

PLANET FINANCE

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The Micro-finance Platform

CHINA

Country Overview

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0. Executive Summary

In 25 years, national output of China has quadrupled and continues to grow at a reported rate of over 8% per year. China is now seen as a major player in international relations; economic controls continue to be relaxed and yet political controls remain tight. Important trends that have emerged for China include: Transition and Reform, Economic Growth and Ascension to the WTO, Maintaining Broader Equity and closing disparities between East and West; Banking Sector Reform, and Growth of IT & Telecoms.

China has done an excellent job to reduce poverty in the past quarter century. However, according to the World Bank, there are currently still more than 120 million people under the absolute poverty line of 1 USD per day. This population represents a huge market for microfinance. Donors, government agencies, and the majority of practitioners see microfinance as fundamentally rooted in a “poverty reduction” objective. Most microfinance programs have been piloted in rural areas (where the perceived poverty problem is most acute) although more recent experiments and programs have emerged in urban areas where State-owned Enterprise reform has caused high numbers of lay-offs, unemployment, and poverty.

Three types of microfinance have emerged over the course of the past decade: 1) NGO-led microfinance, 2) Chinese government microfinance, and 3) formal financial institutions including RCCs and city commercial banks. China’s microfinance sector can best be described as one with a high quantity of low quality programs and a low quantity of high quality programs. Key operating constraints have included the cap on interest rates, the culture of the welfare state (wherein poor farmers expect to be provided relief by the government), a government that is slow to adopt models from outside influences, a weak formal banking sector and administrative/political barriers to enter it, governance and ownership ambiguity at the regional level for non- and banking financial institutions. The RCC model of microfinance far outweighs the NGO sector in terms of loan portfolio size, but the NGO models continue to have models worth sharing and supporting. The Government model of microfinance shall soon become obsolete.

Major opportunities for PlaNet Finance China exist as the trends of RCC reform, the push toward profitability for the banking sector, NGO self-regulation, benchmarking, better poverty targeting, apex funding, liberalisation of interest rates, commercialisation of the microfinance sector, and strengthening of civil society continues.

PlaNet Finance China sees that the large opportunity lies in our ability to **leverage the experience and success of the NGO-microfinance agencies to promote good practice microfinance among pre-existing financial institutions including RCCs and City Commercial Banks**. As each province differs vastly, the opportunity lies in approaching each province with a unique package of institutional reform and capacity building tools.

With a **10**-person staff and a **2** year operating history, the PlaNet Finance China country office has conducted training of **255** microfinance staff from **43** programs in **6** field sessions across China; Design of **15** training modules; IT equipment delivery to **37** microfinance programs; Creation of websites and free email accounts for **23** microfinance programs; Weekly IT training provided to **80** young migrant workers; Gathering of **100** policy makers, IT professionals and NGOs representatives at a conference in Beijing on the potential of IT and telecom for poverty alleviation, and the creation of a bilingual China Microfinance **Web Portal**. We estimate that the programs that we have assisted in 21 Chinese provinces, in both rural and urban areas, directly impact over **30,000 low-income families**.

PlaNet Finance hereby proposes a Country Strategy, based upon the context of the emerging microfinance sector in China, and coherent with PlaNet Finance’s approach to microfinance development around the world that will consist of the following:

For NGO type Microfinance Institutions: technical consultancy, providing needed expertise and experience to the sector, the full range of products and services offered by the TTS

For Rural Credit Cooperatives (RCCs): consultancy services and diagnostic evaluations of RCC microfinance programs in rural China.

For Rural Bank-led microfinance programs: a national training program to allow the ABC to hive off its microfinance responsibility.

For Urban Bank-led microfinance programs: capacity building support for microfinance in urban areas, primarily with laid-off State Enterprise workers, comprehensive market studies to pilot urban microfinance programs.

For the entire sector: Introduction of the Revolving Credit Fund (RCF), introduction of Planet Rating and Diagnostics

In regard to the Chinese Government: Regulatory consultancy, advising, workshops, international exchange.

For the China Microfinance Network: Information Sharing for the CAM, capacity building through the Citibank MF Training Centre, and further expansion of the Platform—as closely related to the CAM's membership.

Expected Achievements between 2005-2010 include:

<i>Expected Number of Microfinance Finance Institutions to be supported</i>	<i>= 200</i>
<i>INDIRECTLY expected number of Clients supported</i>	<i>= 150000</i>
<i>Number of people trained</i>	<i>= 1250</i>
<i>China-specific expertise developed in the areas of Rating, IKM, TTS, TOT, and Roll-out of RCF in China</i>	

These goals will allow PlaNet Finance to play a leading role in a China where we envision the following:

Ten years from now, financial markets will have liberalised and opened substantially. Foreign and domestic banks will increase for ever-narrowing bands of customer bases.

Ten years from now, China's NGO microfinance agencies will have formed a strong network, which will have in turn become an apex fund, which will eventually have consolidated into a large, unified microfinance institution dedicated to serving the poor. There will be only one if not two major national microfinance providers. There will be an average of one microfinance institution to cover each province.

Ten years from now, a few other local microfinance banks will have been set up by international actors, and will undergo a process of tedious localisation. Meanwhile, commercial banks in China will have continued to improve and a number of investor-led initiatives will help these banks move into the markets of informal economy entrepreneurs, issuing SME, microenterprise, and individual loans. Insurance products will become more ubiquitous and the microfinance sector will begin to experiment. Commercial and rural banks will start to use their savings collections (liabilities) to leverage more return on assets. Savings will be much more efficiently directed and worked through the system.

Ten years from now, several successful experiments with RCC microfinance will have been deemed successful, and the RCCs (by then having been consolidated into only 6,000 branches) will be operating microfinance in slight competition with the NGOs' outreach. Because the RCC network will be so broad, NGOs will continue to play a role by taking more risk with product innovation and leading the way for local RCCs.

This Country Strategy is meant as a working document. Revisions are expected and encouraged.

November 15, 2004

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1. An overview of China

For centuries China was seen as a leading civilization, outpacing the rest of the world in the arts and sciences. But in the 19th and early 20th centuries, China was beset by civil unrest, major famines, military defeats, and foreign occupation. After World War II, China was unified under the Communists (led by MAO Zedong) and was brought under tight central control, closed to most outside influences. After 1978, MAO Zedong's successor DENG Xiaoping gradually introduced open market-oriented reforms and decentralized economic decision making. In 25 years, national output quadrupled and continues to grow at a reported rate of over 8% per year. China is now seen as a major player in international relations; economic controls continue to be relaxed and yet political controls remain tight. Growing disparity between rich and poor within the country threatens the most important political agenda: economic growth with social stability.



