902	5,102	49%	260,430	2,701	93%
8.XINJIANG:						
MoYu	902,578	7,401	45%	533,637	4,122	100%
YuTian	380,138	2,800	53%	261,077	1,895	44%
9. SICHUAN:						
YiLong	1,665,634	7,005	91%	443,114	4,195	91%
10. GUANGXI:						
DeBao	301,683	1,190	64%	151,751	912	87%

DuAn	226,622	1,706	50%	148,715	1,266	78%
TianLing	103,124	831	76%	22,675	101	84%
DaHua	173,162	1,172	38%	133,461	965	18%
LongLing	231,937	1,484	48%	84,488	539	80%
11.GANSU:						
JingYuan	335,744	3,600	51%	251,007	3,367	38%
DingXi	1,502,573	5,310	53%	324,172	2,380	99%
WuShan	598,847	4,465	48%	254,803	1,850	95%
Gaolan				201951	1,452	63%
12.NSTC ⁸ : 10 counties	3,452,183	20,799	71%	1,280,998	6,481	86%
Total	14,771,645	93,110	70%	5,975,610	51,667	89%

Appendix 3. Microcredit Pilot for Laid-Off Workers

The primary goal of the microcredit program for laid-off workers is re-employment, and relevant departments have implemented these programs in different cities. The following information is based on five case studies from Jiaozuo city of Henan Province, Kunming city of Yunnan Province, Liuzhou city of Guangxi Province, Shangluo city of Shannxi Province and Tianjin Municipality. Loan products discussed in the five cases include individual, group, and micro-enterprise loans. Collateral or a guarantee is required except for solidarity group loans. The average loan size is US\$250-600. However, micro-enterprise loans sometimes reach US\$12,500. The interest rate is lower than the commercial rate, although Tianjin project rate is equal to that charged by state-owned commercial banks.

Table 6. Scale and Products of Five Programs

	Jiaozuo	Kunming	Liuzhou	Shangluo	Tianjin
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⁸ NSTC: National Science and Technology Committee supported 10 counties in different provinces.

Start date	6/1998	6/1998	11/1999	6/1998	8/1998
Fund scale (US\$)	134,000	110,000	256,000	1,585,000	900,000
Total clients served	1,530	134	316	6,873	---
Active clients (end of 2001)	---	46	---	500	1,324
Loan Term	12 mo	12	12	12 or 18	12
Max. Amount (US\$)	250-1,250	600	400	400-1,250	500
Interest rate	0	4.8%	4.8%	4.5%	7.6%
Repayment frequency	Monthly or lump	Monthly	Monthly	Biweekly or monthly	Biweekly or lump
Loan type	Individual, group, micro-enterprise, small-enterprise	Individual	Individual, group, Micro-enterprise	Individual, Group, Micro-enterprise	Group
Collateral or guarantee	Solidarity group, Enterprise trade union	Individuals, Guarantee,	Solidarity group	Solidarity group, individuals, Guarantee	Solidarity group
Fund Sources	Trade Union	Fiscal	Fiscal	Fiscal and PA subsidy loan	Internal donor and fiscal

The Liuzhou project shows that 80% of the loans go to individuals, accounting for 39% in amount. The rest are group loans. Individual loans mean more work with their smaller size but larger number. They also incur higher cost than micro-enterprise loans.

Table 7. Activities of the Liuzhou Urban Program

Business	Total		Individual loans				Micro-enterprise Loans			
	No.	Amount	No.	%	Amount	%	No.	%	Amount	%
Service	20	123,000	16	80.0%	48,000	39.0%	4	20.0%	75,000	61.0%
Retail or Wholesale	87	286,000	84	96.6%	247,000	86.4%	3	3.4%	39,000	13.6%
Restaurant	12	55,500	9	75.0%	25,500	45.9%	3	25.0%	30,000	54.1%
Processing	28	240,000	15	53.6%	42,000	17.5%	13	46.4%	198,000	82.5%
Transportation	3	9,000	3	100.0%	9,000	100.0%	0	0.0%	0	0.0%
Building	2	6,000	2	100.0%	6,000	100.0%	0	0.0%	0	0.0%
Animal Husbandry	17	69,000	15	88.2%	45,000	65.2%	2	11.8%	24,000	34.8%
Kindergarten	13	155,000	5	38.5%	15,000	9.7%	8	61.5%	140,000	90.3%
Total	182	943,500	149	81.9%	437,500	46.4%	33	18.1%	506,000	53.6%

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