MICROFINANCE AND POVERTY ALLEVIATION:
UNITED NATIONS COLLABORATION WITH CHINESE EXPERIMENTS

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Introduction

Though poverty alleviation has long been a high priority for the Government of China, microfinance is a still experimental tool in its overall strategies. China's microfinance experiments differ from the more substantial microfinance institutions and programmes of its neighbors in South and parts of Southeast Asia not only in their youth and limited size, but also in the policy environment for designing and implementing microfinance. China's socialist ideology, the continuing reforms in the economic and financial sectors as well as the devolution of authority and responsibility to local governments all lend distinctive characteristics to the policy environment for implementing sustainable microfinance for poverty alleviation.

The United Nations system was perhaps the first international partner to China's new experiments with small scale credit schemes. In 1981, IFAD (International Fund for Agricultural Development), and in 1982 UNIFEM (United Nations Development Fund for Women) began projects in China with credit or revolving loan fund components. Since then, UNFPA, UNICEF, UNDP, WFP, and others have supported credit or microfinance projects implemented by Chinese partners. The nature of the collaboration has changed over time. The changes reflect evolution in the policy environment and shared learning from project implementation.

This paper reviews the experience of United Nations supported microfinance projects in China over the past twelve years, giving particular emphasis to two case studies. It undertakes this review in the context of the evolving policy environment for poverty alleviation within which microfinance schemes can be implemented. Using some of the conceptual framework and principles drawn from microfinance programmes elsewhere, the paper draws out some of the lessons learned from the UN supported projects and identifies the implications for future planning. An annex contains case studies of two UN (UNDP and UNICEF) supported microfinance schemes. The text includes brief descriptions of most UN supported projects involving microfinance.

Concepts and Definitions

Knowing what we mean by poverty is basic to assessing the role of microfinance in alleviating poverty. The Policy Advisory Group of the Consultative Group to Assist the Poorest (CGAP) has defined the poor as those living below the poverty line as established by the government in their country, and the poorest as the bottom fifty percent of that group of poor. The difficulty with poverty line definitions of the poor is that they rely on indices that appear to be easily measurable -- such as income or food consumption measures. These indicators may in fact be difficult to measure at the individual household level. They may be useful in tracking progress in poverty alleviation in the aggregate. They may be less useful in designing programmes that assist different categories of poor and poorest households.

Poverty is for many categories of poor not simply an economic phenomenon; it is also a social, cultural and psychological phenomenon. Poverty alleviation can be seen not only as increasing the income and assets of households or individuals, but also as enabling or empowering individuals to get themselves out of poverty. When the definition of poverty alleviation is expanded to include social dimensions, there are profound implications for
the design of microfinance institutions and programmes for poverty alleviation. It implies a social intermediation and even a confidence building role for programmes.

Microfinance is presently promoted as an almost magic solution to poverty. Innovative institutions and programs in Asia and Latin America, some operating as long as 40 years, have demonstrated that providing credit and savings services to the poor can be a powerful and efficient tool for poverty elimination. Looking only at famous success stories, it would be easy to conclude that microfinance is a magic solution. However, riot all microfinance schemes are successful; some lose their capital while failing to make a difference for poor clients. Experience elsewhere does suggest that successful microfinance schemes may have different designs and different institutional bases, and may target different levels of poor people.

Successful microfinance appears to be defined by three main characteristics: sustainability; outreach; and impact.

- **Sustainability** implies that the costs are covered by income. Operational self-sufficiency is usually said to be achieved when interest income and fees ≥ operating costs + costs of loan principal lost to default + depreciation of fixed assets. Financial self-sufficiency implies that the costs of capital are also covered by income. The issues of sustainability and of subsidies for microfinance are sometimes hotly debated. Some observers argue that microfinance for the poor has overriding social objectives that justify subsidies for the poor. Others maintain that poor clients are willing and able to pay rates of interest high enough to cover the high transaction costs of microfinance and even the cost of capital. There are enough examples of self-sufficient microfinance institutions and programmes to argue against subsidies. Moreover, subsidies are inherently unstable, create dependency and contribute to inefficient implementation. The bias of this paper is that microfinance can and should be self-sufficient. Subsidies for the poor may indeed be socially justified, but they should be transparent and support provision of basic infrastructure or basic health and education services. Subsidies should not interfere with or distort a microfinance project. Microfinance institutions and projects should exhibit the same financial responsibility that they demand from poor clients.

- **Outreach** indicates whether the microfinance services are actually serving poor, or the poorest people; how many people are being reached, and the quality and variety of microfinance services actually reaching target groups.

- **Impact**, or moving poor households and Individuals permanently out of poverty, is the ultimately the objective of microfinance services. As suggested above, impact has dual dimensions. It means not only moving people above the poverty line in a given year, but building their capacities to continue increasing assets and income.

The Changing Environment for Poverty Alleviation and Microfinance Policies and Practice in China
This section introduces microfinance and poverty alleviation policies and practices in China. It aims at laying the foundation for understanding the environment in which UN supported projects, and other projects, are designed and implemented.

A. Poverty in the Chinese Context
China is a country of continental breadth and variety of economic and geographic conditions. The causes of poverty, levels of poverty, and the characteristic features of poverty vary according to social, historical, economic and natural conditions, different patterns of economic development and different stages of development. Though urban poverty is an emerging phenomenon, poverty in China is primarily rural. China has experienced unbalanced development, so that the overwhelming majority of the poor live in rural areas and are mainly (but not entirely) scattered among remote and mountainous resource poor areas, former revolutionary bases and minority nationality areas. The biggest concentration of poor are in the Northwest and Southwest.

As elsewhere, the burden of poverty falls heaviest on women and children. In 1978, China had a poor population of 250 million, of whom 138 million or 55.2% were women and children. In 1985, the total number of poor people dropped to 125 million (the poverty line was 206 yuan per capita annual net income), of whom 75 million or 60% were women and children. In 1992, there were 62.86 million farmers whose per capita annual net income was below 300 yuan, and 36 million or 58% of them were women and children. At the end of 1994, there were 80 million poor people living below the poverty line designated by the State Council (a per capita annual income of 400 yuan); the percentage of women and children among the poor population increased slightly.

The Government of China has had a strong poverty alleviation policy. Its success in reducing the number of individuals living in poverty is unprecedented. No other country has achieved such large reductions in poverty in so short a period of time. China's achievements in reducing poverty are related in part to the fast growth of the economy and increases in farmers' income resulting from restructuring of rural economic system. They are also linked to direct poverty alleviation policies. Beginning in the mid-1980s, the Chinese government launched large-scale, well-planned and organized poverty alleviation campaigns. The number of the poor dropped from 125 million in 1985 to 65 million in 1995, averaging an annual decrease of 6 million. Reducing the remaining poverty will be an increasingly difficult task.

B. Poverty Alleviation Policy Evolution
Chinese poverty alleviation strategy has moved from a relief and subsidy approach in the early 1980s; to a regional development approach from the mid-1980s to mid-1990s; and in 1994, to a new policy strategy (Ba-Qi) for eliminating abject poverty by the year 2000 focused on goals for households.

1. 1979 to mid-1980s - Basic Relief and Financial Subsidies
China's economic reforms began in rural areas with the introduction of the household responsibility system. The unleashing of rural household productive capacities was a major contributor to the massive reductions in poverty in the early 1980s. Some rural poverty
was less easily reduced. Traditionally the poorest areas in China were remote, resource poor and lacking basic infrastructure. Some were 'old revolutionary bases'. Poor areas also included many of China's ethnic minorities who had a history of oppression, neglect and discrimination in pre-1949 China. For this reason Government in the new China gave attention to economic development in ethnic minorities areas. Against this background, the policies and approaches of Government in the post 1979 period centered on the provision of basic relief to people and financial subsidies -- a "money-grains-cotton" policy.

The People's Daily reported (Nov. 8, 1987) that the financial allocation to poor areas amounted to 40 billion yuan between 1980 and 1985 (sixth five year plan). Earlier, during the second five-year plan period (1960-65), the central Government gave 162 million yuan of financial subsidies to the 6 provinces and autonomous regions of Inner Mongolia, Xinjiang, Guizhou, Guangxi, Yunnan and Ningxia. By 1980-85, that amount jumped to 28.428 billion yuan. In Tibet during the past 31 years agricultural and industrial production increased fourfold, representing an annual growth of 5.45 %, but financial subsidies from the central government increased sixty-five-fold, representing an annual increase of 14.97%.

2. Mid-1980s to the Present - Regional Development Approach

A new approach emerged in the early 1980s, building on the finding that poverty alleviation should move beyond simply providing basic relief and should be integrated with development of the regional economy. The new approach was aimed at regions, not households in poverty. It sought to expand employment and increase income by expanding production. A key change was that poverty alleviation funds would be delivered as credit rather than grants. Though the loans had a subsidized interest rate, the intention was to push governments and institutions in poor areas to use funds more efficiently. The low interest poverty alleviation credit was largely channeled through the Agricultural Bank of China, though this is being changed by the banking reforms of 1993. Other banks generally provided credit to county enterprises, which were not necessarily linked to poverty alleviation. Poverty alleviation loans were intended to be used to support attainment of food security by poor households. Poverty alleviation was to be transformed from a simple subsidy system where Government transferred capital and materials to poor areas to a comprehensive input of capital, materials, technical personnel and information. To manage this, special Poverty Alleviation Offices with earmarked funds were established to organize economic development in poor regions. In addition, provinces also set up earmarked funds for provincially designated poor counties.

A government infrastructure programme started in the mid-1980s to improve infrastructure, mainly transportation and water conservancy, in areas where poor people are concentrated. In areas where there are sufficient resources, it was expected that rational development and use of resources would achieve regional economic growth and self-sufficiency, allowing elimination of the original pure relief approach. In areas lacking basic resources for even subsistence conditions, Government promoted strategies of resettlement or labor migration as a means of alleviating poverty. In addition, Government pioneered ways to channel new responsibilities was a major resources to poor areas. For
example, central and local Government departments were asked to develop contractual arrangements with poor counties to help them eliminate poverty. Investment in poor counties from these departments has amounted to over 3 billion yuan each year during this period.

3. In 1994, the Chinese Government turned its attention toward the situation of peasant households in the 8-7 (Ba-Qi) Poverty Alleviation Plan. The objectives of the plan are:

- to assure adequate food and clothing;
- to raise the average annual per capita income of the overwhelming majority of the poor to 500 yuan (1990 constant prices) by the year 2000;
- to strengthen basic infrastructure, particularly to solve problems of human and animal water supply;
- to guarantee that the overwhelming majority of poor townships will have a regular farmers' market, supply of electricity and access of roads;
- to change the backward education and health services, popularize primary education, eradicate illiteracy for the young and middle-aged, promote development of occupational and technical education, prevent and reduce endemic diseases and bring the population growth within the nationally set objectives.

The 8-7 Plan directed that at least 70% of poverty funds should go for agriculture.

A separate but related strategy for poverty alleviation is called the "5-1 "; rather than focusing on increasing the agricultural base, it focuses on the household. Basically the "5-1 " approach calls for adequate land for basic grain production for short term crop production and fruit production or pasture, animal rearing to provide cash income, and opportunity for nonagricultural income on or off-farm. At the grassroots levels, many counties began systematically identifying poor households and monitoring their progress.

C. Poverty Alleviation Policies in Practice

1. Before 1986 the relief and subsidy policy ("money-grains-cotton") ignored poor people's initiatives and creativity and lost the opportunity to mobilize the contribution of the poor themselves in sustainable poverty alleviation. On the contrary, some poor who received subsidies fell into a vicious cycle of dependency. Their confidence and self-esteem were damaged as they came to expect basic subsidies. Relief and financial subsidy may have provided subsistence survival for these poor, but it did not bring about sustainable poverty alleviation. The enormous funds and materials allocated by the government to the poor areas were not effectively used to develop production.

2. Since the mid-1980s, poverty alleviation policy has moved to a regional development thrust. Though intended to benefit poor people, poverty alleviation funds focused on poor areas, not poor people. In practice, funds were frequently lent to enterprises which often had a limited connection to poverty alleviation. Local governments welcomed investment in enterprises which they saw as a potential source of local tax revenues. This is an unintended consequence of the ways in which subsidized poverty alleviation loans have been provided to poor counties.
(a) Poverty alleviation funds have been a primary source of capital for development in the poor counties. For example, data from a survey conducted by the State Council Leading Group Office for Poverty Alleviation and Development in eight extremely poor counties in one southwest province shows that two counties together obtained a total of 52.9 million yuan for development in 1990. Of this, 29.807 million yuan, or 56.3% of the total, was allocated by the state. The remaining 23.093 million yuan (43.7%) came from local sources and foreign assistance. Of the state allocation, poverty alleviation development funds accounted for over 90% of the total. The amount of the poverty alleviation fund input is a substantial portion of investment available for economic development¹.

(b) At the same time the existing poverty alleviation policy primarily targets the poor areas rather than the poor people in the poor areas. In other words, the main direct beneficiaries of the poverty alleviation funds may not be the poor people, but the governments at various levels in poor areas.

(c) Central poverty alleviation loans have been heavily used in enterprise development rather than agriculture related projects. In principle, it is intended that poverty alleviation loans should support development projects that can help to feed and clothe the poor and should be focused on crop farming, animal husbandry and relevant processing. In practice, due to repayment and economic benefit reasons, these projects and the poverty alleviation loans focus on the industrial sector. Frequently 60% and up to 70% to 80%² of poverty alleviation loans in some areas were invested in industrial projects. A report on six counties in one southwest province shows that 92.5% of poverty alleviation loans went to enterprises, and less than 8% to agriculture. In a northwest province county studied, 78.5% of poverty alleviation loans went to industrial enterprises. Many studies suggest that in poor areas the speed of industrial development does not produce a correspondingly rapid poverty reduction, but the speed of industrial development does directly correlate with the growth of financial revenues of the government. The beneficiaries of industrial development are the local government rather than the poor people³.

(d) In practice, poverty alleviation loans reach the richer not the poorer areas of poor counties. Poverty alleviation investment and development are centralized in those areas with better infrastructure and other conditions. These sites are located along the roads, in township centers, in places with good water supply and irrigation conditions, which are appropriate for development of the so-called county 'pillar industries'. Few or no poverty alleviation and development projects are located in poor areas which have inconvenient transportation and poorer social, economical, technical and educational conditions. This is an inevitable tension in the implementation of a poverty alleviation policy relying on a regional development strategy. Industrial development investments seek the best investment environment and conditions, whereas the intended targets of the poverty alleviation policy live in the poorer areas with poor social, economic and technical conditions. Therefore, it was inevitable that the richer were supported rather than the poor⁴.

² Liu Wen Pu, Speech at the Sino-German Poverty Alleviation Workshop, Malipo, 96-5-21
³ Ibid.
⁴ Ibid.
(e) According to statistics, a large proportion of poverty alleviation loans - under the regional poverty alleviation and development policy - have not been used in the targeted poor counties. Instead they flow to non-poor or coastal developed areas⁵.

(f) Of those funds used in the targeted counties, the efficiency of their use is very low and many of them become non-performing loans. In one southwest province, for example, only 80% of poverty alleviation loans available in 1990-95 period were actually invested. In the previous five year period, 100 million yuan of poverty alleviation money was not used. Poverty alleviation funds allocated by other institutions also experienced slow or inefficient use. For example, in 1991, the People's Bank allocated 37 million yuan in loans to the remote and mountainous poor areas, but at the end of October, only 13 million yuan or 35 % had been lent out⁶.

(g) The repayment rate of poverty alleviation loans is generally low. It is estimated the repayment rate for State Poverty Alleviation subsidized loans was 14.3 % between 1980 and 1989, 38.03% in 1990, 45.43% In 1991 and 41.3% in 1992. Among loans extended, the repayment rate of TVEs and county enterprises was the lowest. For example, in one county in northwest China, industrial loan projects had the lowest repayment rate, about 33%, agricultural projects were next with a 46.7% repayment rate; while farmers had the highest repayment rate at 72%⁷.