1.1 Political Situation

Chairman Mao Zedong founded the People's Republic of China (also referred to as the "P.R.C.," or "China") in 1949. The country consists of 23 provinces, 5 autonomous regions, and 4 municipalities. The country is approximately the size of the United States of America (22,117 sq. km). It has the largest population of any country in the world: 1.3 Billion people. China is the largest of the three remaining Communist countries in the world, the other two being Cuba and Vietnam. Functionally speaking, China is controlled by a "Party-State system;" the Communist Party and the State Government have separate but highly-linked bureaucratic structures from the national level to the provincial, county, township, and village levels. At many levels the Party is the State and the State is the Party.

Founded in July 1921, the Communist Party of China (CPC) today has more than 67 million members. The ruling party of the People's Republic of China, the CPC holds a National Congress every five years to elect a Central Committee that in turn elects a Political Bureau led by a Standing Committee. Mr. Hu Jintao, the President of the country, is also the general secretary of the CPC Central Committee and lead member of the Standing Committee of the Political Bureau of the CPC Central Committee.

The President of China occupies the highest state office in the PRC. In combination with the Standing Committee of the National People's Congress (NPC), the President exercises the functions and powers of head of state. The current President is HU Jintao; current Vice-President is ZENG Qinghong.

The National People's Congress (NPC), the top legislative body in China, is selected through "democratic" elections (heavily influenced by the Party); it represents the people in exercising state power. All administrative, judicial, prosecutorial and military agencies and other state-level institutions are responsible to, and supervised by, the NPC. The NPC meets once a year for about two weeks.

The Premier of China chairs the State Council, which is the cabinet (or chief administrative body) of the PRC that includes the heads of all governmental agencies. The Premier is nominated and appointed by the President with NPC approval. The term of office of the State Council is five years. The State Council is composed of the Premier, the Vice-Premiers, the State Councillors, the Secretary-General, the Ministers in charge of ministries, the Ministers in charge of commissions, the Governor of the People's Bank of China, and the Auditor-General of the National Audit Office. The current premier is Wen Jiabao.

List of references:

<http://www.cia.gov/cia/publications/factbook/geos/ch.html>

Particularly <http://www.cia.gov/cia/publications/factbook/geos/ch.html#Govt>

<http://www.china.org.cn/english/features/China2004/106706.htm>

<http://www.worldbank.org.cn/English/content/China04-04.pdf>

1.2 Economic Review

In late 1978 the Chinese leadership began moving the economy from a sluggish, inefficient, Soviet-style centrally planned economy to a more market-oriented system. Whereas the system operates within a political framework of strict Communist control, the economic influence of non-state organizations and individual citizens has been steadily increasing. The authorities switched to a system of household and village responsibility in agriculture in place of the old collectivisation model increased the authority of local officials and plant managers in industry, permitted a wide variety of small-scale enterprises in services and light manufacturing, and opened the economy to increased foreign trade and investment.

Measured on a purchasing power parity (PPP) basis, China in 2003 stood as the second-largest economy in the world after the US, although in per capita terms the country is still poor. Agriculture and industry have posted major gains especially in coastal areas near Hong Kong, Fujian and Zhejiang Provinces (opposite Taiwan), and in Shanghai, where foreign investment has helped spur the output of both domestic and export goods.

The leadership, however, often has experienced - as a result of its hybrid system - the worst results of socialism (bureaucracy and lassitude) and of capitalism (growing income disparities and rising unemployment). China thus has periodically backtracked, retightening central controls at periodic intervals.

The government has struggled to (a) sustain adequate job growth for tens of millions of workers laid off from state-owned enterprises, migrants, and new entrants to the work force; (b) reduce corruption and other illegal rent-seeking economic activities; and (c) keep afloat the large state-owned enterprises, many of which had been shielded from competition by subsidies and lost the ability to pay full wages and pensions. From 80 to 120 million surplus rural workers are adrift between the villages and the cities, many subsisting on part-time and low-paying jobs. Popular dissatisfaction, changes in central policy, and loss of authority by rural cadres have weakened China's population control program, which is essential to maintaining long-term growth in living

standards. Beijing says it will intensify efforts to stimulate growth through spending on infrastructure - such as water supply and power grids - and poverty relief and through rural tax reform.

Accession to the World Trade Organization helps strengthen its ability to maintain strong growth rates, but concurrently puts additional pressure on the hybrid system of strong political controls and growing market influences. China has benefited from a huge expansion in computer internet use. Foreign investment remains a strong element in China's remarkable economic growth.

<http://www.worldbank.org.cn/English/Content/China10-03.pdf>

Particularly <http://www.cia.gov/cia/publications/factbook/geos/ch.html#Econ>

1.3 Trends

Transition and Reform :

Above all else, China should be viewed as a country in the process of transition and comprehensive reform (from a state-controlled to market-led economy). The government is extremely focused on the management of state assets – both in the financial market as well as those held in reforming State-owned Enterprises (SOEs). Significant measures have been enforced to cut down on the accesses of the State bureaucracy (punishing corruption and working toward corporate governance standards) while the private sector has been given more support and freedom (the first entrepreneurs were admitted to high-level decision-making positions in 2002). The non-governmental « civil society » sector is still very underdeveloped in China and seen with lingering suspicion unless couched within the framework of the national or local governments (such as the case of government-organized NGOs –or GONGOS).

Economic Growth and Ascension to the WTO:

The World Bank considers that there are three underlying tendencies in the Chinese economy – modernization, urbanization, and globalization. Despite SARS, which dented the economic performance of China in the second quarter of 2003, China ended 2003 with a GDP growth rate of 9.1%. Figures are forecasted to be similar by the end of 2004. China is a preferred destination for the relocation of global manufacturing facilities. Its strength as an export platform has contributed to incomes and jobs even while a reforming state-owned enterprise sector is laying off workers. China is seen as an engine of growth in the Asia-Pacific region, and an influence on prices and industries in the world-at-large.

