NO. 98/2

THE DYNAMICS AND IMPACT OF THE DEVELOPMENT OF RURAL COOPERATIVE FUNDS (RCFs) IN CHINA

Du Zhixiong

March 1998
The Working Paper series provides a means for circulating preliminary research results by members of, or visitors associated with, the Chinese Economies Research Centre. To facilitate prompt distribution, papers are screened but not formally refereed.

About the author

Du Zhixiong is at the

Rural Development Research Institute
Chinese Academy of Social Sciences
BEIJING
P R of China

Copies of Working Papers are available from:

Chinese Economies Research Centre
The University of Adelaide
ADELAIDE SA 5005
Australia

phone 61 8 8303 4460
fax 61 8 8303 4394
email jholmes@economics.adelaide.edu.au
Contents

1. Introduction

2. Origin and Background of the RCFs

3. Evolution and Its Policy Environment

4. Features and Its Business Operation
   4.1 Feature of RCFs
   4.2 Business Operation

5. Contribution and Existing Problems
   5.1 Contribution
   5.2 The Existing Problems

6. Prospects of RCFs

7. Conclusion

Bibliography
1. **Introduction**

Chinese Rural Cooperative Funds (RCFs) were developed to meet the needs of rural economic development during the extensive reform of the rural economy system in the mid 1980s. From their trial establishment in 1984, and since 1991 in particular, RCFs have expanded rapidly in terms of portfolio and extent of business, and become an important component of the Chinese rural capital market.

It is known that financial activities are severely restricted in rural China. The financial institutions, the Agricultural Bank of China (ABC), the Rural Credit Cooperative (RCC) and the recently developed Agricultural Development Bank of China (ADB) are the only ones to be legitimised to access to rural financial activity, although traditional civilian credit has existed in rural China for thousands of years. To some extent, establishment of the RCFs had challenged the conventional rural financial system notwithstanding the fact that the extent of fund raising and the target and availability of loans by RCFs, and so on, were rigidly constrained in the beginning. In practice, more than 10 years’ operation of RCFs has positively and profoundly impacted on the rural capital market and on the reform of the rural financial system though it still faces many development problems. These resulted in RCFs being frequently blamed with disordering the financial market, the rural financial market in particular, during the period of rectifying the macro-finance.

This paper attempts a brief review of RCFs. There are six sections. Section 2 and section 3 will briefly review the origin and background of RCFs as well as their evolution and policy environment; section 4 will analyse the features and business operation of RCFs; section 5 will assess their contribution to rural economic development and discuss the problems existing in the practice of RCFs; and finally, sections 6 and 7 will point out the possible prospects of RCFs and summarise the conclusion of this paper.
2. Origin and Background of the RCFs

RCFs appeared in the mid 1980s as a consequence of the particular historical background of the rural economic institutional reform and the rural economic development at that time.

2.1 Rapid erosion of original rural collective funds and an urgent need to enhance management of the rural collective fund

In the beginning of the 1980s, the agricultural household responsibility system (HRS) became nationwide within less than 5 years, while the traditional people’s commune (PC) system was finally broken and quickly replaced with the HRS. Along with the sudden demise of the PC, the original and newly accumulated rural collective funds were vastly eroded because the original collective management system and methods did not continue to work well and, meanwhile, a new management system had not yet been established. It was reported that during the process of implementing agricultural HRS the loss of the original rural collective capital totalled 20 billion yuan RMB. Of the remaining 80 billion yuan RMB, there was only about 10 billion yuan RMB available and practicable. Another estimation pointed out that there was retained around 82 billion yuan RMB at the commune, production brigade, and production team levels by the end of 1985, of which 25 billion yuan RMB was floating capital. In addition, collective withdrawal from land tenure contract etc. reached 10 billion yuan RMB each year. Up to 1987 nearly 2 billion yuan RMB in the whole nation was misappropriated, and the original collective accumulation decreased by 25 percent. Furthermore, there was a vast amount of collective capital whose return was delayed by both inside and outside collective members with no compensation or any penalty for default. The debt owed to the collective totalled 29 billion yuan RMB, 40.8 percent more than that in 1980 (The Ministry of Agriculture, 1989). It became an urgent task to reorganise the management of collective assets by exploring new management measures.