(h) Poor people have difficulty getting access to loans. With the reform and restructuring of financial institutions in China, loans tend to flow to areas likely to yield maximum profits. Farmers have difficulty competing for scarce capital. Loans to farmers are considered to be high risk and as generating comparatively low returns. Farmers' access is also limited by financial institutions' requirements for collateral and financial guarantees. On average nationally, only about 35% of farmers have access to loans and few of these are poor farmers. For example, the People's Daily reported on July 30, 1996 the findings of a rural survey team in one northwest county. They reported that cadres have easier access to loans, whereas farmers have difficult access to loans. About 80% of the subsidized poverty alleviation loans allocated by a business center of the Agricultural Bank in the county between 1991 and 1993 were lent to county, township and village cadres and their relatives and friends. The rich have access to loans but the poor do not. Ordinary people reported to the team, "Access to poverty alleviation loans is as difficult as climbing up to the sky". When asked about the reason, they reported "Nowadays if you want to borrow poverty alleviation loans, you need first to send a big gift to the person in charge of lending. Then you have to have corresponding savings or bonds as collateral.

3. The Government's Ba-Qi strategy announced in 1994 points a new direction toward balancing support to regional development and production with a focus on households and what is happening to them. Residual poverty is more difficult to alleviate. Focusing on households gets at this poverty at its base. The microfinance experiments that have started in China in recent years are an attempt to combine innovative ways of targeting poor

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⁵ State Council Poverty Alleviation Office, *op.cit.*

⁶ Ibid.

⁷ Ibid.
households with efficient and effective means to enable poor people to get themselves out of poverty. The purpose of this paper is to examine some of that recent experience.

**D. Structural Issues and Poverty Alleviation Loans**

1. National poverty alleviation goals and local government priorities diverge in the implementation of policy. The central Government's regional development poverty alleviation strategy is based on the assumption that local governments and their poverty alleviation offices share the same poverty alleviation objectives. In reality, structural issues push the interests of national poverty policy and local governments in different directions. Additionally, organizational and financial restructuring have delegated more power and responsibility to local governments. With reforms it becomes more difficult for the central responsibility government to control the local governments.

This tension between central and local government priorities is a classic public administration issue. The principal goals of local governments are the increase of local financial revenues and regional economic growth. In poor counties these need to be seen as survival goals. Helping poor people out of poverty is only one of the many other objectives of the local governments. When the principal goals of the local government conflict with the poverty alleviation goals imposed by the central government, the local government may sacrifice the poverty alleviation goals in order to maximize the realization of their principal goals. Local governments, for example, have a greater interest in investment in enterprises whose contribution to tax revenues is direct, rather than loans to a large number of farmers which have high transaction costs.

2. Lack of proper financial services for the poor.
   a. There is an unmet demand for credit and savings from different levels of poor rural households. Poorest households have the least access to credit and savings services. Collateral and capital guarantee requirements make it effectively impossible for the rural poor to access those poverty alleviation loans that are available for rural households. Land is communally owned and only richest households have accumulated material goods that can be used as collateral.

   b. Credit services are not designed to meet the needs of poor customers. The design of poverty alleviation loans redirects the credit services to better-off households and to enterprises. Current poverty alleviation loans are generally large in size with repayment terms usually of one to three years but up to five years. The interest rate of poverty alleviation loans has been 2.88% per year, far less than interest charged for other loans available and less than the inflation rate. Experience of financial institutions elsewhere who successfully lend to the poor suggests that poor households prefer to borrow small amounts of money, repay regularly and repay the loan in one year or less. Repayment by installments not only reduces repayment risks for the lender, but also reduces the attractiveness of the loans to better-off borrowers. Subsidized interest rates are very attractive to better-off borrowers; subsidized loans for the poor tend to be captured by the non-poor.

   c. Poor people are not well organized. With economic reforms and the introduction of the household responsibility system, old systems of peasant organization have nearly disappeared. Under the existing poverty alleviation policy in China, there have not been any effective ways of organizing poor farmer borrowers. They are like "loose sand",...
lacking an organizational base to improve their access to services, improve their knowledge and technical skills or undertake collective action.

d. Savings services are not designed to meet the requirements of poor households. In the existing poverty alleviation practice in China, little attention has been paid to providing savings opportunities to poor households, and to mobilizing savings as a source of capital for on-lending. Lack of productive savings opportunities combined with the inadequacy of credit supply deprives the poor of the basic means to get out of poverty. This contributes to the high rate of 'recidivism' or rate of poor people returning to poverty.

e. Lack of post-lending support and monitoring. In the existing poverty alleviation practice in China, disbursing a loan is the final step. There is usually no follow-up to support efficient use of loans. There is little responsibility for follow-up monitoring and technical support. Without a monitoring and management system, there is no way to support the poorest households in the efficient use of loans. For example, there are reports of poor farmers offered poverty alleviation loans who take the money and lock it away at home so that they could repay the loan on time. The farmers were so risk averse that they were afraid to use the loans. They had no access to technical support to give them confidence in investing in inputs for production.

3. The market mechanism does not always guide decision-making on investment and management in enterprises funded by poverty alleviation loans. Many enterprises funded by poverty alleviation loans are not profitable. This results from inadequate feasibility studies, low level of technology, poor management, poor quality control and lack of sales outlets for products. One county in northwest China, for example, built 22 county and township enterprises with poverty alleviation funds. Records show that in 1994, 11 of the 22 lost money while the rest made only a small profits. Altogether there was a total loss of 4.88 million yuan. The winery in the county borrowed over 60 million yuan of which 50 million yuan was from bank loans. In 1993, they made a loss of 4.2 million yuan. They expected a loss of 2 million yuan in 1994, but the loss incurred in the first ten months was actually 4,824,500 yuan. The winery became a heavy burden on the budget of the county.

**United Nations Mandate for Microfinance and Poverty Alleviation**

The World Summit for Social Development (WSSD) in March of 1995 articulated a global commitment by Governments to eradicate poverty as an ethical, social, political and economic imperative. Poverty eradication was one of three core themes of WSSD. The Programme of Action affirmed the primacy of national responsibility for social development, including poverty eradication, but also called for international support to assist governments in developing strategies. The Programme of Action suggested ways to involve civil society in social development and to strengthen their capacities. It called on Governments to mobilize resources for social development, including poverty alleviation. The WSSD Programme of Action was to be implemented within the framework of international cooperation that integrated the follow-up to recent and planned UN conferences relating to social development, for example, the Children's Summit in 1990, the Environment and Development Conference in 1992, the Human Rights Conference in 1993, the Population and Development Conference in 1994 and the Women's Conference.
The United Nations System Conference Action Plan (UNSCAP) designated poverty alleviation as the integrating theme for follow-up to world conferences. It called for UN system action in five areas:

- the enabling environment
- basic social services for all
- jobs and sustainable livelihood
- advancement of women and gender mainstreaming
- regenerating the environmental resource base

UNDP and UN Resident Coordinators were asked to coordinate UN system efforts in the five areas. UN development organizations have their own individual mandates.

Microfinance is one tool for poverty alleviation. The enabling environment influences the effectiveness of microfinance in the other four areas of poverty alleviation interventions. The UN organizations' mandates in the area of microfinance primarily lies in the area of technical assistance and demonstration of models that contribute effectively to poverty alleviation. The responsibility for provision of capital rests with governments, with support from bilateral donors and international financial institutions.

The United Nations and Microfinance for Poverty Alleviation in China

United Nations system organizations have been collaborating with Chinese counterparts in support of microfinance or revolving loan projects since 1981. IFAD was the first UN related organization to support household credit as part of a programmes to increase agricultural production. UN organizations then used microfinance as a tool for improving women's status and employment opportunities, to promote improved health practices, or to expand choice in reproductive health. Only recently have UN organizations supported microfinance as an explicit tool for poverty alleviation. Government interest in UN credit projects has frequently focused on investments in enterprises or TVES. Key UN contributions in the development of microfinance for poverty alleviation have been in advocacy for a focus on the poorest; a concentration on households and individuals rather than on poor areas; and introduction of voluntary groups as a basis for lending and saving. More recently UN supported projects have been concerned with the sustainability of microfinance designs, food security, and the integration of household level credit with Government's Ba-Qi strategy.

A. International Fund for Agricultural Development (IFAD)

Of all UN related organizations, IFAD has both the longest and the largest experience of cooperation with China on rural credit to households for poverty alleviation. IFAD makes low interest loans to improve food production and nutrition among low income groups in developing countries. It is directed to focus on poorest rural communities, especially small farmers, the landless, animal herders, fishermen and poor rural women.
IFAD has funded 11 projects in China since 1980 for a total of US$258 million. In working in China, IFAD has developed recognition of the different categories of poor, ranging from poorest to several categories of less poor characterized by differences in food security and access to inputs. The poorest households are generally those with little land under irrigation or other limited capacity for food production that requires them to purchase grain from the market and/or eat wild vegetables for survival. They lack not only the cash to buy small livestock, such as pigs, to augment cash income; they lack the food to feed the pig. Without a pig they lose access to manure for food production. Better-off categories of poor have more productive land and income from animals, fruit trees and other sources. IFAD support to projects in China have invested in irrigation, drainage, forest, orchard and shelter belt development and other infrastructure improvements contributing to expanded agricultural production.

IFAD projects have had considerable experience with credit for poor households. A Rural Credit Project in the late 1980s, for example, made available short, medium and long term loans for infrastructure, machinery and other capital investment, and agricultural inputs. Target households were those with less than 0.5 hectare of land and less than the provincial average per capita income. Lending to households was based on groups and group liability, though loans required a 30% down payment. Credit was provided through the ABC and the RCCs at an interest rate to the borrower of 5.04%. Repayment rate was 95%.

IFAD has considerable experience in rural credit implementation, including with different approaches to managing credit delivery and to targeting poor households. IFAD credit to households has gone through the ABC, has been managed by the ABC for a fee, or has gone through Finance Departments or credit agencies staffed by the Financial Bureaux and other agencies. For targeting, IFAD has used incomes to target villages; specific criteria to target individuals; or relying on social pressures within targeted poor villages in order to select beneficiaries who match criteria. It reports that devolving targeting to the village and relying on social pressures is the most effective way of reaching poor people.

IFAD is presently joining with WFP in preparing for implementation an integrated agricultural development project that addresses the targeting questions and uses the RCFs as the basic credit and savings mechanism. This proposal is described below.

B. United Nations Development Fund for Women (UNIFEM)

UNIFEM began support to microcredit activities in China when in 1982 it agreed to fund weaving, knitting and tailoring factories. The Beijing Municipal Women's Federation was planning development or expansion of production in order to create employment for young women while offering skills training. UNIFEM provided $203,000 which supported training and a revolving loan fund which initially provided credit for equipment purchase. The three factories were to repay the loans starting three years after disbursement (1986). Repayment would be made annually for five years in equal installments. The project agreement required the Women's Federation to 'revolve' the money to benefit poor people. UNIFEM involvement with the project ended in 1985. Project monitoring up through

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1987 indicated that repayment was being made and that the Federation used the repayment to make small 100 yuan grants to 260 poor women in 13 townships for productive purposes, and to launch or expand other small enterprises.

In 1989 UNIFEM made funds available for two additional revolving credit projects, this time in Shandong Province: $102,000 for expanding rabbit production and $140,000 for an underwear factory in two locations in Shandong Province. The Women's Federation, in cooperation with CICETE, was the executing agency. UNIFEM involvement with the project was for two years. The rabbit project differed from the others in that activities focused on individual women. It combined skills training with loans to purchase rabbits and build rabbit hutches. Loans were disbursed through the Agricultural Bank of China and the county provided a guarantee for lending. Loans to women were to be repaid in two years, payments once annually with an interest rate of 5%. There was a 100% repayment rate on loans to women. After successful repayment, the market for rabbits declined and prices dropped. The Federation worked with women to diversify production to other small loans.

The Women's Federation in both Beijing Municipality and in Shandong appear to have demonstrated their creditworthiness. In the Shandong cases, the records show that the Agricultural Bank was prepared to use its own money for further lending to individual women's loan projects.

UNIFEM projects were short term (two years) and the amounts of UNIFEM investments were small. Without its own staff based in China, UNIFEM lacks the capacity to build a relationship with the executing agency (ACWF) and contribute in non-financial ways to maximizing the benefits and learning of the projects. Additionally, because the executing agency, the ACWF, may be seen as a social service agency and a marginal player in the poverty alleviation effort, they may be isolated from some of the opportunities for capacity building that would allow them to develop a growing competence in financial management.

C. United Nations Population Fund (UNFPA)

UNFPA was also an early supporter of revolving funds in China. In mid-1986, UNFPA and its counterpart Department of International Relations in the then Ministry of Foreign Economic Relations and Trade (DIR/MOFERT, now DIR/MOFTEC) agreed that unprogrammed UNFPA funds amounting to US$1 million should be used in three Northwest China provinces to address population concerns. Though working in poor areas, the project was not a poverty alleviation project. The premise underlying the project was that women's increased economic productivity and earnings would lead to increased status of women and lower fertility. UNFPA identified the UN Food and Agriculture Organization (FAO) as the executing agency and negotiations on project design began. MOFERT wanted to use funding first for county, township and village industries, believing that women would be able to raise their productivity and income through the expansion of the job market and increased economic activity at the township and village levels. County, township and village industries were desirable because they are a key source of tax revenues for the local governments. UNFPA and FAO proposed formation of women's groups as the basis for individual and group micro-enterprises. Both agreed that in the first round loans should be given to local enterprises employing women and purchasing raw materials produced by women. In the second round, as the enterprises
repaid loans within a mandatory three year period, money would be lent to women's groups, formed on the basis of voluntary participation and with requirements for training and mandatory saving. The first project was launched in 1989 in one county each of Gansu, Ningxia and Qinghai Provinces. Subsequently seven additional projects essentially based on the original design have been launched in Guizhou, Xinjiang, Inner Mongolia, Hubei, Anhui, Shanxi and Shaanxi and expanded in the original three provinces. By project end in 1995 there were activities in 35 counties. UNFPA has invested more than US$9 million and generated additional support from the Australian Government.

About 73% of the international commitment was used for the revolving fund, and 17% for training. UNFPA also funded a similar project in Hainan Province, executed by the International Labour Organization. The discussion here refers to projects executed by the Food and Agriculture Organisation (FAO).

- **Enterprise Loans.** First generation loans were to be given to enterprises that could absorb agricultural production from local households and provide employment and other returns to households. The enterprises were to commit to providing basic health services and to increase the number of women in management positions. The loan maturity was to be three years, with 30% repaid at the end of the first and second years and 40% at the end of the third year. Enterprise loans were interest free, but the enterprises agreed to pay annually up front a 4% social development fee to be used for the benefit of women employees. The final report by FAO on the enterprise loans indicates the following:

<table>
<thead>
<tr>
<th>Status of Loans</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total amount of revolving fund lent to enterprises</td>
<td>30,435,895Y</td>
</tr>
<tr>
<td>Total repayments due</td>
<td>20,766,383Y</td>
</tr>
<tr>
<td>Total repayments made</td>
<td>18,469,606Y</td>
</tr>
<tr>
<td>Repayment rates</td>
<td>89%</td>
</tr>
<tr>
<td>Number of enterprises funded</td>
<td>72</td>
</tr>
</tbody>
</table>


Performance of enterprises and repayment of loans apparently varied by location. There were late repayments by a number of enterprises, delaying the start of second generation lending to women's groups. There were reports that repayments were made not by the enterprises but by the county finance bureau, suggesting that not all enterprises had reached a break-even point. An October 1995 meeting of 35 county Governors and operations managers recommended that in the future revolving funds should only be used for loans to women's groups, not to enterprises.

- **Women's Groups.** Women's Groups are the basis for project revolving fund lending. Each group signs a contract with the county governor that commits
the group to liability. The township governor acts as a guarantor. The group
on-lends to individuals (or sub-groups) using the loan received plus any
savings or interest income generated by the group. Field staff from the county
government (the All China Women's Federation staff), who have been trained
by the project, are responsible for mobilizing women's groups. The first step
for prospective members was to participate in a 64 hour training in group
formation and small enterprise management. After participation in at least 90%
of training, women were eligible to form groups based on voluntary
association. Project reports indicate that early groups averaged about 30
members while later groups were 25, which was found to be a better size.
Once formed, the group elects officers, establishes a bookkeeping and
management system and begins saving. The project rules required that
members save for six months before being allowed to borrow. Project records
indicate that old groups started by requiring savings of 2-5 yuan per month and
that newer groups require savings per member of 10 yuan per month.