After China officially joined the WTO in November 2001, it has had to prepare to comply with a set of phased mandates including those related to tariffs, trade barriers, production policies, pricing, and food security. WTO assension will touch all sectors, including agriculture, technology, and banking. Nicholas Lardy of the Brookings Institution estimated that a WTO agreement would lead to about a one-third decline in the output from several economic sectors, the main one being agriculture. It is likely, however, that employment would increase in light manufacturing, particularly textiles and clothing. Competition-led growth will be used to complement the traditional Chinese model of fostering growth by promoting exports, domestic consumption, and investment. Clearly, China hopes that the costs of adjustment to the new market rules will be short-lived and will be offset by long-term economic gains.

<WTO China Updates> <http://www.china.org.cn/english/21693.htm>

<What's This Organization (WTO): An Annotated Glossary of Terms and Concepts

About the World Trade Organization; V. China and the WTO> <http://www.fpif.org/wto/china.html>

Maintaining Broader Equity and Closing Disparities between East and West :

But the key processes of modernization, urbanization, and globalization bring about both the convergence and divergence of incomes. Between 1997-2000 there has been a marked decline

in farm incomes and by many measures, an increase in rural poverty. China has recently placed stronger policy emphasis on « growth with equity » that has become more evident under the new administration of Hu Jintao. Rural development is a special focus, as rural poverty is high, rural-urban income and non-income disparities continue to widen and the orderly management of out-migration from rural areas is seen as the key to managing the productivity and « livability » of China's growing urban areas. The phrase « all-around well-off society » was widely publicized to describe the ideal level of living that China hopes to achieve for its people-at-large.

Since the late 1990s, China has pursued a « Go West » campaign to bring infrastructural development to the underdeveloped regions of Western China (including the arid regions of the Northwest including Gansu and Xinjiang as well as the Southwest regions of Sichuan and Yunnan). The « Go West » campaign has largely consisted of highway, telecom, and R&D investments (including industrial parks).

In addition, a package of measures presented in February of 2004 prescribes a set of action in three areas : (1) increases in fiscal resources for rural areas, (2) access to finance, and (3) improvements in the provision of public goods and services. The Central Government budget for rural development will rise from 30 billion CNY to 150 billion CNY in the next year. This money will include direct subsidies to farmers, and training to rural migrant workers to improve their access to remunerative off-farm employment. A fee-to-tax reform piloted in 1999 has been rolled out to all provinces as of 2003.

Banking Sector Reform :

The Government of China has moved slowly in reforming the financial systems. In 1983, the People's Bank of China was formed as the central bank. Four state-owned banks dominate the banking sector, under the supervision of the central bank, creating a two-tier banking system. However despite restructuring, government interventions into the lending of the banking system remains a frequent occurrence and by 1993, the sector was in crisis – a number of unofficial financial institutions had failed and politically-motivated lending by the 4 state-owned banks produced non-performing loan (NPL) ratios of 25%, with inadequate loan loss coverage. New stricter controls were subsequently introduced, including closing unsanctioned financial institutions and imposing artificially low interest rate ceilings in an attempt to curb inflation.

Today China's financial system remains tightly regulated in several key areas, including competition, inter-bank lending and interest rates. However China is committed to opening its financial sector to international competition under the terms of the WTO agreement, and further substantial reforms of the sector appear likely to occur soon. At long last the government is ready to tackle the problem of weak banks, where the ability to make headway has depended on the progress of reforms in housing, social security, and state enterprise performance.

The picture is already changing rapidly, with new private banks and city commercial banks emerging as active players in the financial market, and further relaxation of interest rate controls recently announced. Over the next 5 years, the sector will also open up to foreign banks, increasing competition and bringing in new technologies and expertise. Foreign banks will be able to engage in consumer lending for the first time beginning sometime between 2006-2007.

Growth of IT & Telecoms :

The development of IT in China mirrored global trends in the late 1990s—the giddy high and the painful, sudden downturn of the dotcom bubble—but the Internet revolution marched on: China now claims some 70 million Internet users, with over 473,000 Websites. The three leading Chinese Internet portals Sina, Sohu and Netease all ranked among the best-performing stocks on the Nasdaq exchange for 2003. China now boasts over 260 million fixed phone line subscribers. But that figure, however large, was surpassed in 2003 by mobile subscribers, who numbered 270 million by November 2003, making China the largest mobile telephony market on earth. Mobile data services continue to grow in popularity, from the prosaic SMS—an estimated 180 billion SMS messages were sent in China in 2003—to the multimedia messaging (MMS) and picture messaging now possible with the latest camera-equipped handsets. 3G wireless services are widely expected to launch in China in 2005. Broadband is now available across

much of the country, and subscribers, already numbering more than 10 million, are expected to hit 70 million by 2007.¹

Paul Ulrich, expert on ICTs in the development sector, reports that in the early 1990s, the Chinese government decided to leverage communications technologies for more effective and transparent administration through e-government. Since then, various government ministries have added additional programs so that there are now thirteen huge information infrastructure projects underway. Overall, the government accounts for about one quarter of ICT investments and in 2004 is on track to becoming the sector's largest investor, with annual purchases of hardware and software amounting to several billion and nearly a billion U.S. dollars, respectively.

The Ministry of Information Industry (MII) has stated its intention to implement universal service obligations for the major carriers to provide coverage in high-cost, rural locales but, in the absence of a telecom law, has not yet done so. There is greater room for the provision of less costly universal access via public phone and Internet centres for shared usage in rural areas, but to date, efforts in establishing publicly supported user centres, apart from those in schools for students, have been experimental rather than nationwide. In the future, there may be scope for relaxing the ownership limits on foreign investment in western China to encourage overseas capital to invest in areas lacking in infrastructure.