2.2 Increasing demands on funds by the rural economy’s rapid growth in the
beginning of the 1980s

As reform on the rural economy system was gradually deepened, demands on funds in rural areas to develop agricultural production, to adjust rural production patterns, and to satisfy development of township and village enterprises (TVEs) sharply increased. In Heilongjiang Province, for instance, agricultural production loans from the rural formal banking system matched only one third of the needs of agricultural development requirements. Agricultural production capital input increased nearly 5.5 billion yuan RMB each year in the whole province (Zhang, 1989). This suggested that the enormous gap between demand and supply of funds should be well met by new sources other than the sole channel of the state-run bank.

2.3 The imperfect rural financial system and its failure to finance the rural economy

For a long time, the operation of the Chinese rural financial system featured planning, monopoly and obturation in no accord with the needs of development of the rural merchandise economy. Because of the longer agricultural production cycle and its lower comparative profit, rural formal financial institutions at grassroots levels were reluctant to provide agriculture production with sufficient loans. On the one hand the benefits seemed limited and, on the other hand, in the mid 1980s rural secondary and tertiary industry were developing with correspondingly vast demands on capital, and rural formal financial institutions could not match these demands because of limitation of scale and plan of their loans. Besides the consideration of their own benefits, the bureaucracy of transactions and low level of staff enthusiasm in the rural formal financial institution at grassroots further alienated farmers who probably needed only minimal capital, seasonally. Given this situation, rural civilian credit prevailed. In Sichuan Province, for example, the Provincial Statistics Bureau estimated, on a sample investigation of 5,500 rural households in 55 counties of the province, that the whole provincial sum of civilian credit in 1988 reached 3.5 billion yuan RMB, being 39.84 yuan RMB
of civilian credit per capita. In the same year, only 10.04 yuan RMB of loans per capita were from formal rural financial institutions. The same investigation further suggested that civilian credit increased at an annual growth rate of 17.35 percent between 1986-88, while loans from the formal financial institution increased only at 4.69 percent (Shen, 1989). The great gap between capital demand and supply in rural areas in the middle of the 1980s even resulted in a recurrence of usury prevailing in some specific regions (Xu, et al., 1994).

3. Evolution and Policy Environment

The development of RCFs has, so far, experienced three stages, namely, creation (1984-86), experimentation (1987-91), and extension and stable development (1992-). Accordingly, government policies towards RCFs also experienced a gradual evolution along with its three development stages.

In the first stage, as mentioned in section 2, the erosion of the original rural collective funds resulting from the sudden breakdown of the PC system and the implementing of HRS brought RCFs to the central government’s attention. At the requirement of State Council, in 1985 and 1986, the liquidation of the original collective assets was launched in most provinces. After liquidation, local governments began to explore new measures of managing collective assets. It was in this situation that financial activities such as converting the collective funds defaulted on by its members into a ‘loan’ and financing the newly liquidated collective funds within the same collective appeared. And in some provinces, RCFs were formally established under the guidance of the Agricultural Monitoring Station at township level (Nongye Jingying Guanli Zhan) and of the Agriculture Bureau at county level.

In light of this development, RCFs were often voluntarily instigated by local authorities, and the financial activities were operated without approval from
the central government or the central and local financial administrative departments. In some regions, it was even restricted by local governments.

There were almost no statistics or other information on RCFs in this first stage. They operated with no standard models to imitate and often no existing regulations to abide by.