The UNFPA projects used a two-tiered system of lending: lending to the groups based on
procedures set up by the project; and loans from the group to the individual where
procedures were to be partly determined by the group. The group request to the County
Governing Body for a Group Loan was to be based on individual feasibility studies of their
own micro-enterprises for which they wanted loans. The Group Loan Committee with the
help of the county project office was to amalgamate individual proposals. The County
Governing Body was to assess proposals and decide on the fund total to be released to
each group. The Group contract signed with the county governor specified repayment in
three years on a 30%, 30% and 40% schedule. Loans to Women's Groups were to be
interest free, but there was an annual charge of 5% for a Social Development Fund,
deducted on loan release and payable each year after. Fourth-fifths of the Fund is under
the management of the County Governing Body and intended to fund maternal child
health/family planning activities and project related training. The groups control the
remaining one-fifth of the Social Development Fund. Individual loans are based on the
individual feasibility studies. Individual contracts are signed with the Group President,
treasurer and loan committee chair. The exact terms of the contract are determined by
each group, but include:

- the duration of the loan, which must be less than one year;
- the interest rate, amount and time of payment
- repayment schedule with amounts and dates
- penalties in case of default

The group treasurer keeps a record of all loans and keeps individual passbooks up to date.
Effectively some of the transaction costs of working with small borrowers are transferred
to
the group leaders, especially the treasurer. Savings did accumulate to more than seven
million yuan.

The intention of the revolving fund design was that Women's Groups would accumulate
their own funds, through mandatory savings and interest payments, which they could use
on a continuing basis to re-lend to members once the group loan was repaid and the
revolving fund moved on to other groups.
FAO's final report on the project reports the following performance:

Number of groups established: 1,751
Number of members: 49,804
Average number of groups: 1.5

Savings
Total amount of savings: RMB7,799,414
Percent of savings used for on-lending to micro-enterprises: 85%

Status of Project Revolving Fund
Total amount of project loans to women's groups: RMB28,947,781
Total amount of loans due: RMB7,856,756
Repayment Rate: 96%

Loan Operations
Total Amount of Loan Fund Available (Project revolving fund plus savings): RMB36,747,195
Total amount lent to individuals: RMB49,800,574
Number of loans to individual members: 1.9

Purpose of Loans
Production: 70%
Processing: 11%
Trade: 12%
Service: 7%

Income Change
Estimate change in annual income after joining group: RMB393
Average savings per member: RMB156


Performance of Women's Groups varied significantly. Overall the high repayment rate suggests good performance. The Terminal Report notes low repayment rates on some group loans due to natural disasters or poor leadership and lack of commitment by local Government leaders. The report ranks 28% of groups as lacking good financial systems and reports that many groups are still in a formation phase. Development of strong groups is a long term process.

Targeting and Outreach.
Project reports indicated that the project reached poor women, but not poorest women or the poorest communities. Logistic constraints in some cases tended to concentrate implementation in areas near the county center or on roads. The number of loans for processing, trade and services would suggest that not all groups were in remote areas as they had access to markets. Still, the average loan size has been small (reported at 700 yuan), suggesting that the program did, on the whole, serve small borrowers.
The UNFPA projects have not been formally evaluated. A contribution of an evaluation if done would be to assess what types of county level implementation arrangements were most successful in management group formation and loan operations and assuring proper targeting of the project to poor women; what factors assured proper implementation of training, adherence to policies and procedures for group loans and prevented diversion of loans to nontarget groups. Anecdotal evidence suggests that where county leadership and management were strong and careful attention given to training and supervision, formation and transformation of groups was more successful. Where county leadership was weak or there was frequent change of personnel, there are reports of breakdowns in group procedures, erosion of regular group meetings and failure to meet project goals. Because of the size and length of experience of the UNFPA project, a thorough evaluation is recommended. An evaluation of the social development activities and their impact on member attitudes and behaviors would contribute to debates over minimalist or integrated approaches to poverty alleviation and the role of microfinance as an entry point or tool for other development objectives. In particular, an evaluation may add to the growing evidence that women's participation in the economy has a strong correlation with reductions in fertility.

One of the criticisms of the UNFPA project has been that it is not financially sustainable and that the loan fund is decapitalizing because interest rates do not cover effects of inflation or cost of defaults. Before making this criticism it is important to remember that sustainability was never a primary objective; the long term objective was to improve the status of women through increased economic participation, thus contributing to acceptance of a small family norm. Thus design agreements never explicitly provided for a strategy for reaching self-sufficiency or institutional sustainability. Moreover, the project operated in 35 widely distributed and difficult to reach counties, complicating management and supervision. Creating a new system for microfinance is a labor intensive process. The success stories of microfinance elsewhere have not attempted creation of a new system dispersed over 35 counties in difficult to reach areas. Generally speaking, the success stories have focused on institutional growth in one area before moving on to another (Grameen Bank), or they have built on an existing system (Bank Rakyat Indonesia). The success stories have been able to address systematically the challenge of reducing operating costs, and particularly reducing the number of staff related to clients served. This is difficult to do in project entities so widely dispersed.

The project has major accomplishments that have contributed to design of subsequent projects. The Women Population and Development project demonstrates the contribution of successful group formation to building human capacity and to addressing the human side of poverty alleviation. The project demonstrates that poor women can save. Its experience illustrates the role the group in China can play as a bridge between the poorest households and access to small scale banking services.

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9 Grameen Bank in Bangladesh is one of the early and successful models of lending and savings services to poor landless women and men. The model manages risk and reduced transaction costs by relying on groups of five organized into centers of about 30 members. Group liability, weekly meetings, weekly repayments and group peer pressure help assure high repayment rates and successful microprojects for the members. Strong management and higher interest rates allow operations to he cost-covering. Bank Rakyat Indonesia emerged from a heavily subsidized, state owned agriculture bank in the 1980s to the largest bank in Indonesia that makes a profit granting individual loans and mobilizing savings from relatively poor households.
D. United Nations Childrens Fund (UNICEF)

Like UNFPA, UNICEF has supported microcredit schemes as an instrument to achieve larger social goals. UNICEF's mandate is to promote the survival and healthy development of children so that they can fulfill their potential. The status of women is closely related to capacity of mothers to contribute to child survival and development. Women are more likely than men to contribute increased income to food, health and household expenses. Education of mothers is positively correlated with lower infant and child mortality. Willingness of families to educate daughters is related to the perceived status of women. UNICEF has long been working with the All China Women's Federation in support of projects to promote women's capacities and status. Some of these projects have included credit activities. Since the early 1990s, UNICEF has also collaborated with its counterpart the Department of International Relations (DIR) in MOFTEC on a basic services project which has attempted to integrate health and education inputs with support to building women's capacities. Presently UNICEF is beginning implementation of a new Social Development Programme for Poor Areas (SPPA) which uses microfinance services and group formation as the key strategy.

All China Women's Federation in Luliang Prefecture, Shaanxi Province

UNICEF supported credit projects implemented by the ACWF have generally been small. One exception has been the credit activities carried out since 1989 by the Women's Federation of Luliang Prefecture in Shanxi Province. These activities are interesting for several reasons. First, the Luliang project was an indigenous response to poverty. The credit designs originated solely with the Federation and were not the design of the donor. UNICEF assistance, in fact, supported training with US$70,000 and did not directly fund the credit. Despite the small amount of assistance, UNICEF maintained contact with the Luliang Federation over the years and in 1996 participated in an inter-provincial workshop in Luliang which brought together representatives from elsewhere to observe the Luliang approach. Second, the Luliang Federation leadership deliberately decided to test different models of credit to see what would work most effectively in Luliang. Finally, the Luliang Federation, on the basis of its work, has been able to attract increasing amounts of poverty alleviation loan money from Government, and has obtained a World Bank commitment of US$1 million for expanding credit experience. The Luliang experience is presented as a case study in the annex.

ACWF involvement in credit for poverty alleviation began in 1989 when Women's Federation leadership concluded that poverty alleviation grants were not working but were creating dependency on the government. Strategies adopted by the Federation grew out of their experience with skills training linked to literacy training being supported by UNICEF. The Federation gave priority to building the technical capacity of poor rural women, but realized the need to find capital to allow women to fund rural activities in which they could use new skills. The first model relied on demonstration households. Able women were given 7-8,000 yuan for a small scale enterprise, often pigs or chickens; in turn they were expected to help three other women, with per capita incomes less than 300 yuan, out of poverty. Demonstration households provided loans, usually in kind (e.g. one or more...
pigs) and technical support and training. Since this first model, the Federation has tested several other models: the Woman's Cadre First, where small loans are given to poor women's cadres to start or expand production and increase income; the Women's Committee model where the loan is given to the village women's committee for group production; in kind loans of production materials (improved breeds of animals and feed) to poor households; the Company Plus model where loans are given to a Township and Village Enterprise that will provide training and generate employment for women; and finally a group model that is adapted from the Grameen approach. The Federation expresses concern that the Company Plus model is a high risk model. From the data available on the carpet factory visited, it was not possible to assess the rate of return on the investment. Production in this model is farmed out to production sites, run by small, female entrepreneurs or to households with one loom. Payment is piece rate. Earnings per month were reported as high as 2-300 yuan. Looms can be bought (with credit) or rented. There appears to be a high demand by young women for this employment opportunity.

The ACWF leadership made a deliberate decision to focus first on capable women and households (though not necessarily rich households) and use them as the means to extend capital and skills to other households. The project is characterized by a remarkable reliance on the responsibility of women for the development of others. The demonstration households, for example, are now reported to be a 'poverty alleviation chain' of six links, where households helped out of poverty become the demonstration household at the next level. Targeting of households to be helped is left to the demonstration household.

Behind the ACWF strategy to rely on capable households first and to strengthen women's cadres was their need to prove to poverty alleviation and banking officials that poor women could indeed repay loans for production. When the Federation sought its first loan of 135,000 RMB in 1989, the Poverty Alleviation Office was unwilling to grant it, citing the high risk involved in small loans to women. To obtain the loan, the Federation offered its training center building as collateral. Since then, Federation officials indicate that they have placed high priority on assuring repayment, and have been reluctant in some cases to put cash directly in the hands of poor people, preferring to deliver loans in the form of production materials.

ACWF has also worked closely with government officials at different levels and with technical services. There has been a heavy emphasis in the project on training and raising women's technical skills in animal husbandry and agricultural production.

It was not an objective of the Federation to establish a sustainable microfinance mechanism. They have relied on poverty alleviation loans, channeled through the Agricultural Bank, for the capital needs of projects. It is clear that the demand for small loans, both for poor and less poor households, far exceeds the supply. This is a serious limitation on efforts to expand the size of the rural economy, and to extend opportunity to poorest households. ACWF is also limited in the design of projects by the requirements of the Agricultural Bank and the conditions of poverty alleviation loans. The terms of Agricultural Bank loans are for three to five years with a lump sum payment at the end of the term. Bank officials presently do not want to manage more frequent repayments or
shorter loan terms. Interest rates on loans are determined by the poverty alleviation loan rate of 2.88% per year. None of the projects included a savings mechanism, though the Federation leadership is now considering how to include a savings component.

The project began with a needs assessment, focused on women's productive skills. There was no base line data survey which would allow a systematic assessment of changes that have occurred in targeted households. Luliang Federation reportedly has collected much data on the project, but it has not yet been aggregated and analyzed.

The Luliang Prefecture Women's Federation projects are at a turning point. They have experimented with several models, and now wish to focus on two models, the group model and the women's committee model, and to expand them in the Prefecture and indeed in the Province. This implies addressing the challenge of reaching out to the poorest women. The World Bank has recently agreed to provide a credit of US$1 million to Luliang Prefecture for expansion and diversification of existing livestock development projects and to support loans to households. While the models have provided promising results, they are not financially sustainable and their replication as is would be very staff intensive. The Federation has focused on demonstrating to Government and the banking system that poor women can repay loans. It has not yet addressed ways to manage costs or to develop accounting systems that support planning for sustainability.

The new UNICEF Social Development Programme for Poor Areas (1996-2000) uses a model of group formation, credit and savings based on the Grameen model; it adds on a number of functions intended to achieve health, education, water and sanitation and women's empowerment goals. The project has a set of eight commitments which effectively set goals for changes in health and social practices. There is a heavy emphasis on training. Project preparatory activities are just beginning in 1996.

E. United Nations Development Programme (UNDP)

UNDP has only recently begun to support microfinance demonstration activities as part of larger poverty alleviation projects in poor, remote and generally mountainous areas of China. Projects are executed by CICETE and through the county governments, with cooperation from provincial levels, including the Poverty Alleviation Offices. The UNDP supported examples are interesting in the present stage of microfinance experimentation because of several features:

- They use microfinance as a tool to support Government poverty elimination objectives and strategies, in particular implementation of the National Eight-Seven (Ba-Qi) Poverty Reduction Plan and the Five-Ones approach.

- The UNDP supported microfinance schemes are closely based on the Grameen Bank approach and the Rural Development Institute replications in China.

- The projects are experimenting with different channels for managing the microfinance, including use of existing institutions and creation of new
• All the projects are in difficult to access, mountainous areas, facing a low resource base and environmental degradation. Some are in predominantly minority areas where there is little off-farm production. These are locations in which poverty is likely to be most resistant.

• There is an attempt to coordinate UN system poverty alleviation effort in Yunnan through a Joint Consultative Group on Policy (JCGP) effort to promote parallel implementation of activities by UNDP, WFP, UNICEF and IFAD.

Implementation of projects in Malipo and Jingping Counties in Yunnan, Yilong County in Sichuan, and four counties of the Qomolangma Nature Preserve in Tibet began in 1995 and 1996. Only Yunnan and Sichuan counties have begun lending and savings activities. Preparations are underway to expand the project approach to other counties in Sichuan, including the mountainous, minority areas of western Sichuan where population density is low, the resource base is fragile and the economy subsistence. UNDP has recently approved a credit and savings project in Gansu Province. Credit will be used in drought-prone counties to fund appropriate technology for water conservation measures, enabling households to meet food requirements and develop cash crop or tree production. The experience of Yilong County is presented as a case study in the annex. The summary of project experience below is largely limited to the three counties operational in Yunnan and Sichuan.

Microfinance Design
There is variation in the UNDP designs, but their common objectives are to develop comprehensive, replicable, low cost and participatory models for poverty alleviation. Microfinance is one activity of many planned and is expected to provide capital for expansion of agriculture, horticulture and animal husbandry production. Other project elements including technical support, expanding opportunities, mostly through enterprise development provided for off-farm employment for one household member, and infrastructure development to stabilize the environment, promote efficient use of water and facilitate marketing. Environmental protection is a critical issue in the Sichuan, Tibet and Yunnan counties.

To implement the microfinance component, the project in each of the counties recruits Community Credit Corps (CCC) staff and Group Organizers (GOs) who are responsible for organizing small groups of five unrelated persons and centers of four to eight small groups. (CCCs are supervised by a provincial level CCC). Groups are voluntary and they elect their own leaders, who are supposed to be women. The project requires that participation focus on households whose income is in the bottom quartile of the population and toward women heads of households or male heads of households whose wives are disabled or lack productive capacity. Operationally, CCCs and GOs use objective criteria, based on quality of housing, lack of furnishings and farming equipment, periods of food shortage, and school drop-outs to determine eligibility. Group members are required to save one yuan per week. Loan proposals are made by the clients themselves but endorsed by the group and the center who share group liability. Loans are approved at the county level. Loans are disbursed on the phased 2:2:1 pattern. Repayment plus required savings are made weekly at required weekly meetings. The ceiling for first
loans is 1000 yuan with increased amounts available on subsequent loans. In practice loans have averaged 6-700 yuan with a minimum of 300 yuan. Interest rates are higher than the poverty alleviation loan rate of 2.88% per year, but they are lower than the commercial rate. In Yilong for example, the nominal rate is 8%. Interest is payable up front, making the real rate higher. Loans have almost all been used for primary agricultural production or animal husbandry, and not for processing, trade or services.

Because of the brief period of implementation, the 100% repayment rate is not an indicator of the success of the projects in the three counties. Loans appear to be disbursed in a timely manner, meeting credit needs. Group members appear to use loans for more than one kind of investment; for example, several small animals and agricultural inputs. This may be seen as a way of spreading their risk, and of having investments that generate small amounts of income at different times. Though the income from these investments is lumpy, the group members do not appear to have difficulty making weekly repayments. They may sell a small animal or vegetables in the market to generate cash, or rely on income from day labor or from a family member who provides remittances from migrant labour. Some local officials report that the weekly repayment may be a way of capturing earnings of husbands that might otherwise be used for consumption, including alcohol and gambling.