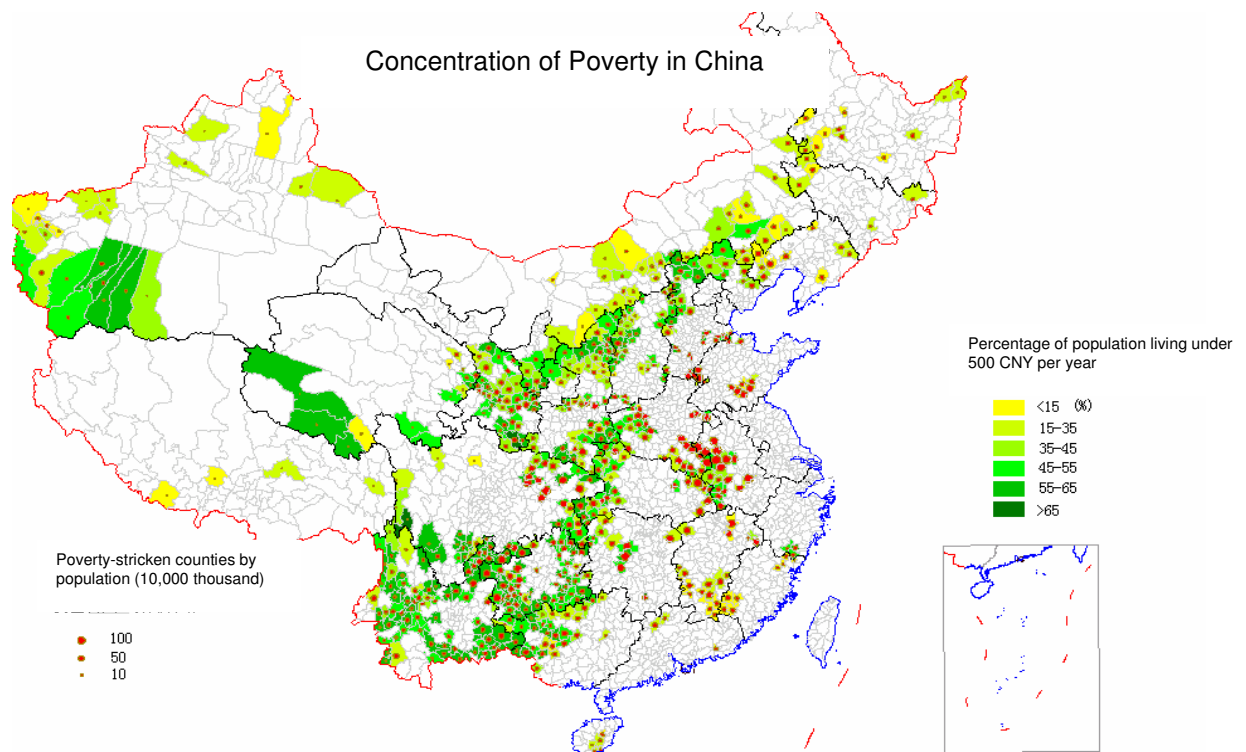
For the general population, the private sector has responded with tens of thousands of for-profit Internet cafes in under-developed areas. Their coverage, however, rarely extends below the county seats because virtually all rural villages and towns lack the purchasing power or customer base to support them. As incomes in major urban centres rise and personal ownership of PCs with Internet connections increase, these cafes also tend to lose their customers who no longer need to leave home or work to go online. Hence, as incomes rise in the east, there is a natural westward push of the cafes to ever-poorer inland areas. However, the government has had a love/hate relationship with privately run Internet centres where users can surf websites or chat rooms with some degree of anonymity. In mid-2002, the Ministry of Public Security used the pretext of safety violations and the fact that nearly half were not officially registered to shut down many of them, at least temporarily.

1.4 Poverty and Microfinance role in poverty alleviation

Overview of Poverty in China

According to the World Bank, there are currently more than 120 million people under the absolute poverty line of 1 USD per day in China. According to the more stringent standard of the Chinese Government there were 29 million people below the Chinese poverty line. Official statistics on Poverty are made public through the State Council's Leading Group Office for Poverty Reduction and Development. In the past year, the number of absolute people actually *increased* which breaks from the trend of extraordinary poverty reduction (from down from 250 million according to World Bank statistics in 1979). This may be due, in part to natural disasters that occurred in Anhui, Henan, Heilongjiang, and Shaanxi. Still, the poorest people continue to reside in the far West, while the population of poor is most highly concentrated in the middle corridor.

¹ Forecast of broadband subscribers by BDA, an IT and telecom consulting firm based in Beijing.



China's 8-7 National Poverty Reduction Program

Since the reforms of 1978, China has made remarkable achievements in reducing large-scale poverty. Nevertheless, rural poverty in China still exists while income inequalities are widening. The 1994 "8-7 Plan" (National Plan for Poverty Reduction) greatly contributed to both social and economic development of China's poor areas but had negligible impact on the actual number of poor. Chinese government's capacity for resource mobilization and institutional innovation, as well as continuous learning and experimentation permitted China to learn from its own and international experience, and to work toward improving the participation and effectiveness of a large number of projects at village and household levels. As a result, more effective poverty alleviation plans and programs were launched to benefit truly poor villages in non-poor counties excluded from previous efforts. Furthermore, China is now experimenting with basic health and social security schemes in rural areas to upgrade the quality of life of the poor.

New Century Rural Poverty Alleviation Plan

The Chinese government has launched a New Century Rural Poverty Alleviation Plan for the period between 2001-2010. In addition to poor counties, the plan targets 50,000 poor villages. This will bring help to poor villages that were left out because they are in counties that were not amongst those designated as « poor » in the 8-7 plan. The New Plan is complemented by policies to further reduce the obstacles to rural-urban migration and to strengthen education in rural areas. At the urging of international agencies, and in a clear break from formerly top-down policy standards, there is now a great emphasis on « participatory » development in all village projects.

Along this vein, policy discussions linked to the 10th National Peoples' Congress (NPC) Conference of early 2003 identified the following new directions for development in China: (1) promotion of *people-centred* development, in the sense that the objective of economic development will shift from a rather exclusive focus on CGP growth to the enhancement of quality of living; (2) increasing the role of the *private economy*, a clause now written into the revised Constitution; (3) raising the *incomes of rural residents* and agricultural production; as well as (4) the protection of *private property*.

Donors, government agencies, and the majority of practitioners see microfinance as fundamentally rooted in a “poverty reduction” objective. Additionally worth noting is the fact that most microfinance programs have been piloted in rural areas (where the perceived poverty problem is most acute) although more recent experiments and programs have emerged in urban areas where State-owned Enterprise reform has caused high numbers of lay-offs, unemployment, and poverty.

In China, the Central Bank¹ estimates that only 25% of rural households have access to formal credit². With a population of 1.3 billion, of which almost 900 million are rural, the need for pro-poor financial services is evident. Microfinance, begun as a small-scale experiment ten years ago, has grown into a multi-part sector, attracting attention from international aid agencies, government, state-run financial sector—and increasingly—the private sector. The microfinance sector in China has become very large, but with mixed results and major problems.

<State Council Leading Group for Poverty Reduction> <http://en.cpad.gov.cn/index.html>

credit for the map should go to Mr. Wang Yingjie. Find the reference

<China’s 8-7 National Poverty Reduction Program>

<http://www.worldbank.org/wbi/reducingpoverty/case-China-8-7PovertyReduction.html>

<First Session of 10th NPC to Hold Elections on March 15, 16 and 17 >

<http://www.10thnpc.org.cn/english/features/54360.htm>

¹ The Central Bank is the People’s Bank of China.

² Statistic drawn from report on Rural Financial Sector by Dr. Han Jun, Development Research Center of the State Council.

2. Microfinance sector in China

2.1 Introduction

In total, more than 10 million poor families receive some sort of microfinance in China, through a set of nearly 20,000 microfinance programs, employing thousands of “barefoot bankers” (loan officers, accountants, and branch managers) throughout the country. The set of people concerned with microfinance in China (from poor clients, to microfinance staff, to policy makers) is what we refer to in this paper as the **Microfinance Community**.

In a recent speech, Vice-Governor of the People’s Bank of China, Ms. WU Xiaoling, classified the development of microfinance into three phases.

- 1) In the first phase, **non-governmental groups** pioneered microfinance in the early 1990’s; most were funded by foreign sources.
- 2) By the late-90’s microfinance had gained popularity among **Chinese government** agencies and was rolled out throughout most of the country.
- 3) Since the beginning of this century, 2001, the predominant model of microfinance (from the Central Bank’s perspective) has become that implemented by formal financial institutions. As a prime example, the so-called **Rural Credit Cooperatives**, a pre-existing network of 38,000 non-bank financial institutions throughout the countryside of China.

Because microfinance has been slow to develop in China (due to a number of severe financial, political, and social constraints that will be explained below), the term “microfinance with Chinese characteristics” has come to connote a stifled sector that awaits sector-wide policy reform and enhancement of individual organisations.

China’s microfinance sector can best be described as one with a high quantity of low quality programs and a low quantity of high quality programs. Key operating constraints have included the cap on interest rates, the culture of the welfare state (wherein poor farmers expect to be provided relief by the government), a government that is slow to adopt models from outside influences, a weak formal banking sector and administrative/political barriers to enter it, governance and ownership ambiguity at the regional level for non- and banking financial institutions. To illustrate this dynamic, it is useful to compare the scope and size of the different existing models of microfinance (consistent with the three phases of development.)

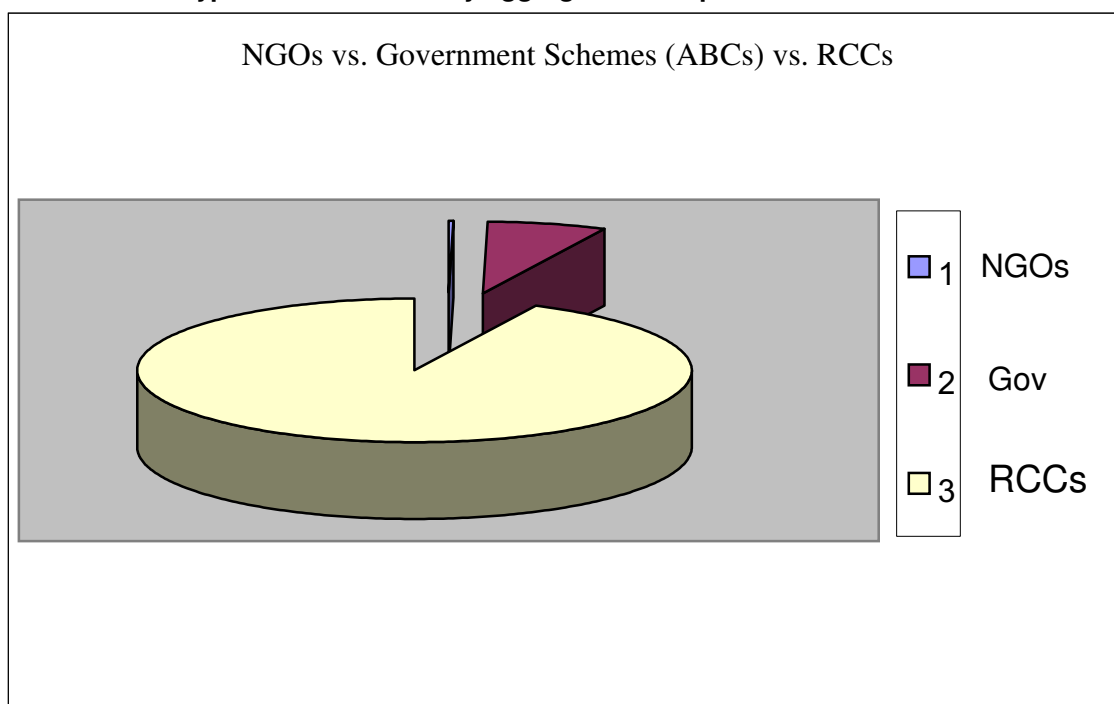
1) Firstly, 260 **non-governmental programs** (sponsored by various international aid agencies) serve tens of thousands of clients with a total of 30 million USD across the country. However, these programs suffer due to lack of operating capital, insufficient staff capacity, and an unfriendly policy environment. Most programs rely on sponsorship from private donors, international NGOs, bi- and multi-lateral donors such as AusAID and UNDP. These microfinance programs operate as county-level “projects” or experiments and are often terminated once donor terms come to an end. A select number of these programs have received special permission from the government to conduct lending at rates above the interest cap; other groups ignore interest rate ceilings and hope that their small size will allow them to operate below the radar screen without government interference. None of such programs has reached financial sustainability, and only a handful could boast to have covered some their operational costs.

2) Meanwhile, **governmental microfinance schemes** serve hundreds of thousands of clients and operate with 1 billion USD of fiscal funding. Yet as other cases around the world have shown, government programs get caught in the bureaucratic mode of welfare delivery; the impact of these government programs has proven either insignificant or detrimental to the poor families. By delivering “relief loans” with low interest rates and little incentive to repay, it

continues to trap people in a cycle of welfare dependence while many go unserved. Instances of fund misallocation and leakage are abundant. Certain authorities have recognized that government programs would best be phased out and clients redirected toward non-governmental professional microfinance schemes.