A key issue that has emerged in implementation has been the requirement for weekly meetings. In Yunnan some groups have met only rarely. In Sichuan there have been requests for suspension of meetings during periods of heavy agricultural work. The hilly topography and dispersed housing of these China project sites differs from the flat terrain and central villages of Bangladesh where the weekly meeting concept originated. At least at some times of the year, group members perceive an opportunity cost in weekly meeting attendance. For the moment, project officials are attempting to maintain weekly meetings to assure discipline and to serve as an opportunity for technical inputs.

Project monitoring suggests that the loans are reaching poorest households in the three counties, though in an early stage in Malipo in one village 80% of group members had previously borrowed from the Rural Credit Cooperative (RCC) and were not the poorest households. They were attracted to the scheme because of the lower rate of interest. Many of the villages served are off the road and can be reached only by foot, and not even by motorcycle. This puts practical limits on the number of centers a CCC or GO can serve, given the requirement for participation in weekly meetings.

The projects have also encountered resistance to the requirement that group and center leaders be women. There are also concerns expressed in some areas about the safety of CCCs and GOs carrying cash.

Implementation in the three counties appears to have benefited from a long design period that allowed the implementers to understand and become committed to the group approach used. The project also relied on national consultants, some of whom had experience with the Grameen Bank replications being tried by the Rural Development Institute and by study tours to the RDI sites. The long design period contributes to the heavy human resource investment required for this microfinance model.

At present operations are not sustainable without donor support, or without government assuming the costs of the labor intensive group mobilization and management. Project planning has not yet addressed the task of developing a longer term strategy for
sustainability and self-sufficiency.

Institutional Mechanisms
Overall activities in the three counties are managed by a Project Implementation Office (PIO), but in each case responsibilities for microfinance have been partly or largely delegated to a separate institutions. In Yunnan, the project worked to develop and remodel the function of the Rural Credit Foundations (RCFS) at the township level, through which credit funds are being channeled to the households. RCFs are non-profit, share-based mutual aid associations of farmers, limited to operation within their own township. Their interest rates are limited by those set by the RCCS. They have a reputation for providing services relevant to farmers' needs and obtaining a good repayment rate. The strategy in Yunnan is for the RCFs to manage the credit and savings. The CCCs and G0s are active staff of the RCF, though paid by the project during the life of the project. RCF Directors and the CCCs were trained together at the Grameen Bank replication in Hebei, and Directors and staff were also trained in Kunming. CCCs are responsible for organizing and managing the groups, (effectively reducing the transaction cost and the risk for the RCF). In Yilong County the project authorities decided to create a county level NGO called the Yilong Rural Development Authority (YRDA) which is intended to serve as an association of the peasants. The YRDA credit unit is responsible for supervising the CCCs and G0s and for implementation of all aspects of the microfinance operation. Funds are channeled through the RCC at the Township level. Because of banking laws, the YRDA cannot accept savings deposits; it deposits mandatory savings in a bank account and maintains individual passbooks for clients.

Integration with Complementary Activities
The UNDP projects are integrated projects, intended to provide technical support and demonstration of improved technologies relevant to poor households. Technical activities started earlier in Yunnan, in part because implementation of the microfinance activities were delayed for more than one year, and staff could focus on improving farming systems. In Yunnan project managers, local authorities and CCCs have been trained in sustainable agriculture and resource management and demonstration activities started in selected locations on improved farming systems for food, tree crop, cash crop and animal husbandry production (four of the five-ones). In Yilong County, the microfinance was implemented first, and the technical support has received less attention. Technical training for newly formed groups is presently largely organized by YRDA staff. Systematic linkages with other technical units do not yet appear to exist.

Enterprise Development
The enterprise development effort in Yunnan differs from the general practice in China. Ownership of enterprises funded with UNDP money are to belong to targeted poor households, who are organized into a Local Poor Farmers Association. Associations have been registered in all townships where the project operates. Several enterprises related to local agricultural production have been proposed for funding. In Yilong a proposal for a sweet potato processing plant has just been approved, but the funding comes from a poverty alleviation loan that is part of counterpart funding provided by the Provincial Poverty Alleviation Office.

JCGP Cooperation
Coordinating parallel UN system inputs is difficult and only partial success appears to have been achieved in the three counties. World Food Programme (WFP) assistance in Yunnan supported land levelling and terracing which was the prerequisite for production increases. Disbursement of planned IFAD funding of US$500,000 for credit has been delayed. UNDP reprogrammed $100,000 from a township and village enterprise budget line to enable lending to households to begin. Health, functional literacy and skills training were to be supported by UNICEF and WFP but have not yet started. Water and sanitation activities were designed to attract funding from another donor.

F. World Food Programme (WFP)

World Food Programme is known for its relief assistance to victims of natural disasters and war, but a substantial part of its work, including its work in China, is aimed at making poor people self-reliant. WFP support to poverty alleviation in China has long emphasized infrastructure development for road transport and communications, irrigation, water conservancy, watershed protection and afforestation. More recently, WFP programmes have given new emphasis to the role of women in poverty alleviation and they have begun experimenting directly with credit schemes. Fundamental to WFP's credit strategy is the assumption that food security is a precondition to successful credit for poverty alleviation. Food for work programmes, improving terracing, irrigation or drainage systems, for example, can enable households to double crop or otherwise increase food production. With food security, households are able to take advantage of credit for agricultural inputs, or for animal husbandry and sideline production. These linkages among infrastructure development, food security, and credit are evident in recent WFP supported projects, and in the joint work with IFAD planned for northern Sichuan and Qinghai Provinces that is described in a separate section below.

WFP is supporting two relatively recent projects in Henan and in Ningxia Provinces that introduce credit as part of poverty alleviation and environmental rehabilitation. In four poor project counties of Henan, the per capital food availability was estimated at 155 kilograms per person (minimum requirement for rural populations is estimated at 200-220 kilograms per year). Food aid is being used as wages to support irrigation and drainage construction, land development, forestry development, drinking water and sanitation systems, rural access roads and training. Women were estimated to represent 42% of the labour force in the project. The training included about 500,000 days of training to reach 100,000 women to upgrade skills in sericulture, embroidery and pig raising. Credit is introduced into the project in two ways. First, Government agreed to make available 25.8 Million yuan in poverty alleviation loans through the Agricultural Bank of China (ABC) to be lent at a 2.8 % a year interest rate to the majority of farmers. ABC agreed to re-schedule all outstanding debts of project farmers for a period of five years. Second, the project generates an estimated US$1.3 million in savings that the local count governments are not obliged to disburse as relief million grain or relief funds. By agreement a portion of these savings was set aside to be used collateral for ABC loans to women and a portion was to be used for direct lending to women without collateral for income generating activities related to the training.

The project is still under implementation. In the first half of 1996, the ABC had released 523 million yuan to seven local enterprises (silk, embroidery, carpets and others) and had
released small loans from 300 to 1400 RMB to 6,650 poor and needy women for income generating activities, some of which are linked to the enterprises receiving credit: for example, planting mulberry trees and purchasing silk worms; machine embroidery; weaving straw mats and also animal husbandry. Additionally, most of the 15,000+ women who had received income generation skills training under the project also obtained start-up loans from the ABC, some of which were poverty alleviation loans at 2.88% interest with collateral provided by the savings generated. Others were loans financed by savings from project savings for which the interest was 10.98%.

The Ministry of Agriculture has primary responsibility for implementation of the project, but a system of leading groups, project management offices and committees from the county down to the village takes day to day responsibility. Village leading groups and committees, for example, make contracts with individual households for participation. Along with the township leading group and project offices, they have a major responsibility for targeting poor households. The Women's Federation played a role in mobilizing women for training and income generation.

WFP has supported a subsequent project in three counties in Ningxia Province which has monetized some of the food aid to provide collateral as a guarantee for small loans to women. The Ningxia project seeks primarily to benefit 34,000 poor households by using food for work to rehabilitate soil and water resources in an area which has serious environmental degradation of rainfed agricultural land and limited irrigated land. It is an area of high illiteracy, particularly among women, and of low health standards. To assure incorporation of women in the project and address social factors accompanying poverty, WFP agreed to monetize about 4365 metric tons of wheat over four years and deposit it in the ABC as collateral for loans to women. ABC agreed to lend 2 yuan for each 1 yuan deposited as collateral. Part of the proceeds of monetization were to be used pay cash incentives to 25,000 women attending literacy classes. Government is to provide 8.9 million yuan as counterpart support. The methodology of providing collateral to encourage the local banking institution to grant and recover loans from women was new to the local authorities. Additional the project included agreement to recruit a woman United Nations Volunteer to assist with the credit activities in the three counties.

In the Ningxia project, WFP relied heavily on the design used in the UNFPA/FAO project described above, particularly the group formation approach. The UNFPA project was being executed in several counties in Ningxia, including Guyuan, one of the WFP counties. County governments and the Women's Federation were familiar with the UNFPA model and training materials. In Ningxia, the Women's Federation was given responsibility for mobilizing women's groups, providing training for 8 to 14 days to groups and working with groups to develop loan proposals. Group loan proposals are forwarded to the county for review and approval by the Project Management Office, the Bank and the Women's Federation. Maximum loan term is one year with payment at the end of the term. Maximum loan size is 500 yuan. The interest rate is 8.6%. There is no savings requirement. About 6378 women have been organized into groups and trained. The first loans were disbursed in 1995 and used for vegetable production for the market, purchase of chickens and sheep, sewing, noodle and starch processing. There is no repayment data available yet. The UNV joined the project in May 1996.
The WFP projects have too little implementation experience to draw conclusions. The projects are important to discussions of the functions and design of microfinance because of design features:

- the provision of collateral to encourage existing banking institutions to provide small scale credit to client previously thought to be too risky or entailing too high a transaction cost too reach;

- the linkage of credit to infrastructure inputs intended to assure food security, not unlike the linkages of the five-ones approach; 0 the role of the Ministry of Agriculture, local government and the Women's Federation in providing intermediation between poor women and credit opportunities.

G. International Fund for Agricultural Development and World Food Programme Collaboration in Integrated Agricultural Development.

The Integrated Agricultural Development Projects in Northeast Sichuan and Haidong Prefecture in Qinghai Province represent the first collaboration between IFAD and WFP in China. The two project areas selected are hilly and mountainous with only 14.5% of land cultivable. The quality of soils is poor and has been subjected to erosion. Irrigation is limited or inadequately designed.

From the perspective of microfinance design for poverty alleviation, the projects offer the opportunity to test the strategy of assuring food security as a precursor to credit for production and poverty alleviation. For IFAD, the projects are an opportunity to expand outreach to poorest households. Food for work participation is generally self-limiting to poorer households and is not attractive to better-off households. The projects are also interesting because of their reliance on the RCFs for channelling small scale credit, and for the planned capacity building of the participating RCFs. The projects as designed are complex and bring together a range of inputs to address both the income/asset and the social dimensions of poverty. They are scheduled to begin implementation in mid-1997. The Northeast Sichuan project overlaps with the UNDP supported project in Yilong County and with the planned World Bank credit project in Lanzhong County.

Principal objectives of the projects are to ensure food security and to increase income for 370,000 households. The project strategy expects that WFP Food for Work resources will build the food production infrastructure and support training, creating the base on which IFAD credits can finance expansion of production and income generating activities. Project support along with counterpart funds will also support key social development inputs and human capacity building including mid-wife training, health and family welfare training, literacy training and improvement of health and education facilities. IFAD funds will provide flexible packages of credit to households including:

- seasonal credit for production inputs
- livestock development
• economic trees including mulberry trees
• women's income generating projects

The packages are flexible in that their purposes can be designed to the needs of the borrower. Loan terms are linked the nature of use. For example, credits would be available for pig breeding or pig fattening. A pig fattening credit would provide a medium term credit for construction of a pig shelter and a short term credit for purchase of piglets, concentrate feed/grain and veterinary drugs.

A Village Implementation Group (VIG) that includes the Women's Federation and representatives of the community is to be responsible for project management at the village level, with initial responsibility for identifying beneficiaries. The households will determine for themselves the activities for which they seek credit. The Women's Federation will work with women beneficiaries on determining feasibility and developing training for income generating activities.

Credit policies and operational guideline will be established before implementation, spelling out terms and conditions tailored to needs of intended beneficiaries. There will be loan ceilings for households, but no lower limits to assure access even for households with limited repayment capacity. Interest rates will be based on the prevailing market rate and adjusted by the Provincial Finance Bureaux. A separate credit line will be established for women's income generating activities with separate ceilings and repayment schedules suited to their requirements.

Project Management Offices are to be established as permanent units to manage the projects. Within the PMOs, credit units will be established to manage the credit and provide technical support to the RCFs through which the credit will be channelled. All RCFs involved in the project will get a credit line, and a comprehensive training package to build their capacity.

H. Others
The Food and Agriculture Organization (FAO) and the International Labour Organization (ILO) have served as executing agencies for UNFPA funded microfinance projects for women. FAO has contributed some of its own funds to the UNFPA projects. UNHCR is funding small scale credit for refugees in southern China, using a model based on the UNFPA model.

The World Bank is presently designing credit schemes based on the Grameen Bank model for implementation in two counties in Sichuan (Lanzhong) and Shaanxi (Ankong). The World Bank will make US$1 million available for credit operations in each county.

Findings and Lessons
Introduction

Over the period from 1980 to the present, Government has moved from a relief and welfare approach for the poor, to a focus on poor areas, to the present 8-7 Strategy and the 5-1 approach which set specific goals for households. Poverty alleviation begins to include a focus on people, not on areas. This may be important in view of the challenges China's poverty alleviation policy faces. China has had substantial success in reducing numbers of people living in poverty. The people it has reached have been the ones relatively easy to help out of poverty. The residual poverty is substantially hardcore poverty, difficult to alleviate. It may require careful targeting of households.

Drawing lessons from UN supported microfinance projects is difficult. They were designed and implemented at different times. From the UN side, a focus on poverty was slowly being refined. From the Government side, policy and experience were evolving. And the economy and economic structures continue to change. This section looks at findings and lessons related to three standard questions that one might want answered about microfinance projects for poverty alleviation: outreach, sustainability, and impact. It also looks at some common design questions.

A. Outreach

Recent UN supported projects have introduced targeting and other design strategies aimed at assured outreach to the poorest. A major hurdle in reaching the poorest is overcoming the assumption that poor are difficult to help.

In interviews for this study, contacts often expressed preference for working with the less poor first. One widely held view is that the poor cannot increase their income because they lack the special skills for income generation. Training the poor is difficult and costly. Providing relief and waiting for the effect of changes in the overall economy to reach the poor, this perspective suggests, is the best approach. The alternative assumption is that the poor have demonstrated their capacities through survival under difficult circumstances, and that poor people need and can use opportunities to change their situation. These two assumptions have important implications for design of outreach, targeting and other aspects of microfinance. The first assumption implies that the burden of poverty work is on the Government and government staff. The second implies giving poor people the opportunity and responsibility for lifting themselves out of poverty. Recent UN funded programmes are experimenting with design features based on this second assumption, and it is the assumption itself which may enable outreach to the poorest.

Many of the recent projects use criteria for targeting that are based on field studies and which can be practically applied by field workers and villagers. Many recent projects include base line studies to identify target households. Instead of income limits, many base line studies or eligibility criteria use characteristics of housing, equipment ownership or school attendance that are easily observed or verified by villagers. They are design features that take the burden of targeting off the shoulders of cadres and staff and move to the people themselves. Through the use of voluntary groups and village committees, the projects push the responsibility for targeting down to the village level.

Key design elements are suited to the needs of the poor, and discourage participation of the non-poor. On the one side, formation of small groups and regular meetings help poor
people, especially women, who may have had little contact with formal credit, to get access. Groups serve as a guarantee for people without collateral. Participation may also build confidence and be a means to obtain technical information. Small loans are suited to the needs of the poor. On the other side, small loans, especially with the move toward market rates of interest are less attractive to the rich. Requirements of group membership and regular meeting attendance may be a disincentive to the non-poor.

Projects that concentrated on meeting the food security requirements of poor households while providing credit for other productive inputs are probably reaching poorer households than those projects providing credit only to women for an agricultural or off-farm income generating activity. The latter type of project may be self-selecting for women in households where food security is already assured.

B. Operational or Financial Self-sufficiency

None of the UN supported models of microfinance for the poor visited or reviewed can be ordered sustainable by standards of operational or financial self-sufficiency. However, asking whether they are sustainable may be the wrong question. It may be more important to explore in what ways sustainability is important in the context of the dynamics of China today.