3) Lastly, and more promising, the **Rural Credit Cooperative** network of state-owned rural banks has most recently rolled out a massive 13 billion USD throughout more than 15,000 of its nation-wide branches and purports to be reaching millions of poor families with micro-credit. However, the banks are mired in financial difficulties including non-performing loans, bad debt, lack of governance, and ownership ambiguity. These programs would also best look to the NGO sector for “best practice” in pro-poor operations, while drawing upon their formal bank status to push towards operational and financial self-sufficiency.

Breakdown of types of institutions by aggregated loan portfolio



Description of Prospectives for each type of MFI in China

Type	Numbers	Potential Outreach and	Poverty Focus	Future Assessment	Org sustainability
RCC	BIG	Huge	No; or if Yes, then at odds with mandate to commercialize	Main focus of national level reform, key instrument in rural finance	Inconceivable that Central Bank would let collapse, MF is part of greater organizational sustainability
Gov	MED	Very large, but short-lived	Yes, very, but funneling money through ABC	Subsidized credit is not sustainable, particularly through the apparatus set up here	ABC has requested to be absolved of the organizational responsibility. Most likely that the org structure will change
NGO	SMALL	Almost insignificant so far	Yes	Need to be strengthened	Dependent on local management, sufficient funds, and policy

2.2 Donors' role

Since the early 1990's, International donors have worked with domestic institutions (and International NGOs) to initiate and sustain the microfinance movement in China. These donors are emblematic of the first phase of microfinance development, with a few exceptions. There are more than 200 donor-funded microfinance pilots across the western and central parts of China. Unfortunately, "best practice" microfinance has largely been donor-driven and less community-based, nor localized appropriately. The important donors currently active in the sector are:

United Nations Population Fund – UNFPA.	Active in China since the late 1980's, UNFPA aims at improving the economic status of women through the provision of microcredit. Working initially with the FAO and the China Women's Federation, and more recently with the RCCs, UNFPA has granted USD15 million to the sector.
United Nations Development Programme – UNDP.	Working with its counterpart agency, the China International Centre for Economic and Technical Exchange (CICETE), UNDP has supported microfinance in 48 counties since 1994. They have more recently provided intensive support to 4 of the most promising institutions, and are involved with the planning and formation of the China Association for Microfinance (CAM).
United Nations Children's Fund – UNICEF.	Active in microfinance in China since 1996, they are currently considering the optimum means of channelling funds to women – either through project offices, RCCs, or village level revolving funds.
World Bank.	Microfinance has been part of the 3 poverty alleviation programmes financed by the bank, and is likely to be included in the 4th programme currently being negotiated. The World Bank works with the Government of China in the area of financial regulation and RCC reform.
Australian Agency for International Development – AusAID.	Involved in both urban and rural microfinance delivery, it is notable for its funding of the Qinghai Community Development Project, working with the Agricultural Bank of China. It has also more recently become involved with credit delivery through an RCC in Chongqing.
Canadian International Development Agency – CIDA.	Active from 1996, CIDA piloted savings and credit cooperatives in Xinjiang. However policy constraints affected the ability to locate an institutional home for the cooperative when funding ended in 2003.
Asian Development Bank.	Role restricted to policy advice and sponsoring workshops on financial sector reform.
Department for International Development (DFID) – UK government	Involved only insofar as integrated rural development projects comprise rural financing schemes.
GTZ/kfw – German bi-lateral donor agencies	Involved in technical assistance to RCCs as well as more recent plans to invest in a formerly UNDP-sponsored microfinance scheme in Inner Mongolia
International Fund for Agriculture Development – IFAD.	Working initially through the Ministry of Agriculture and more recently with the RCCs, IFAD provides soft loans for on-lending to small farmers. IFAD is also supporting the ongoing RCC reform process.
European Community	The EC has pledged money to one microfinance program in Guizhou through the China Foundation for Poverty Alleviation. This grant was obtained through the Mercy Corps Scotland office in Edinburgh

Note : USAID is not active in China except for the Tibet Autonomous Region. There, no US-funded microfinance operations exist as of yet.

In the main, donor funded projects have been to NGO's. Two distinct exceptions are the Qinghai Community Development Project, funded by AusAID, which channels loans through the ABC, and the Desjardins Microfinance Project in Luanping, implemented by RCCs. Here is an example of how these programs compare. *Could consolidate this data into the chart above.*

Table: Major on-going microfinance schemes in China, categorized by Donor

	Loan Portfolio	Counties	Active Clients	Implementing Agents
FPC	1,187,624	3	12,700	GONGO
UNDP	8,200,000	47	67,000	NGO or PMO
UNICEF	4,337,349	24	35,900	PMO
World Bank	890,003	2	12,599	NGO
AusAID Qinghai	1,253,518	3	18,325	ABC
Desjardins DID	739,317	1	7,200	RCCs

Table taken from 'Rural financial markets in China' Findlay, Watson, Enjiang and Gang, Asia Pacific Press 2003, p125

2.2 International NGOs role

Microfinance activity by international NGOs started in China in the early to mid 1990's. Most of the programmes were small scale, targeted the poor, followed the Grameen Bank model, and were undertaken in collaboration with international NGOs and international donors. Some were taken up by special offices within Government-organised NGOs (GONGOs). This section provides a look at some of the international NGOs that have established programs in China (often through local GONGOs such as CASS or the WF). Since their inception, they have achieved a mixed record of success: a few claim to have reached or be nearing local operational sustainability; some relied on one-off grants from donors and were unable to continue once these funds were used; some were victim of regulatory restrictions; some failed outright. Here is a list that summarizes the activity of some of these groups.