Whether or not a microfinance scheme is operationally or financially self-sufficient is an important question in international microfinance circles. There is substantial evidence that subsidized credit usually does not serve the poor but is hijacked by the non-poor. Moreover, subsidized credit tends to damage or distort financial sectors. Translating theory of self-sufficiency into practice in a country like China confronts the specific conditions of China's ongoing economic reform and development of economic structures. Government remains the principal actor in poverty alleviation, not independent banking structures. The policy environment does not yet enable self-sufficiency; for example, legal restrictions and ideological considerations impede increasing interest rates to cover transaction costs of reaching poor household. Institutionally, the transaction costs of reaching poor households are often carried by the project and/or by government departments.

The transaction costs of providing small loans and savings services to poor households are high. There is substantial anecdotal evidence that poor peasants in China, like poor peasants elsewhere, are prepared and able to pay high rates of interest in order to get access to scarce credit. Nonetheless, there remains deep-seated resistance to charging anything but a subsidized rate of interest to the poor borrowers. The design of the UNFPA projects, for example, reflected the prevailing thinking in Government about interest rates. The subsidized interest rates in the project cannot cover operating costs or the costs of defaults and inflation so that the revolving funds are in the process of decapitalizing. Before that happens, the funds will have revolved a number of times, providing more benefit than a direct grant, and an opportunity for learning about management of funds.

UN supported microfinance projects have not, for the most part, had sustainability goals until recently. The earliest UNIFEM and UNFPA projects had social objectives. One of the immediate objectives of the UNFPA projects called for long-term project viability and replication by building management skills; but it was not designed for financial
sustainability. IFAD loans for rural credit were provided through Government which has the responsibility for repayment. Responsibility for self-sufficiency and financial viability was not placed on the scheme itself.

As experience with rural microfinance has grown, Government and the UN partners have begun to grapple with some of the sustainability issues. Recent project designs supported by UN organizations have called for "near commercial interest rates" (UNDP), "prevailing market rates as determined by the People's Bank of China and adjusted by the Province Finance Bureau" (IFAD) or as high as or higher than the costs of alternative rural credit from institutions such as rural cooperative banks and credit foundations (UNICEF).

Commercial rates are higher than the subsidized rate of 2.88% for poverty alleviation loans. The use of commercial rates reflects the reality of the policy environment; it does not address the question of whether the commercial interest rate covers all costs of reaching poor households. Several recent project designs call for sustainability, replicability and institutional capacity building. With consultant support, the UNDP supported project in Yilong County has begun to develop longer range projections that would allow them to estimate what income they need to generate in order to cover costs. A part of the planned IFAD credit for Qinghai and Northern Sichuan includes a training package for staff of the Rural Credit Foundations.

There are substantial management obstacles to government implementing agencies' capacities to implement strategies aimed at making microfinance schemes financially sustainable. Beyond the lack of a clear objective for sustainability, agencies may lack the accounting skills to identify all the costs of operation and of capital. This may be especially true of organizations which have been predominantly involved in social development or where implementation of microfinance is mixed with other activities (e.g. training) and it is difficult to disentangle real costs. Finally, while donors have in some cases provided training in financial management and accounting, it is not clear that this training has been aimed at enabling Chinese partners to generate cost and revenue data on which basis they could make longer term strategic plans for financial management.

In urging the Government of China to assure operational or financial self-sufficiency through interest rates set to cover costs, outsiders need to be clear on all the reasons why self-sufficiency is important. Sustainability may not seem to be the critical issue at a time of economic transition when Government still plays a dominant role and economic practices and institutions continue to change. The important issues may be that subsidized credit is more easily accessed by the non-poor, and that the lack of the objective at least to "break-even" reduces incentives to control costs of operation. Review of documents and field observations suggest that implementing organizations have not yet given much attention to cost cutting mechanisms or thinking long-term, for example, about how to reduce the ratio of staff to clients served. Staff cost is one of the key factors driving up transaction costs in microfinance. Finally there is a psychological question related to poverty alleviation. Should a microfinance programme that expects clients to run cost-covering operations also demonstrate the same kinds of practices in its own operations. If field staff are not held accountable for cost-effective operations, what is the message given to poor clients?

C. Institutional Sustainability
Where microfinance schemes remain 'projects' that do not become embedded in existing,
usually government, structures, they are not institutionally sustainable. When we talk about sustainability here, it may be useful to refer to two functions, the banking or microfinance services themselves, and the mobilization or bridging activities that link the poor to services. A related issue is that of autonomy and whether the institutions responsible for microfinance services can be held accountable for applying objective criteria in selection of poor clients and in management.

All UN supported projects have used the existing banking institutions for deposits of money. Some projects have negotiated with rural banking institutions to play a direct role in disbursals and collection of loans and in savings, providing a fee for the service. Some projects have provided training for rural banking staff. The relationship between outside funded microfinance experiments and the rural banks remains experimental. The banks are a potential resource for poverty alleviation and microfinance for poor households. They have a large network and trained staff through much of rural China. Microfinance for poverty alleviation elsewhere has demonstrated its financial viability and even profitability. In China, the banks do not yet appear to see microfinance (small loans and small savings) as a productive business interest.

All UN supported projects have used some local institutional framework to manage the targeting of poor households, and mobilization of poor individuals for small scale credit and sometimes savings. Sometimes the institutional structure has been a project office set up for the project scheme and which works through county, township and village authorities and often with an existing ministry or bureau. The All China Women's Federation has frequently been used for mobilization and training of women's groups. There has also been experimentation with autonomous organizations, like the Yilong Rural Development Association, which are responsible for credit activities, including the management of field staff with the day to day relationship with villagers.

The lessons of UN support project experience with institutional sponsors are limited. In some cases Government is incorporating into their own operating procedures group methods of organizing poor households, using their own staff and resources to expand approaches demonstrated in UN supported projects. In China a key question may be whether institutions implementing microfinance projects have sufficient autonomy to keep their focus on poorest households and to be accountable for management of microfinance. An autonomous implementing agency has the capacity to become an independent cost (profit) center. It is easier to monitor and improve the cost efficiency of operations.

**D. Managing Risk**

Collateral, guarantees and group liability are three methods for managing the risk of lending. The need for special mechanisms to control risk flows from the fact that the very poor have no collateral. Some projects reviewed have relied on guarantees by township or county officials for individual loans; others have deposited a guarantee fund with a rural bank against which the bank would lend an equivalent or multiple amount to poor target clients. More projects have relied on some form of group mechanism, including group liability, group risk funds, and peer pressure. Allowing the individual borrower to decide what productive investments to make with credit has been demonstrated elsewhere to reduce the failure of the small enterprise, and reduce the risk of lending. There is a tendency for technical specialists or implementing agencies to want to decide for the poor.
Problems occur when the borrower lacks commitment to a project not of his/her choice, or where the implementing agencies failed to understand individual preferences or capacities. Increasingly UN supported projects have been stipulating that the decision should be the responsibility of the borrower. Reported repayment rates do not yet tell us whether and to what degree different methods of risk management are more effective; most are over 90%. Where cases of poor repayment are reported in schemes based on group liability, they are attributed to poor leadership or commitment by government leadership or interference by local officials in standard implementation procedures.

E. Designing Credit Arrangements: Loan Terms and Frequency of Repayment
A common question about the design of credit arrangements concerns the length of loans and the frequency of repayment. Some argue for long-term loans to ease the burden of repayment on poor households; others argue for loans of one year as a way of keeping loan size to manageable proportions; still others suggest linking the loan term (and repayment) to the production cycle. Frequency of repayment disputes may reflect differences in philosophy; for some repayment should be geared to the production cycle or should be annually to allow microenterprises time to generate income. Others insist on weekly repayment (and savings) as a way of: (a) developing disciplined financial behaviour on the part of households who have not previously been oriented to future planning; and (b) as a way of avoiding the psychological and financial stress of making a large lump sum payment at the end of the term that appears to absorb all profits. Weekly repayment in this sense is a form of forced savings. At the end it leaves the borrower with a paid off loan, continuing income from the loan investment, and ownership of the capital financed by the loan. It also helps the client achieve a long-term preference for asset accumulation, by preventing the client from acting on a short-term preference for delayed repayment.

Observations and study of UN system supported models do not answer these questions definitively, but they do suggest that many poor households can repay on a regular weekly basis and that weekly repayments contribute to the capacity of poor households to accumulate assets. Where weekly payments have been practiced for six months (Yilong County), there have been no late repayments to date. Interviews with households and field workers suggest that where cash is short and repayment difficult, households find multiple ways to obtain cash. Though their micro-enterprise investments are all in agriculture or animal husbandry, most have more than one investment. Some were prepared to sell an animal, perhaps ahead of schedule, to obtain cash. Others had access to migrant labour or day labor income. Field staff and officials said that the demand for cash for weekly repayment prevented some of this outside income from being siphoned off to unproductive investments such as gambling and drinking.

Where repayments are annual or greater and terms of the loan are more than one year, households and officials interviewed expressed satisfaction with those arrangements, and concern that frequent repayment would not correspond with production cycles. One woman borrower said she preferred loans for three years or longer. If she repaid the loan at the end of one year she said, she would just have to borrow the money immediately to buy new animals for her small business. Annual loans were too much trouble she said. This comment raises the question of whether the loan for this type of borrower is allowing accumulation of assets; whether she is simply re-borrowing and rolling over the loan
without improving her situation; or whether she is using the loan as a source of low cost, medium term operating capital while she accumulates assets used in other areas.

**F. Savings**
Savings accounts suited to the needs of poor households are generally not available. Existing banking regulations discourage experimentation with savings mobilization by microfinance schemes. There is little recognition of the role savings mobilization can play in assuring and expanding access to locally generated capital for on-lending to poor households.

**G. Multiple Models Locally Developed or Centrally Designed Model?**
A country as large and diverse as China needs more than one model of credit. Observations of UN supported models suggest that there are significant management benefits in terms of shared vision, high commitment, and practical learning experience when models are developed locally and benefit from local experience as well as from new ideas from the outside. The key roles of outsiders in these cases appear to have been, or could have been, introducing new ideas, catalysing changes in thinking, setting and enforcing minimum standards, monitoring, and mobilizing resources.

**H. Minimalist Models of Microfinance or Integrated Projects Using Microfinance**
Another debate in microfinance design is whether 'minimalist' models that offer only credit and savings services are more likely to be successful and sustainable than integrated models that provide skills training or aim at other social and/or economic development goals. The experience of UN supported models in China cannot provide clear answers to this question. None of the UN supported projects are minimalist approaches, providing only access to credit and savings services.

The challenge for project design in China is how to balance the demand for integrated inputs with the capacity for management. The experience of projects observed and studied suggests that they are designed on the assumption that if projects are to reach poorest households, more than credit is needed. Food security and increased income generation at the household level are essential goals of many recent projects, reflecting the priority of the Government's 8-7 Strategy. All projects demonstrate a keen awareness of the linkages between social development and economic development. The key question here concerns the management capacity of projects and implementing partners. How many inputs, how much coordination of different sectors can they effectively manage.

Project experience suggests that attention needs to be given to marketing advice and to technical support for production. For example, initially successful investments in rabbit, pig and chicken production were reported in several projects as driving up supply and thereby pushing down prices, with obvious adverse consequences for borrowers. Even models that take a 'minimalist' approach to group based finance can facilitate the groups being used as the unit through which technical inputs, such as marketing advice, or other social and economic development inputs.
I. Microfinance, Enterprises and Poverty Alleviation

In line with Government's regional development approach, many UN assisted projects included a component for lending to township and village industries. The early UNIFEM projects were primarily credit for enterprises. The UNFPA projects required that credit funds first be cycled through local enterprises. The experience of the projects suggests that township and village enterprises in poor counties are not necessarily viable and able to make repayments. In poor counties, bureaucrats may lack the capacities to formulate, appraise and manage enterprises on sound market principles. One Women's Federation informant identified loans to township enterprises as their most high risk venture. The county governors and project managers of the 35 UNFPA supported counties have recommended against further investment in enterprises.

J. Gender Issues

All UN supported projects observed or studied are biased toward women as participants, either because participation is limited to women only, or targeting criteria give priority to women. In both types of projects, officials at all levels stressed that they consider women better credit risks and more likely than men to return earnings to the household. In mixed groups there is evidence that special measures may be required to encourage the emergence and exercise of female leadership. In fact we do not know much about the dynamics of groups and gender relations in microfinance in China.

In many cases the All China Women's Federation has managed poverty alleviation loans extremely responsibly to reach poor households. The Federation is one of the first institutions in China to pioneer credit for poor households. Despite a track record of both responsible management and capacity to reach households, the Women's Federation may not have been granted the increasing access to capital for on-lending as well as latitude to experiment with modifications to terms and conditions of loans and with savings. This is a missed opportunity for poverty alleviation and a missed opportunity to allow the Federation to professionalize its microfinance operations. It may also make it more difficult for the Federation to implement group models where the responsibility for repayment moves from the cadre to the group and the individual.

K. Microfinance for the Poor: Looking at Impact

Those projects that have been operational for six or more years have not yet had systematic evaluations. Those who are implementing microfinance, most often with great commitment, need independent assessment of whether the microfinance works, whether it reaches target households, and whether it makes a difference for the poor.

Recommendations

The framework for the future is the apparent move of Government poverty alleviation policy from an area based approach to a new focus on households and specific targets for moving households out of poverty. The experience of recent UN supported microfinance projects shows that targeting mechanisms and baseline surveys along with group based microfinance help to insure that poverty alleviation resources reach the poorest families, helping them to meet their food security and income requirements.
A. Rethinking Basic Assumptions

1. Trusting the Poor to Use Credit for Alleviating Their Own Poverty

Traditional assumptions about the poor and the role of outsiders in alleviating poverty need to be re-examined. Where microfinance planners and implementers doubt the capacity of the poor to make rational decisions to pay back loans or to carry out successful microenterprises, poverty alleviation efforts will not be sustainable. When planners and implementers take responsibility for the poor in making decisions and guaranteeing loans, they continue the responsibility against further investment in enterprises.

2. Using Market Interest Rates for Loans to the Poor

Setting interest rates on poverty alleviation loans is a sensitive and controversial issue. It is popularly believed that credit projects for the poor should have a low interest rate and that high interest rates contradict the goal of helping the poor out of poverty. Experience in some UN supported projects and projects abroad suggests that a low interest rate is actually an obstacle to the access of the poor to loans. Low interest loans are captured by the non-poor with good connections. A market interest rate is in fact a way to assure the access of the poor to credit. A market interest rate is a basic guarantee for sustainability of credit for the poor. Very importantly, a market rate may be a precondition for the involvement of rural financial institutions in providing microfinance services for the poor. China's rural banking system is widespread and well-organised. Using market interest rates is one part of a policy to encourage the involvement of the rural banking system in the untapped market for rural microfinance.

Calling for market interest rates is not to say that poverty alleviation activities should not be subsidised. Launching viable microfinance mechanisms for the poor is a labour intensive, time consuming effort, that must be subsidised initially. One way to begin to think about separating subsidies from sound microfinance practice is to separate the banking functions from the social mobilisation, group formation and other activities that may be necessary. These start-up activities do need subsidy. Other inputs to poverty alleviation need subsidy, such as infrastructure development, health services, education, water supply and sanitation. The issue is not that subsidies or income transfers to the poor are wrong; they need to be designed so that they do not interfere with the banking function; accounted for explicitly; and managed in ways that do not encourage dependency.

B. Establish a Policy on Microfinance for the Poor

In mainstream economics credit is considered the lubricant of business, trading, industry and production. It is a supplementary and essential role. Therefore access to credit has social and economic implications. Credit is a tool for control of assets. The more an individual has access to credit, the more power he/she has to expand production and become self-sufficient. For these reasons a policy is needed that guarantees access of all poor people to small-scale credit and savings and which provides a framework for microfinance models to operate in China, linking to poverty alleviation offices and the rural banking system.

C. Multiple Models of Microfinance for Poverty Alleviation
In a country so large as China, multiple models of microfinance should be encouraged to flourish. The extensive rural banking system in China is an unexploited opportunity for extending credit to poor households. Policy frameworks need to allow the financial incentives for rural banks to deepen their outreach. At the same time policy frameworks need to give scope for expansion of group models, like those being tried in several UN funded projects or the Grameen Bank replications implemented by the Rural Development Institute. These models, chiefly through the functioning of the group, play an important 'bridge' role in facilitating access for the very poor. These models play a major role in managing credit and savings. In effect they package the loans and savings and use the banking system for deposits. If incentives for rural banks to offer small loans and savings accounts change, another model for bridging may be one where field staff of Government units like the All China Women's Federation or the Ministry of Agriculture mobilise poor households into groups and rural banks take responsibility for offering the services, disbursing loans and collecting repayments and savings. The encouragement of multiple models fosters experimentation to find the most effective designs for the varying requirements of poor areas and poor people in China.