Grameen Trust & Grameen Foundation USA.	This Bangladesh-based and USA-based combination of Grameen-family institutions have funded the Funding the Poor Cooperative, a leading microfinance initiative currently active in four counties in Hebei and Henan. Funding the Poor Cooperative, for example, has a loan Portfolio of 1,187,624 CNY, 12,700 active clients ¹ , and is considered a GONGO under the Rural Development Institute (RDI) of the China Academy of Social Sciences.
World Vision.	Operating initially in the southwest of China and subsequently expanding to urban areas of Kunming, World Vision has combined microfinance with skills training in integrated rural development programmes.
Oxfam Hong Kong.	Similar to World Vision, Oxfam Hong Kong has included microfinance within integrated rural development programmes, principally in the south west of China.
Opportunity International.	OI has recently started an operation in China, in Anhui, in a programme, which guarantees loans from the Hefei City Bank to small entrepreneurs.
Mercy Corps International.	This US based NGO is a major partner and technical consultant to China Poverty Alleviation Foundation which has a growing portfolio of microfinance projects in 4 provinces. Mercy Corps also operates a microfinance program in Jilin Province through the local Women's Federation. This program is part of their "North Korea Region" portfolio (Poverty Alleviation in the Tumen River Area – or PATRA).
Heifer Project International.	From 1996 to 2003, HPI has provided more than 4 million livestock to farmers, across 12 provinces. 'Interest' on the livestock loan is paid to neighbouring households, through the provision of offspring.
Trickle up Program and International Crane Foundation.	Working through local government partners, these two NGOs work together to provide loan funds to groups of farmers in wetland areas of Guizhou. This program has been concluded.
Opportunity International.	In an interesting configuration, OI has chosen to start its microfinance operations in the urban areas of Hefei, capital of Anhui Province. OI China acts as a guarantee company, linking clients with a local bank.
Hope International.	Hope operates a small program in Hebei province. It is a Christian charity.
Salvation Army Hong Kong.	SA led a small program in Yunnan province. It is a Christian charity; it has since ceased its operations in micro-credit.
CARE	CARE operates a small micro-credit scheme in the Southwest regions of China. These schemes are part of a larger integrated rural development program including health, sanitation, and education.

¹ Data taken from taken from 'Rural financial markets in China' Findlay, Watson, Enjiang and Gang, Asia Pacific Press 2003, p125

Development of Rural Sichuan (DORS)	A British woman established this British Charity as an integrated rural development program. It operates in a single poor county in Sichuan.
Plan China	Formerly known as "Plan International", Plan is a child-centred development organisation that operates microfinance in China through the local Shaanxi Women's Federation as part of a "livelihoods" approach to enhancing the lives of children and their families.
Tibet Poverty Alleviation Fund	TPAF is an American NGO that focuses on microfinance for Tibetan herders, villagers, and artisans. It operates in both rural and peri-urban areas of districts outside and within Lhasa.

Note : ACCION, WWB, and FINCA are not active in China.

2.4 Government and Government agencies' role

After its initial scepticism that micro-finance models were appropriate for China, the government in 1997 decided to adopt a Grameen style approach to disbursing loans as part of its longstanding programme of subsidized loans for poverty alleviation administered by the Poverty Alleviation Office (PAO) through the Agricultural Bank of China (ABC). There followed a period of rapid expansion, quickly dominating the NGO/GONGO pilot initiatives that had started a few years earlier.

In large part, the best the international programs described above could have hoped for was to serve as a positive model for government programs or formal financial institutions. Because of the State-centric welfare environment, However, the political and cultural environment was not right ; and like many government microfinance schemes around the world, the government lending programs have largely failed. Even though it has inadequate human or financial resources to conduct proper lending, the government continues to exert tight controls over the financial sector through the People's Bank of China, the China Banking Regulatory Commission, and the Ministry of Commerce and Ministry of Finance.

Tight government control of the financial sector may best be understood in terms of enduring communist ideology. Usury was one of the evils, along with exploitation by landlords and capitalists, which the Communist Party set out to eliminate. Officials schooled in Party history – and let us not forget that Party documents still routinely, if speciously, contrast the peasants' situation before and since Liberation – do not easily accept the startling claim that it benefits the poor to be offered high-interest loans. Officials are more inclined to believe that the poor need special assistance and subsidies, rather than additional burdens.

This welfare mentality is often accompanied by a perception of the rural poor as 'backward' or of 'low quality': people who need 'lifting out of poverty' rather than people who, if they had a ladder, could climb out by themselves. Given this attitude, it becomes natural to see the challenge of poverty in terms of limited resources – land is too scarce, the state is cash-strapped – rather than in terms of policy constraints on the productive capacity of the capable poor.

China's ongoing anti-poverty drive is certainly in earnest, and has prompted some useful reflection and debate, but it has so far largely reflected a welfare mentality and approach. To many international observers, it is increasingly apparent that economic reform in policy areas such as fiscal decentralisation has proved regressive, hitting the poorest hardest. Yet the government's war on poverty has largely been conducted through the injection of funds into regional poverty alleviation 'projects'. This is not a policy response so much as a remedial, compensatory mechanism. 'Poverty alleviation loans' have figured prominently in these government projects, – and have, latterly, often been presented as microfinance components. But, true to the welfare orientation of the programmes, these have always been offered at low interest (typically 2-3%).

Without adequate training, incentives, or oversight, the government programme was poorly implemented and suffered poor performance. Attempts to utilise a cooperative structure for the administration of the programme were soon reversed, with the loans returning to direct

administration by the ABC. According to Ms. Su Guoxia at the head office of the national PAO, her agency now pledges to cease its direct involvement in microfinance implementation and instead to play a facilitating role.

Local Poverty Alleviation Offices at the provincial level, however, continue to channel funds towards microfinance. These programs have had mixed, if not limited success.

2.5 Private Sector's role

2.5.1 International Foundations or Private Sector Donors / Investors

The number of private foundations active in China is quite limited, and the number of private sector donors or investors even fewer. This is largely reflective of the limited scope for civil society and the dominance of the government and State-centric approach to poverty reduction. There is less perceived need for private charity or civil society. However, the Ford Foundation is a notable exception in terms of its pioneering work, and other private foundations have begun to get involved, particularly as the country opens up. Several notable individuals have been pillars of support and charismatic personalities in the news.

Meanwhile, a new wave of Corporate Social Responsibility has begun to sweep through China, first through the multinational corporations that hope to win favor with their local government counterparts. CSR has yet to take hold among many Chinese corporations, but this shall be inevitable as the private sector develops further in China.