D. Eliminate Township Enterprise Components from Microfinance for Poverty Alleviation Projects
Township enterprises have contributed significantly to poverty alleviation in coastal and other better off areas. They can contribute in poorest areas, but they should be funded and managed on market principles. Pairing them with credit to households unnecessarily complicates the management of microfinance.

E. Introduce Savings as an Essential Element of Microfinance for the Poor
Introduction of small-scale savings has implications for rural banking policy and practice that are beyond the scope of this paper. Mobilising savings is an important way of obtaining capital for lending. The poor want savings that are immediately accessible, secure and pay a positive rate of interest. Savings give poor households a resource they can use when natural disasters, medical expenses or other events that threaten to put them back into poverty.

F. Professionalize Microfinance in China
Government and donors need to support the development of standards and the practice of standard accounting, independent auditing and public reports for microfinance activities. Transparency and comparability are essential to monitoring.

To lay the basis for sustainability of microfinance for the poor, there needs to be substantial investment in capacity building in accounting and financial management for microfinance project activities. One outcome of the capacity building should be standard accounting practices that allow realistic internal financial planning as well as comparisons of performance across projects. Capacity building should also permit development of strategies for cost reduction as operations expand. For example the development of strategies to decrease the ratio of staff to clients, or to model the cost efficient expansion of credit and savings units. Training for capacity building, perhaps through training resource centres that offer quality training in microfinance management (financial and
human resource), should also develop skills for effective experimental training of adults in poor areas.

G. Continue Experimentation and Research on Microfinance
There has already been considerable microfinance experimentation in China, far beyond that which has been supported by the UN. These micro-finance projects have made positive contributions and contributed lessons. The following tasks need to be done:

1. Micro-finance experiments in China have been testing different methods of directly targeting and reaching the poor with credit. The objectives and methods of these projects need to be catalogued and assessed, and findings disseminated to relevant parts of Government responsible for microfinance and poverty alleviation.

2. Group based microfinance approaches for poverty alleviation should be tested in the extremely poor, mountainous and border areas.

3. Conduct systematic evaluation of the social and economic benefits of selected microfinance models that have been tested in poor areas of China.

4. Find a way to disseminate information about microfinance activities in China across sectors within Government and academic institutions and with relevant donors, with the intention of promoting dialogue and learning.

Case Study: Experimenting with Models of Credit for Poverty Alleviation Luliang Prefecture Women's Federation with UNICEF Support

The credit models in Luliang Prefecture are an example of a local, Women’s Federation initiative in designing poverty alleviation models based on credit and aimed primarily at households. UNICEF financial support to the project was limited, but important in encouraging local innovation.

In the late 1980s, the leadership of the Luliang Prefecture Women's Federation (Shanxi Province) became convinced that a relief approach would not solve the poverty problem in remote, rural areas. With UNICEF support they had initiated training for women in income generating skills. They realized that women needed small amounts of capital to put new skills into practice. The Women's Federation began to mobilize funds for credit, mostly from Government poverty alleviation funds, to experiment with a variety of approaches to credit. UNICEF’s financial role was limited to funding training (about US$70,000). UNICEF has maintained a relationship with the Luliang Prefecture even after its original support finished. In 1996, for example, they participated in an experience exchange workshop where Women's Federations from other provinces had the opportunity to see the Luliang models in practice.

The Women's Federation was responding to the observed need for credit in poor and less poor households. It differs from other projects in its link with training, and the relatively high technology of animal husbandry and crop production achieved. It worked well with
other Government departments, using existing technical support. It won increasing support from Government, including access to increasing amounts of poverty alleviation loans. The models were not designed to be operationally self-sufficient. They did place heavy emphasis on good repayment, and on management of risk. Once good repayment was established, they turned to finding better ways to reach poor households.

I. Background
Shanxi is a poor province with mountainous and former revolutionary areas where a poor natural resource base makes poverty resistant to alleviation. Out of 118 counties (cities or districts), 50 are poor counties of which 34 are national poor counties with 3.8 million poor people and an annual per capita less than 200 yuan. The Provincial Party Committee and the Government have a strong commitment to poverty alleviation. Programmes to date have met with success in helping the rural poor to get out of poverty. The situation of the remaining poor in Shanxi is fundamentally different from that of households who were previously poor. Rapid economic growth and income increases are no longer so successful in lifting these remaining poor out of poverty.

The Women's Federation in the province has been given a major role in helping poor women find employment and income generation opportunities so that women can help meet household food security needs, generate cash income and take responsibility for self-development. In this way, the Women's Federation is uniquely placed to focus on individual poverty, not poor areas. In Luliang Prefecture, the Women's Federation has laid the basis for implementing a new household-based approach that carries out the intent of the 8-7 Poverty Alleviation Strategy enunciated by the central Government in 1994.

The Women's Federation in Luliang started experimenting with credit in 1989 because they realized that poverty alleviation grants to the poor were creating dependency. At the same time, a Provincial Vice-Governor who had learned about Grameen Bank work in Bangladesh, suggested that the ACWF start a revolving loan fund. Work began with the support of UNICEF, the Provincial ACWF and Government. Though the Women's Federation experimented with several models, they generally based their work on three principles: (a) focus on the household; (b) rolling the money over so that resources are used repeatedly and incrementally; and (c) moving from labour intensive to higher technology production. Presently none of the six models includes a savings component, though the Federation plans to introduce savings in the future. So far, some 41,540 project households in Luliang including over 165,900 participants and beneficiaries have participated in activities. Of these participants, 39,770 households have or are moving out of poverty. Project authorities report that the per capita income of the participants in the Luliang credit activities has increased from 300 yuan in 1989 to 1,069 yuan in 1996. Luliang credit activities are characterized by small investment, low risk, short cycle loans that target households, reaching wide range of beneficiaries and yielding good returns and high repayment rate.

II. Development of the Six Credit Models
At the end of 1989, the Luliang Prefecture Women's Federation took the lead in conducting a needs assessment of about 1,000 rural poor women in the prefecture. The studies revealed a demand by poor, rural women for technical training as well as small financial assistance to purchase inputs. For example, many women were interested in raising pigs, but the piglets available were of poor quality and the women had no access to veterinary advice and medicines. As a consequence, the pigs they did own had a high mortality rate. The women said that if they had funds to purchase piglets, costing 50-60 yuan per piglet, they could raise 10 pigs per household. Through the profit from the sale of pigs they could increase their income and make fundamental changes in their family's situation.

The Women's Federation's report on the needs assessment led to UNICEF support of $70,000 for training, and matching funds pledged by the Party Secretary in the prefecture. The Poverty Alleviation Office was at first reluctant to provide small loans through the Women's Federation because the project was targeted at poor households without collateral. The Women's Federation offered their Training Center building as collateral. The first loan of 135,000 yuan was granted in 1989 and repaid in 1990.

The skills training led to the first credit model, which the Women's Federation calls the "Poverty Alleviation Chain". The other models followed.

- **Model I - Poverty Alleviation Chain**

  To launch the Poverty Alleviation Chain, the Federation selected four counties in which they would work from the nine in the Prefecture. They set aside 30,000 yuan for credit. Their strategy was to select demonstration households where there was a capable woman who had participated in the training. The demonstration households would be lent money at the poverty alleviation interest rate, but would be obliged to take responsibility for three other households, all with income under 300 yuan per year, and to help them out of poverty. Initially the Federation selected four demonstration households and lent them 7-8000 yuan each. Loans were to be repaid at the end of one year. The demonstration households financed their own enterprises, mostly pig production, and provided help to the households they were assisting. This help to the three households was in kind, not cash assistance. For example, demonstration households provided piglets, technical training including vaccinations for animals and technical support, using the practical animal husbandry and other skills acquired in training. After the piglets grew up and were sold the women were to repay the demonstration household. During the pilot period, a women's cadre was assigned to each group of four.

  After a year, all the 12 households were out of poverty and each of them took on another 3 to 5 households to help. The incentive for the demonstration household to help the others was that they were receiving a low interest loan that enabled them to set up a substantial enterprise. For example, one women used her loan to buy one hundred pigs. Of the original 12 women, all remain out of poverty and three have
started other businesses.

Once started the project expanded rapidly. The Federation lent all of the original 135,000 yuan loan to 200 households. By 1996, The Federation reports that the "Poverty Alleviation Chain" is now in its sixth round and it has reached more than 35,400 households.

During the field assessment, Federation staff stressed that the success of the Poverty Alleviation Chain depended on selecting women with the 'right spirit' to serve as the demonstration household. Demonstration households visited during this assessment tended to be women with junior or senior secondary education. Some continued to provide technical support to poor households long after they had repaid their loan.

• **Model II - Women's Cadres First**

  A second strategy for the Federation was to reach women's cadres first. Village women's cadres, unlike those at the township and county levels, are not usually paid a salary. Unless cadres' food security and capacity to begin increasing income was first assured, the Women's Federation believed it was difficult to ask them to manage poverty alleviation loans for others.

  In this model, the Federation made funds of about 500 yuan per cadre available to the township. The township was responsible for assisting cadres. The township distributed animals, chickens, or other livestock or materials to the cadres and provided technical training and support. Though the loan is in kind, the cadres repay in cash. The Federation reports that participating cadres reached an annual income of 500 yuan after participation.

  From the Federation's point of view, this strategy is extremely important because it strengthens their village level capacity. They believe that good women cadres can be extremely influential in the village. For example, in one village after the cadre had success in raising pigs, she was able to start ten households on raising pigs the following year; by the third year there were 30 households participating in improved animal husbandry; now 70% of the villagers are raising improved piglets.

• **Model III - Production Materials to Poor Households.**

  This model, an attempt to reach poorest households, delivered production materials (rabbits, piglets, chickens) directly to households organized in groups of 4 to 10 people. The Federation officials explained that they were afraid to give cash to the poorest households. In one activity, for example, the Federation provided rabbits to 120 households. They coordinated with other government departments to provide technical assistance to the groups on rabbit rearing, and with a foreign trade company to take responsibility for marketing. In implementing this project, the Federation brought in improved breeds of animals from Beijing and elsewhere. By 1996, the Federation had provided animals to 490 households. They report a 100% repayment
Model IV - Women's Committee

This model provides a loan to the women's committee in the village to undertake a size-able enterprise that will benefit everyone in the village. The approach requires that the village make available central land for enterprise activities. Some of the enterprises started include greenhouse production of cash crops and breeding chickens and rabbits. The Federation reports that Women's Committee approach has reached 750 households and made loans totalling 300,000 yuan; the repayment rate is reported at 100%.

Model V - Group Model

The Federation began experimenting with a group model after one of its leaders returned from a visit to Bangladesh and the Grameen Bank in 1993. The Luliang experiment makes several adaptations to the Grameen group model. Voluntary groups of 3-5 are formed on the basis of their location and with the requirement that group members are poor but have a productive base; and are law-abiding and pay taxes. There is a requirement for a group meeting every week or three times a month and the center meets once a month. Loans are repaid in a single installment at the end of the year. Loans range between 200 and 1000 yuan. Risk is managed through group liability; if one member fails to repay, the group cannot access loans the next year. In July 1994, the Federation began to set up the first groups in four centers. The first loans were disbursed at the end of 1994. Because of a serious flood in 1995, some repayments have been postponed. Early results suggest women participating have increased income, skills and literacy. While this model is still being developed, the Luliang Women's Federation indicated that they wish to promote it in the future as one of the best way of reaching poor households. They believe has the greatest potential for sustainability.

Model VI - Company Plus

For a final model, the Federation has experimented with support to township enterprises that generate skills development and employment for rural women. They consider this the most risky of their loan schemes because it is heavily dependent on the management of the company. Overall the Federation has invested in 16 company plus projects. The experience of a carpet factory in Ling County demonstrates how this model works. The carpet factory had been producing carpets since 1988 but lacked capital to expand production. The Federation provided a portion of the capital needed to upgrade production, in return for which the factory agreed to provide training for prospective women workers and credit to women to purchase their own loom(s) at 700 yuan each. With their own looms woman can produce at home or set up a processing site where they hire women workers to produce the carpets. The factory also rents looms. The factory takes the responsibility for providing raw materials, quality control and marketing. Women workers in the factory or at processing sites are paid on a piece work basis. They report earning 2-300 yuan per month for full-time production. Some women have become small entrepreneurs, running processing sites that employ 5-6 women. The Federation says that
the company plus model can be beneficial to both women and the factory. During a field visit, there appeared to be a high demand among women for employment in the carpet factory or production sites.

III. Phased Expansion and Resource Mobilization

The Luliang Women's Federation appears to have planned a phased expansion strategy, assuring successful repayment and successful implementation of women's microenterprises before expanding outreach in a measured way. Through their successes, they won the respect of Government. Government has made available increasing amounts of poverty alleviation credit, and more recently provided funding for the Provincial Women's Federation to expand the models to the whole province. In 1996, agreement was reached to earmark $1 million of a larger World Bank credit for the Federation's poverty alleviation loans.

The Federation began their experiments with credit and training in only four counties in 1989-1990. To consolidate and further explore the experience, project organizers extended the experiments to all nine poor counties in Luliang prefecture in 1991, covering over 2,000 farmer households, allocating more than one half million yuan in loans. This produced broad and far-reaching social and economic impacts on poor households that the Federation was able to demonstrate to Government.

In 1993, the Provincial Women's Federation organized experts to conduct a systematic assessment of project execution and results in 14 villages, eight townships and five counties in the pilot areas. They submitted the study report to the Provincial Party Committee and Government. In October of that year, the Provincial Women's Federation, the Poverty Alleviation Office and the Agricultural Bank jointly convened an on-site experience exchange meeting on the Federation's credit projects in Luliang prefecture. Officials from 50 poor counties in Shanxi and 10 prefectures attended the meeting. The meeting laid the basis for the extension of Luliang experience to the entire province.

In April, 1994, the Provincial Party's Committee and Government decided to allocate annually 5 million yuan of funds to the Provincial Women's Federation system as earmarked loans for them to extend Luliang credit experience to all the 50 poor counties in the province. The Provincial Women's Federation, having secured the loans, then asked the relevant counties to work out project implementation plans. The Provincial Federation screened and revised county plans and supervised implementation. At the end of 1995, credit projects were developed to cover 58,600 members in 50 poor counties. By 1996, the Provincial Government has agreed to allocate 10 million yuan annually to the Provincial Women's Federation to develop credit projects for poor women throughout the province.

IV. Assessing Outcomes
The evidence from reports and surveys as well as from a field visit suggest that the Women's Federation has been able to demonstrate how to reach households; how to assure repayment; and how to make an impact on poverty reduction.

A. Project loans directly reached rural poor households.

Apart from some demonstration households in the Poverty Alleviation Chain model, the per capita income of most of the project targets households is lower than the average in the region. Reaching households with income lower than average is a major achievement of the project. The significance of this accomplishment is two-fold. First, the Federation able to reach rural poor women with loans for self-employment that enabled women to build their own capacities and accumulate assets. Second it demonstrated replicable ways for other poverty alleviation agencies to reach poor rural households with credit.

Poor households, especially rural poor women, have great difficulty in getting access to loans. This directly affects whether the poor farmers are able to go above poverty line and meet the objectives set in the Eight-Seven Poverty Elimination Strategy. Without capital, poor households cannot invest in the improvements envisaged in the Eight-Seven Strategy.

B. Loans to households show a high repayment rate.

The Luliang projects have achieved a repayment rate of 96%, far higher than that of other poverty alleviation loans. It is estimated that the repayment rate for poverty alleviation subsidized loans was 14.3% between 1980 and 1989, 38.03% in 1990, 45.3% in 1991 and 41.3 % in 1992.

The demonstrated capacity for repayment of households in the Federation projects is reflected in the increasing willingness of Government to make growing amounts of poverty alleviation loans available to the Federation (see above). The Women's Federation system has little other income apart from Government financial allocations to cover their routine administrative expenses. This means that if the project borrowers cannot repay loans on time, the Women's Federation would not be able to subsidize the borrowers by forgiving debt. These circumstances establish the credibility of a high repayment rate.