The Ford Foundation.	Involved in the early stages of microfinance development in China working with CASS in the formation of FPC. They have also funded research on three different models of integrating microfinance services into RCC operations and have been actively involved with setting up the Microfinance Training Centre.
Citigroup Foundation	A recent addition to the mix of international donor community to microfinance. In China, Citigroup has coupled with Grameen Foundation USA to administer 1.3 million dollars worth of loan capital and capacity building funding to the sector. It has also worked to fund the new China Association for Microfinance and the Citigroup Microfinance Training Centre.
Kadoorie Foundation Hong Kong	This small foundation has invested in microfinance for the US NGO operating in the Tibet Autonomous Region called Tibet Poverty Alleviation Fund.
Nike Corporation	Recently, at the invitation of Mercy Corps International, has donated loan capital to China Foundation for Poverty Alleviation in Fujian province where the corporation has its shoe factories
Motorola	Recently, at the invitation of Mercy Corps International, has donated loan capital to China Foundation for Poverty Alleviation in Fujian province
Freshfields	Recently, at the invitation of Mercy Corps International, has donated loan capital to China Foundation for Poverty Alleviation in Fujian province

The International Finance Corporation (the private sector investment arm of the World Bank Group) is not yet active in microfinance in China but has expressed interest.

International Investors such as BlueOrchard or Oikocredit have not yet entered the market, but have expressed interest and are being actively pursued by key individuals.

2.5.1 Local Banks, Investment funds or Private Investors

The number of local banks, investment funds, or private investors that have investment directly in microfinance is even more limited than their International counterparts listed above

Mr. Yang Lin	A private Taiwanese tycoon, Mr. Yang Lin has been a long-time friend and supporter of the microfinance movement in China. He has channelled his support through the CASS RDI Funding the Poor Cooperative initiative.
Mr. Mao Yushi	A luminary in the economic spheres of Beijing, particularly in light of his chairmanship of the

	progressive Unirule Institute of Economics at Peking University, Mr. Mao Yushi has become famous for his private microfinance initiative in the village of Shuilongtou of Shaanxi Province. He collects private investments from his overseas friends and channels them into a single village's microfinance scheme.
Fuping Foundation	A new foundation spearheaded by Mr. Mao Yushi and managed by a local manager will likely get involved in microfinance investment soon
Huaxia Bank	This private bank, most active in the Southeast region of China, has donated money to a microfinance scheme run by the China Foundation for Poverty Alleviation

However, there are a number of schemes which serve to link disadvantaged clients with local city commercial banks. These banks should be noted

Tianjin City Commercial Bank	This bank offers loan capital to beneficiaries who are pre-selected and guaranteed by the Tianjin Women's Federation
Jilin City Commercial Bank	In a lending scheme promoted by the International Labour Organisation (ILO) and funded by a Japanese source, the Jilin City Commercial bank uses the donor's Credit Guarantee Fund to offer loans to laid-off workers screened and trained by the local Ministry of Labour and Social Security.

PlaNNet Finance is currently in discussion with 2nd tier stock-holding commercial banks such as Everbright Bank about what kinds of microfinance could be taken up in urban regions of China.

3. PlaNet Finance's Vision for the sector in China

3.1 Major Trends

The current trends of the microfinance sector will be shaped by the economic, political, and social factors described above in this report. The major trend among donors and policy makers is to concentrate efforts on "financial institutions" that do microfinance, particularly Rural Credit Cooperatives (RCCs). This means that there will be more resource allocation to the **reform of the RCCs**, the fostering of working or "best practice" models, and a **push toward profitability**. This trend has been set by agencies such as IFAD, Ford Foundation, CGAP, and ADB.

Meanwhile, the major trend amongst the NGO and quasi-NGO sector of microfinance is to gain political/Central Bank recognition to operate, not as financial institutions, but as legal entities in civil society. These programs will not take savings, but will look to adopt means of **self-regulation, benchmarking, better poverty targeting, apex funding**, and potential future consolidation.

One major trend is the overall **liberalisation** of the financial sector, for example, **interest rates**. In October 2004, the Central Bank raised the base line interest rate for the first time in a decade. The forces of capital markets, demands of foreign investors, and stipulations of the WTO will mean that banking and banking regulation must be carried out according to market principles. This will open China's microfinance sector up to the possibilities of following international "best practice" of charging interest rates and the level the market can bear, allowing for healthy competition between institutions, and helping the microfinance sector commercialise.

Commercialisation of the microfinance sector can happen in a number of ways. On the one hand, rural banks (namely RCCs) can take on more and more microfinance activities while themselves commercialising. Another way is that commercial banks in urban areas can come downstream to serve poor clients. However, an important movement will also take place as China engages in **strengthening civil society**; community organisations will begin to gain clout and the NGO—particularly the Chinese NGO—will begin to have more staying power, and possibly provide the proper infrastructure for integrated and/or credit *plus* programs.

3.2 Microfinance sector's opportunities

PlaNet Finance China sees that the big opportunity lies in our ability to **leverage the experience and success of the NGO-microfinance agencies to promote good practice microfinance among pre-existing financial institutions including RCCs and City Commercial Banks**. As each province differs vastly, the opportunity lies in approaching each province with a unique package of institutional reform and capacity building tools.

PlaNet Finance China chooses to take the optimists view. Ten years from now, financial markets will have liberalised and opened substantially. Foreign and domestic banks will increase for ever-narrowing bands of customer bases. Ten years from now, China's NGO microfinance agencies will have formed a strong network, which will have in turn become an apex fund, which will eventually have consolidated into a large, unified microfinance institution dedicated to serving the poor. There will be only one if not two major national microfinance providers. There will be an average of one microfinance institution to cover each province.

Ten years from now, a few other local microfinance banks will have been set up by international actors, and will undergo a process of tedious localisation. Meanwhile, commercial banks in China will have continued to improve and a number of investor-led initiatives will help these banks move into the markets of informal economy entrepreneurs, issuing SME, microenterprise, and individual loans. Insurance products will become more ubiquitous and the microfinance sector will begin to experiment. Commercial and rural banks will start to use their savings collections (liabilities) to leverage more return on assets. Savings will be much more efficiently directed and worked through the system.

Ten years from now, several successful experiments with RCC microfinance will have been deemed successful, and the RCCs (by then having been consolidated into only 6,000 branches) will be operating microfinance in slight competition with the NGOs' outreach. Because the RCC network will be so broad, NGOs will continue to play a role by taking more risk with product innovation and leading the way for local RCCs.

A high level of competition should be allowed so that the natural process of survival-of-the-fittest can persist.