C. Substantial numbers of households have moved out of poverty.

Records and field surveys indicate that the annual per capita income of participants in the Women's Federation projects has increased. Some women have seen an increase in income of several hundred yuan per year, while a few have had increases exceeding 1000 yuan. With increased income and assets and expansion of the scale of production, the living conditions of beneficiary households have improved. An estimated one half to three quarters of the 41,540 households participating in the Luliang project have moved out of poverty since 1989.

For example, data on selected households in Linxian County (Luliang Prefecture) show that 1,486 households out of a total 2952 poor households have increased their annual per
capital income to 1000 yuan or more. In Fangshan County, the Federation estimates that 70% of poor households have moved out of poverty, with per capital annual incomes of 650 yuan.

Equally interesting, the Federation projects enabled some women to become small entrepreneurs, moving beyond income generation micro-projects to small enterprises employing several staff (for example, chicken farms and carpet processing sites.

V. Main factors behind the success of Women's Federation credit projects.

A. Lacking its own financial resources, Federation leaders substituted commitment, perseverance, advocacy and problem-solving.

Implementing credit programmes for women is difficult work. Success depends on the quail of leadership. Women's Federations tend to be relatively weak and under-funded institutions compared to other government units. In the case of the Luliang projects, Federation leadership appears to have compensated for lack of financial resources with extraordinary personal commitment and a capacity for effective advocacy with Government. For example, through effective advocacy and skilled negotiation they mobilized funding and technical support from other departments.

B. The Women's Federation invested in capacity building for women, not just income generation.

The success of the Women's Federation project is reflected not just in increased income and assets and improved living standards of participating households. There was also improvement in women's knowledge, skills and values. Project organizers at the Women's Federation believe that without skills and education women cannot contribute effectively to a prosperous economy. The Women's Federation's priority strategy in poverty alleviation was to transform the culture of poverty and enable the women to take responsibility for eliminating their own poverty. The Women's Federation did not see poverty reduction in simple economic terms. They saw the need to encourage women to take opportunities for self-development. They recognized that poverty is spiritual as well as economic. Therefore, they attached great importance to expanding the capacities of beneficiary households. For example, they requested women participants, if illiterate, to become literate. They asked primary and junior and senior middle school graduates to improve their qualifications. They asked households to pledge to keep children in school, and avoid gambling and violations of the law. Only those willing to meet these requirements qualified for participating in the credit projects. From its side, the Women's Federation invested in technical and knowledge training for group members.

C. The Women's Federation gave high priority to building a supportive relationship with government at all levels.

In China, the success of a project can not be separated from government support. While designing, organizing and implementing the credit activities, Women's Federations at various level took care to keep Government informed and to communicate the philosophy,
purposes and accomplishments of the credit projects. An indication of Government
leaders' understanding of the objectives and strategy is that they supported but did not
interfere in the implementation of the credit activities.

D. The Women's Federation tried experimental approaches to finding the best way
to reach poor households and assure sustainability of their efforts.

During the implementation of the project, the Women's Federation did not simply wait for
development opportunities to appear, they went seeking opportunities. They reviewed
experience as they implemented the different models. They used experiences from
elsewhere and continuously adjusted new poverty alleviation methods to the local realities.
This learning process approach made contributions in one way or other to the success of
credit activities. The Women's Federation's process of testing the six models is part of its
overall strategy of finding ways to incorporate effective poverty alleviation methods into
its routine operations. Though the Federation has tested six models, it now plans to
concentrate on two models, the group liability model and the women's committee village
projects. It believes that these two models give the greatest promise of reaching out to
poorest households, and of being easiest to implement.

The Federation project distinguishes itself from other donor-assisted credit projects in two
ways. First, the Federation controlled the design process, while learning from outsiders.
Second, unlike usual donor assisted credit that takes the form of projects, this credit work
is integrated in the Federations routine work.

The Women's Federation projects are not presently financially self-sufficient. They depend
on continuing access to increasing amounts of subsidized poverty alleviation loans and on
the staff work provided by the Women's Federation system. Their sustainability is linked
to continuing subsidies of staff and capital.

E. The Federation developed an explicit implementing strategy and standard
operating procedure.

1. The Federation used standard approaches for selection of sites, project activities and
farmer households.

For example, they generally began with a base line survey of project areas, looking at the
social, economic, technical, and historical conditions for development. The focus was on
poor areas. In the beginning, where the base line studies showed similar conditions among
areas, the Federation gave priority to the areas where party and government leaders
supported women's work, where women's organizations were strong and where able
women were relatively concentrated. At the initial stages (Poverty Alleviation Chain), they
selected for participation women farmers who showed strong demonstration and
leadership abilities, participated in training and mastered specific production skills, and
who agreed to help others. As project experience deepened, the Women's Federation
increasingly tried to reach poorer households.
Project selection criteria encouraged loans for activities that could be implemented quickly and produce visible benefits in a short time. The Women's Federation wanted quick benefits in order to build confidence. They also wanted activities which would sustain a momentum of development and which were related to other industries. For example, they encourages rabbit rearing and greenhouses that were linked to marketing.


a. The Women's Federation has established job descriptions, standard operating procedures and clear responsibility for management of funds. They have routine reporting systems and follow-up supervision intended to identify and resolve problems in implementation. To clarify responsibility for funds, the Federation requires signing of letters of responsibility at all levels. These letters strictly define the scope of fund use, investment amount and project's progress and standards.

b. Over time, the Federation has set up a comprehensive system of documentation, which includes basic data on participating women, villages and townships, project implementation, and all the steps following project formulation and investment. They also have photographs and videos. This is a potentially useful resource for a systematic evaluation of the experience.

c. The Federation has integrated technical support with lending. They have, for example, provided improved breeds and new varieties, supported marketing, and made training an integral part of credit.

VI. Recommendations

A. The Women's Federation system should continue to deepen its focus on poor households.
The remaining poor in China are difficult to reach. These poor mainly live in remote, mountainous areas with persistent endemic diseases. It is difficult to eliminate this kind of poverty which has social as well as economic roots. The strategies for helping these poor need to be clearly different from old strategies. There are special constraints to implementing programmes that reach this residual group of poor people. One obstacle is convincing implementing agency staff that poor people can manage small loans and are trustworthy. Unless the implementers value the capacities of these poor people, project execution may move away from the loan targets toward better-off households. The challenge is to correctly identify and select the real poor in project operations; to promote and mobilize these poor households so that they truly understand and accept the conditions and requirements of a loan programme so they can make regular repayments; to help poor farmers to select project activities, manage them and secure stable income.

B. The Women's Federation, with the support of Government and donors, needs to develop its management capacity to meet new challenges.
The Women's Federations in both Luliang and the Province are at a turning point. They have successfully demonstrated their capacities to reach increasingly poor households and
use available resources effectively. They have decided to focus on two credit models that they believe are most promising. They are ready to go to scale in both the Prefecture and the Province. Increased resources from Government and the World Bank make expansion possible. Now is the time to train staff and raise their management capacities to a new level. Training should particularly include skills in preparing a balance sheet and an income statement as well as calculating the break even point. These skills are important for the Federation to be able to increase the cost-effectiveness of their operations and manage expanding poverty alleviation programmes that move toward self-sufficiency.

**C. Pay attention to cost-effectiveness and efficiency measures.**

Maximizing profit with minimum investment is a basic principle of the market economy. The Women's Federation projects, as currently designed, do not have the objective of covering costs with income. They use subsidized capital for lending. Federation staff time, essential to implementation, is effectively another subsidy. Schemes such as those operated by the Federation should nonetheless be designed on the basis of business principles. This requires concern for cost-effectiveness in project implementation. For example, attention needs to be paid to the number of staff required per borrowers served. Maximizing the number of clients one field staff can effectively serve is one way of keeping costs of operation to a minimum. Reducing costs allows the most rapid expansion of services. Operating on business principles also demonstrates to clients the way they should conduct their own microenterprises.

**D. Incorporate savings into credit schemes as a basic part of the poverty alleviation strategy.**

The Women's Federation projects do not presently include a saving component. The Women's Federation should explore the role they can play in mobilizing savings to build assets for the poor and to create additional capital for lending, on which farmers can pursue independent development. Regular saving helps project participants to form good habits. More importantly, savings give farmers security for their future life and project activities. Savings can also add to the capital available for lending to poor households. In successful schemes elsewhere, savings mobilised from the poor can form the largest part of the funds available for poverty alleviation loans.

**E. Recognise the importance and difficulty of sustaining high repayment rates.**

High repayment rates are the basis and a necessary condition for sustainable development and final success of any poverty alleviation loan scheme. Poverty alleviation projects with low repayment rate are only relief projects. So far, the repayment rate of the Women's Federation's projects has been high, ranging between 96-100%. They can sustain this high repayment rate with continued hard work. However, repayment is a complicated issue. Unexpected problems can occur. There is danger in rapid expansion that high repayment rates can drop off and bad practices begin to infect the whole scheme.

**F. Build strong groups among the participants.**

The Women's Federation plans to focus on the group model and the women's committee model in its future work. One key to the success of microfinance schemes like the Grameen Bank and others has been bottom-up organisation structure that invests in building strong groups and group discipline and which devolves responsibility to groups...
and centres. Disciplined groups and centres strengthen the base of the microfinance scheme and lay the foundation for success. The repayment rate of a good centre can exceed 98%. Credit rules are observed, centaur meeting attendance is high, credits are effectively used. This discipline contributes to increased income of the members, which in turn leads to capacity for repayment and to improvement of living situation and social status.

**G. Develop information systems that support better project monitoring and evaluation.**
The project has collected a considerable amount of data, but it has not yet been analysed. Work needs to be done on identifying indicators that can be used to measure and compare the performance of different credit projects, and measure their impact on poor households. This kind of assessment is necessary to the extension and further development of the project.

**VII. Conclusion**

The organic development of credit approaches that reached poor households, achieved high repayment rates, and had an impact on poverty reduction is the story of a local organisation’s response to persistent poverty. The Luliang Prefecture Women's Federation recognised that poverty alleviation loans that were not repaid did not produce development, only relief. Using their own staff resources, they mobilised a small amount of money from UNICEF for training and increasing amounts of loan capital from Government as they tested different ways of reaching poor households while assuring high repayment. Government and outside donors have recognized the Women's Federation success in poverty alleviation that reaches households. Increased funding is now available to the Federation to expand their approaches in Luliang and throughout the province.

Looking to the future, it is important that Government and donors not set unrealistic expectations for the Women's Federation system. Credit for poverty alleviation is difficult and can face unexpected complications. The Women's Federation needs to be allowed to expand in an organic way building its capacities as its responsibilities grow. If growth is pushed faster than capacities allow, the Women's Federation will face the problem described in a Chinese proverb where it is "the hardworking cow that is whipped". The Women's Federation is very serious in its work and committed to expansion. If it faces setbacks, this will be a great blow not only to the Federation but also to household based poverty alleviation work. Government and donors have a critical role in setting realistic expectations for the Federations work, and providing all necessary encouragement, training and capacity building. For its own part, the Federation can rest confident on its success in reaching so many households and continue the same measured approach to expansion.

**Case Study: Credit and Savings Component of the Poverty Alleviation and Sustainable Development Project in Yilong County, Sichuan CPR/91/164**

*Credit and savings activities in Yilong County, Sichuan Province, are an example of a group based lending approach designed and implemented as part of a larger development project "Poverty Alleviation and Sustainable Development in Yilong*
County, Sichuan”. The United Nations Development Programme is supporting the Yilong project as part of a larger programme of assistance to the Government of China that seeks to demonstrate models of sustainable credit and savings that contribute effectively to poverty alleviation.

This Yilong model for microfinance is still in its infancy. Early results show that the project has been successful in creating a field staff able to form viable groups and centres, in lending to targeted households, in assuring collection of required savings, in achieving a 100% repayment rate, and in launching micro-projects that appear to be generating income for participants.

Features contributing to this early evidence of success include:

• a deliberate and iterative design process that sought to take advantage of learning from earlier efforts to adapt the Grameen model of credit to China
• measured implementation, with a focus on building the experience of field staff
• creation of a registered NGO (Yilong Rural Development Association) by the local government to enable implementation of credit and savings separate from but in collaboration with township and village administration.

The Yilong model faces problems as it seeks to expand microfinance activities. Under current banking regulations, the microfinance scheme is not likely to generate enough income to cover transaction costs or to become self-sufficient. In expanding to additional townships and villages, project implementers need to give attention to training, support of field staff, and ways to increase the cost efficiency of existing staff. It will need donor support longer than the planned two and one half years.

1. Background

The project for "Poverty Alleviation and Sustainable Development in Yilong County, Sichuan" is linked to Government policy for elimination of poverty by the year 2000, and adopts the strategy of the Government's 8-7 Poverty Alleviation Program, and particularly the "Five-Ones" approach. UNDP's support for the project is intended to help Government design a sustainable, comprehensive, replicable, low-cost and participatory model for poverty elimination. Though this case study is concerned with the credit and savings activity of the larger project, the context in which it operates explains the intended links between microfinance and poverty alleviation.

The project explicitly supports the National 8-7 Poverty Reduction Plan announced by the State Council in January 1994. Its implementation strategy is based on the Five-Ones approach aimed at assuring poor households access to multiple strategies for subsistence and poverty alleviation: minimum land for staple crop production; for cash crops; for orchards or woodland; animal husbandry or a sideline production; and outside employment for one family member. UNDP support for the project is part of the growing emphasis of its country programme on poverty alleviation. The Yilong project was planned in tandem with similar projects in Yunnan Province (Malipo and Jinping Counties) and in Tibet (the four counties of the Qomolangma Nature Preserve). The design and implementation experience in Yilong is expected to contribute to the design of UNDP
supported poverty alleviation projects elsewhere. The Poverty Alleviation Office in Chengdu, which is providing counterpart funds equivalent to the UNDP investment in Yilong, has been monitoring the project and proposes using the basic Yilong design to extend credit and savings access to poor households in Sichuan, first in a proposal for twelve additional poor counties.

The over-all development objective of the project is "to design a holistic, participatory and replicable approach to the elimination of poverty in China's remote, mountainous and absolute poverty-stricken areas which have a high proportion of minority nationalities." Project implementation is to focus on the poorest one half to one third of villages in selected townships, and on the poorest households in those townships. There are three major components to project activities:

i. the development of community participation, including formation of groups of peasants and the development of a village and township planning process;

ii. technical support to agricultural production and to the development of individual farm plans and ecosystem management plans for natural villages;

iii. development of township and village enterprises (TVES) and of access to rural credit for poor rural households.

The Grameen type of model selected for implementation of credit and savings is linked to all three components. Group formation activities in component one provide the foundation for the joint liability credit and the savings to be offered in component three; while the capital available on credit enables expansion of agricultural production, animal husbandry and other activities in component two.

The executing agency for the project is CICETE of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) while the implementation is done through the County Governor's Office in Yilong, which has established a special Project Implementing Office (PIO). The project began implementation on January 1996, though preparatory activities throughout 1995 developed the design and detailed implementation plans. World Food Programme (WFP) and the International Fund for Agricultural Development (IFAD) may implement parallel activities (infrastructure development and support to capital for credit).

Yilong is an example of a remote, hilly, poor area with limited natural and human resources, poor infrastructure and population size exceeding productive capacity. Ninety-six percent of the nearly 1700 square kilometers are hilly. Of the 965,000 population, 95% live in rural areas and are dependent on agriculture. County authorities estimated that there are more than 400,000 farmers below the poverty line indicators of 250 kilograms of staple food and 300 RMB per capita per year. Population density is over 565 per square kilometer, and cultivated land per inhabitant is estimated a 0.8 mu. Fengyi, one of the project townships, on which farmers can pursue independent development. Regular saving helps project participants to form good habits. More importantly, savings give farmers security for their future life and project activities. Savings can also add to the capital available for lending to poor households. In successful schemes elsewhere, savings
mobilized from the poor can form the largest part of the funds available for poverty alleviation loans.

The area is likely to be one of high iodine deficiency which may contribute to higher incidence of mental retardation and limits on human resource capacities. Fanning households may have high tax burdens relative to their incomes; in addition they have to meet surcharges for local road construction and may have to pay public school fees for primary education. Over 200,000 residents work outside the county. The population is Han.

II. Introducing and Adapting a Credit and Savings Model In Yilong

Design Process

The key characteristic of the Yilong model is that its design emerged from a process that benefited from the experience of other credit schemes in China and which involved the ideas of staff who would be involved in implementation. This iterative process of consultation and learning enabled the Yilong model to surmount a major hurdle facing designers of many microfinance schemes for the poor. The hurdle, a reluctance to operate on the assumption that the poor can and will repay loans---blocks many schemes from giving the responsibility and accountability for repayment and sound management of micro-projects to poor clients and their fellow group members. Schemes that do not cross this hurdle tend to place responsibility for repayment on officials, creating a disincentive to lend to poor households traditionally considered not creditworthy. In the case of the Yilong design process there was movement from early drafts of regulations for credit that emphasized penalties and negative incentives to the February 1996 version that emphasized the role of individuals in deciding their own micro-project for financing and in emphasizing the responsibility of the individual and group for participation and repayment. Additionally, early drafts of the regulations called for infrequent repayment and loan terms up to five years. The final regulations require weekly repayment for a one year loan, a design that experience elsewhere suggests is suited to the needs of poor households and less likely to contribute to loans being hijacked by better-off farmers. This measured process of design appears to have been facilitated by involvement of county level managers, and technical support, including limited international advice but more importantly national consultants. Some of the national consultants brought the experience of the Grameen Bank replications in Hebei and Henan. The final operational regulations for microfinance in Yilong evolved from group discussions with the China Community Corps (CCCS) who would manage the group mobilization and the microfinance operations at the township level, and consultation with partners.

Institutional Arrangements in Yilong County

The County Government created the Yilong Rural Development Association to promote community participation and innovation in rural development. It is registered as an NGO with the local Government and its Director selected by Government. The charter of the YRDA provides for farmer participation in the selection of leadership and in setting priorities for YRDA activities. The Credit Unit of the YRDA is responsible for management of the revolving credit fund, for maintaining a separate bank account and
depositing all cash in the bank. It is limited to working with project identified poor households and is a non-profit institution. In accordance with the banking laws, it cannot accept deposits; it does collect mandatory savings from members which are deposited in an interest bearing bank account. The Director of the Credit Unit is responsible for microfinance activities, including supervision of the CCCs (Community Credit Corps) and the Group Organizers (G0s) who work at the township and village level. For the life of the project, the CCCs and G0s are recruited by CICETE and funded by the project. They are supervised by a Provincial CCC, also recruited by CICETE and funded by UNDP, who works part-time in the county. The Project Implementing Office, which is responsible for other aspects of the Yilong project, serves as secretariat to the YRDA. An organogram attached tries to summarize the relationships.

Though the YRDA was created to allow implementation separate from township and village operations, the Yilong model also envisages that CCCs will collaborate with Township and Village leaders, keep them informed, and assure their support.

Microfinance Guidelines

The Yilong microfinance models owes much to the Grameen Bank model and to the adaptations already tested in China.

- **Group and Center Organization** - Five non-related individuals voluntarily form a group; between four to eight groups may form a center, which have a mandatory weekly meeting for repayment, savings, discussions of any problems with microactivities, and technical support. Meetings are to have a fixed time and place decided by members. Group members may be women, single men, or married men whose wives are not capable of production. Groups and Centers elect their own leaders, though leaders are required to be women.

- **Targeting Households** - The project has developed concrete criteria relevant to the Yilong situation for identifying eligible households. First, it identifies household that should be excluded --- if the standard of housing is high by local standards (and has cemented or limed walls), if the household owns farming equipment, or if the household already has a stable outside employment or business. Second, a household should be included if they have school dropouts; if they have no electricity in an electrified village, if they have little furniture, suffer a food shortage some months of the year, are female headed, or receive social relief. A first step in implementation in a village is to be a base line household survey to understand the conditions of poor households and to develop an initial name list of poor households for participation.

- **Loan Procedures and Rules** - The maximum loan in the first year is 1000Y (US$120) and 1500Y (US$180) for the second loan. Interest is 8%, with half to be paid before disbursement and the other half in the two weeks following repayment of the total principal. All loans are for one year, with 2% to be paid each week. Loans may be repaid before they are due, but the interest charge is not reduced. The borrower cannot take a second loan until one year after disbursement of the first loan. Loans are disbursed on a 2-2-1 principle. Group members make application for loans, but only two loans are disbursed at first; if repayment is good for one
month, two more loans may be disbursed and so on. Decisions on loan approval are made by the head of the credit unit in the YRDA, but depend on the recommendations of the group and Center. Risk is managed in several ways: group liability; retention of YRDA title or ownership of any materials bought with the loan until the loan is repaid; and through a Group and Center Security Fund generated by an automatic deduction of 5% from every loan granted. Additionally each borrower is required to use the loan for intended purchases within seven days of disbursement. GOs are required to check utilization.

- **Compulsory Savings** - Every group member is obliged to save one yuan per week. Savings are recorded at a center meeting in individual books. The YRDA deposits savings in the bank and pays the current rate of interest.

**Implications of Design Process on Implementation**

The process approach to designing the model spills over into implementation. The process approach probably contributed to building among Yilong officials a shared understanding and commitment to the credit and savings model, and has also begun to generate support from outside the project. The outside national consultants were able to bring new ideas and approaches to Yilong, but gestation period for model design and the involvement of county officials and of the Provincial and Township CCCs appears to have provided opportunity first to understand gradually the concepts behind the model being introduced and second to plan detailed steps for implementing the model. From county to township levels, officials noted that the approach was different—"Before our work was top down; now this project requires that peasants make decisions for themselves." A county level official said she always tells people that "the important work of the project is not just making credit available but is a change in spirit, in people's way of thinking." She said that repayment alone was not important but that by making regular repayments poor people could realize at the end of the year that they have paid a loan; they have the proceeds from the loan investment, they have savings, and that the achievement is all theirs. Developing this kind of understanding or vision of the complex role microfinance can play in poverty alleviation can contribute to effective project leadership. The role of the leader is to be able to articulate and communicate where the activity is going.

The joint process of developing regulations and detailed work plans may also have contributed to shared understanding and a common approach to implementation. Officials at different levels, in government and in the project, said in interviews that at first they did not believe the model being introduced in Yilong would work. A few said that they began to believe the model would work only after a training workshop with national and international trainers in November 1995 gave an opportunity to discuss concepts and experiences elsewhere. For most belief came later. One senior County official said that they began implementing the project according to instructions, but they did not believe it would work. Only when they saw how implementation worked and that it could work in Yilong were they convinced. One Township Governor said that when the project began, because it was being implemented through the Yilong Rural Development Association, he thought it was a top down project that had nothing to do with him. Now he sees that it is able to get credit directly to the households, and that the groups work. Now he supports the project approach and wants to promote it everywhere.
## III. Implementing the Model

Yilong Rural Development Association Group Formation, Savings and Credit as of July 31, 1996

<table>
<thead>
<tr>
<th>Township</th>
<th>Fengyi</th>
<th>Shuangsheng</th>
<th>Qishan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clients:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>female</td>
<td>40</td>
<td>81</td>
<td>77</td>
</tr>
<tr>
<td>male</td>
<td>5</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>No. Group</td>
<td>9</td>
<td>18</td>
<td>16</td>
</tr>
<tr>
<td>No. Centres</td>
<td>2</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Amount Loans Disbursed</td>
<td>RMB33,650</td>
<td>RMB67,400</td>
<td>RMB42,700</td>
</tr>
<tr>
<td>Average Size of Loans</td>
<td>RMB748</td>
<td>RMB749</td>
<td>RMB534</td>
</tr>
<tr>
<td>% Loans &lt; RMB500</td>
<td>44%</td>
<td>43%</td>
<td>60%</td>
</tr>
<tr>
<td>Weekly repayment rate*</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Weekly Meeting Attendance Rate</td>
<td>94%</td>
<td>90%</td>
<td>92%</td>
</tr>
</tbody>
</table>

Discussions with CCCs and G0s, with a small number of group members, and with other officials, plus observations of two center meetings suggests that the Yilong model was implemented largely as planned and resembles the Grameen model adapted by the Rural Development Institute experiments in Henan and Hebei. There are some differences between the Yilong implementation and practice in the Grameen model, perhaps stemming from the short time of operation. Implementation experience has raised some questions about the frequency of center meetings in an area where hilly topography raises the opportunity cost of meeting attendance, particularly in busy agricultural seasons. Despite the fact that members loans are used for agricultural or animal husbandry purposes which produce irregular income, there was no evidence that borrowers found it difficult to make weekly payments. There is anecdotal evidence that groups are beginning to play the social intermediation role intended.

Implementation of the microfinance component began after New Years in 1996. The first centers were formed and the first loans granted by March 1996. Three teams of one CCC and three G0s each were assigned to each township and in the first six months the teams appear to have worked together in each village. The first steps were to introduce the project to the Township leaders, consult with the village cadres and then go to villages to
explain the project, encourage group formation and undertake the household survey. Those who would become members must participate in three days of training, including the regulations of the Yilong Rural Development Association, procedures for borrowing and saving. The YRDA approves the formation of centers and issues certificates of membership. Training does not include details on making a business plan or estimating the profitability of a proposed microenterprise. Members interviewed appeared able to detail the costs of their microenterprise and to estimate profits after costs and repayment of principal.

As of July 31, 1996 there were 215 members and 7 centers, with several more centers ready for approval. The table above summarizes the accomplishments to date.

Though the Yilong Rural Development Association was formed to assure independent implementation and decision-making on loans, the relationship with Government at different levels appears to have been positive and facilitating. The Governor visited the townships and encouraged them to respect the independent operation of the credit and savings groups and centers. Township leaders advised on which villages to choose first and sometimes went to villages to introduce the CCCs and G0s. At one meeting of three newly certified centers observed for this case study, the county Governor and the Township party secretary attended, lending importance to the occasion. Women participating said it was the first time they had ever met a Governor. At the same time, these Government officials, as noted above, seemed to value this credit scheme. Unlike others, they said, it reached poor households while the RCC (Rural Credit Cooperative) only gave loans to those they thought could pay back.

The weekly repayment appears not to have been a problem, despite the fact that loans granted went only for agricultural production or animal husbandry. Project officials reported that weekly payments may be difficult, but households find a way. Husbands may go out for day labor, earning 4-5Y per day. There is also migrant labor outside the county. Project officials noted that groups may put pressure on a husband to return earnings to the household, and not to spend it on alcohol. Microfinance schemes may play the role of capturing for productive purposes outside earnings that might otherwise have been used for consumption. They said there was group pressure for repayment because each cared what the others were repaying. Some households interviewed reported selling small animals periodically for cash needs. Many households appear to use their loans for several purposes, to spread the risk of failure and to diversify sources of income.

Though repayment is 100%, there is a lower rate of weekly meeting attendance. Weekly meetings come out of the Bangladesh experience, where the terrain is flat, and houses in villages tend to be clumped together. Yilong is hilly and the houses are dispersed. While some Yilong households questioned say there is no problem attending weekly meetings, centers have asked CCCs and G0s for less frequent meeting during rice harvesting or other busy times. New Centers recently formed in Qishan Township requested smaller centers so that groups would not be so far from each other, reducing the walking time to meetings. Some Center meetings were suspended during the May busy season, but the project leadership believes this has caused problems. They want to make the meetings
useful to members beyond hem. a mechanism for repayment and savings (see below).

Communication in Yilong County is difficult. Group members may have to walk half an hour to attend meetings. CCCs and GOs will have to walk longer distances. Because of the lack of roads (many villages are accessible only by narrow paths) and the poor condition of existing roads, the motorcycles originally planned for CCCs have been abandoned as unsafe.

Though groups are still young in all the townships, they appear to be developing some of the solidarity that may support repayment and good implementation of members microenterprises. CCCs and GOs interviewed relayed anecdotes of group members helping each other out; assisting a women without a husband on how to spray her fruit trees; advising another group member without experience on how to buy baby geese. CCCs and GOs spoke about the trust developing within groups. Township officials pointed out a reduction in conflict in the villages following the establishment of the groups.

While the YRDA regulations require that only women can be leaders, some groups and centers have chosen men, and some women have expressed reluctance to be a leader, preferring a man. Project officials appear to be pressing for implementation of the requirement so that the group and center membership provides leadership opportunities and builds women's capacities.

Linkages to Technical Support - The microfinance activities were intended to be linked to technical assistance components of the larger project. A Provincial Technical Assistance Group (TAG) is responsible for assessing needs and building the capacity of county and township staff to provide appropriate technical assistance. Households appear to have needs for technical support; many households interviewed reported the deaths of one or more small animals purchased with loans, sometimes because of lack of knowledge on how to select animals for purchase. The YRDA organizes technical experts to speak at some center meetings. Extension agents working with poor rural households may need training, not only in the content of technical support, but also in experiential, non-formal training methods appropriate to poor, semi-literate households.

Management Issues

In looking to the future, there are a number of inter-related management issues that the project and YRDA leadership need to address if microfinance for the poor in Yilong County is to be sustainable. Essential to sustainability is a strategy that aims at least toward operational self-sufficiency. A strategy for self-sufficiency is important for two reasons. First it assures the viability of operations and of capital over the long run. Second, it models the responsible financial management expected of poor borrowers.

Self-sufficiency implies that income from interest and other sources is equal to or greater than expenses, including administrative costs, an allowance for bad debts and loan losses, and the cost of capital. There are two ways to move toward self-sufficiency: one is by
increasing income; the other is by decreasing costs. YRDA ability to increase interest rates is presently limited by banking regulations (though there is substantial evidence that poor households are prepared to pay high interest rates to covering the higher transaction costs of credit and savings for the poor). YRDA and project authorities can focus on reducing costs, gaining economies of scale as they expand; on developing accounting capacity so that they can track income and expenses and develop accurate models of efficient operation, and on organization development efforts for YRDA. Training of new field staff and continuing motivation of existing field staff will remain important management tasks.

**Expansion and Cost Efficiency** - YRDA and project leadership are already developing plans for phased expansion of groups and centers. In doing so they need to be conscious of ways to increase the efficiency of the township teams. During an initial period, the teams have each worked as a four person unit to organize new centers and to provide routine support to existing centers. As the teams gain experience and confidence, G0s need to work separately. Overall, YRDA needs to increase the ratio of clients to field staff. Current CCCs and G0s estimate, when asked, that they could manage three to five centers each. Bank Assistants in Grameen Bank manage ten centers once they have all been organized. YRDA needs to answer the question of what is the maximum number of centers a GO can manage and still maintain the quality of center operations?

**Building Independent Accounting and Financial Management Capacity at YRDA** - Accounting arrangements for the microfinance component reflect the realities of a donor supported project. Because of the linkages of YRDA to the Project Implementation Office, it may be difficult to estimate some operating costs. However, YRDA needs to be able to track all costs, including those now covered by donor subsidies, and all income. This is a prerequisite to developing longer-term strategies for sustainability. It is also an area where donor technical support can be beneficial.

**Organization Development for YRDA** - Except for the credit unit, YRDA is not yet fully developed and is dependent on the Project Implementation Office for functional support. To realize the potential of YRDA, county authorities and YRDA, perhaps with support from appropriate national consultants need an opportunity to plan gradual development of YRDA so that it has the capacity to manage a self-sufficient microfinance program. They should also look at the role of YRDA as an intermediary for technical support to centers and groups and spell out the ways to enable Center members participation in YRDA.

Indeed, the potential for Centers as platforms for social as well as technical development has not been realized. While Centers have the capacity to play multiple roles, they should not be pushed to take on too many activities before the microfinance functions are routinely satisfactory.

**Training** - With expansion or dropouts of existing staff, YRDA will have to plan for training of new field staff. It will not be possible to replicate the learning experience of the first CCCs and G0s who learned by doing in the design and initial implementation. New training should try to capture the learning by doing experience and link brief classroom
training with apprenticeships with experienced staff.

**Motivation** - The success of the microfinance scheme depends on the field staff who take responsibility for the quality of Center work. Working daily in villages is difficult, and more so in Yilong because of the topography. While financial forms of motivation are limited, YRDA and the project authorities need to think of non-financial rewards and recognition, as well as opportunities for advancement for those who seek it.

**Conclusion**

The Yilong experiment in microfinance is young. Its apparent success in initial implementation does not guarantee that the microfinance will be able to continue and thrive. Some of the questions facing YRDA are discussed above. What is certain is that the microfinance experiment will continue to need the support of government and of donors though a reasonable development period. The literature on microfinance schemes in other countries suggests that between three to seven years are necessary to attaining operational self-sufficiency. Microfinance schemes in China face questions that have not faced experimenters elsewhere. These questions include the role of Government and value questions about subsidizing credit for the poor.