The central government for the first time definitely confirmed its name and permitted the experiment in the second stage of RCFs. In 1986, the Chinese Communist Party Centre Committee (CCPCC) and State Council jointly issued a document, Opinions on Liquidating Rural Collective Assets (Guanyu Qingli Nongcun Jiti Chaichan De Yijian). The document noted that, by centralising idle and unused collectives’ funds according to the principle of voluntariness, some collective economic organisations (CEOs) in recent years had adopted some new methods of fund utilization with repayments and compensations to support agricultural and non-agricultural productive activities within the same township or village. The document further pointed out that the central government encouraged and permitted the experimentation and demonstration of these new methods of collective fund utilization as long as they were operated within the membership on the principle of reciprocity, without deposits raised from and loans provided to the client outside the CEOs. In the same year, ABC also issued a document requiring its local branch banks and affiliation not to intervene in the CEOs’ financing activities and to provide them with business guidance by acting between branch ABC, RCC and the CEOs. The ABC’s document further added a new restraint of no loans to be defaulted by the CEOs, while repeating the emphasis of no deposits raised from and no loans provided to clients other than that in the same CEO. This approval by the central government and financial departments accelerated greatly the extension of these methods.

In its early stage, there were various names used to label the similar rural financial activities mentioned above and RCF was formally used probably in 1987. In this year, the Political Bureau of the CCPCC issued a No. 5
Document, Guidance to Deepen the Rural Reform (Tonghui Banzhu Gaiyao). In this, RCFs were first used in an official document to refer to the CEO’s financial activity. Furthermore, RCFs were positively confirmed and evaluated. The document pointed out that various rural fund financing sources need to be developed. In recent years, ... some cooperative economic organisation at township or village level have established RCFs; ... accommodating the various requirements of the developing market economy, the RCFs’ financing activities are helpful to centralise a COMMUNE’S idle capital in rural areas and to relieve the scarcity of capital supply when the ABC and RCC were the sole suppliers of capital, and their further development needs to be supported.

In 1990 and 1991, the CCPCC twice repeated its support of the development of the RCFs and they were recognised to be helpful in managing and utilising the original collective funds while not aiming at profit-generation.

In accordance with the central government’s supportive policies to RCFs, as a part of the rural reforms, central administrative department began some experiments successively in Shangzhi County of Heilongjian Province, Yutian County of Hebei Province, Pingdu County of Shandong Province, Yulin County of Guangxi Autonomous Region and Guanhan County of Sichuan Province, whereby rural reform experimentation areas were established by the Agriculture Ministry, to develop the standardisation of RCFs and gradually to shape their new institutional frame.

In view of its important role in enhancing the management of the original collective funds and in financing agricultural production, central government policy in this stage gave RCFs general support. And it is due to the government’s support that RCFs developed in diverse types and more regions.

By 1991, on statistics, there were 18,000 townships and 120,000 villages to finance the collective fund, accounting for 33 percent of all townships, and 16 percent of all villages, respectively; the funds raised by RCFs at the end of the
same year reached 9.99 billion yuan RMB, 4.33 billion yuan RMB more than that in 1986; the annual accumulative fund lending was 10.17 billion yuan RMB, 3.46 billion yuan RMB more than in 1989. In Jiangsu (1.68 billion yuan RMB), Sichuan (1.64 billion yuan RMB) and Hebei (1.03 billion yuan RMB) the funds raised by RCFs by the end of that year exceeded 1 billion yuan RMB; and there were, in total, three provinces where the annual RCFs’ accumulative funds lending exceeded 1 billion yuan RMB: 2.39 billion yuan RMB in Sichuan, 1.47 billion yuan RMB in Jiangsu and 1.09 billion yuan RMB in Shandong. In addition, in Liaoning, Jilin, Heilongjian, Zhejiang and Guangdong, by the end of the year, the funds raised and the annual accumulative lending by RCFs exceeded 300 million (Hong, 1992).

In signing the document of Notification on Some Issues of Enhancing the Standardizational and Institutional Construction of RCFs (Guanyu Jiaqian Nongcun Hezuo Jijinghui Guifanhua Zhiduhua Jianshe Ruogan Wenti De Tongzhi), issued by the Ministry of Agriculture in December, 1991, the development of RCFs entered its third stage. In the document, by summarising the development experiences from various regions, the character, essential aim, fund raising, loan target, profit distribution, organisation, regulation and business operation of RCFs were defined. The document also required various regions to work out the detailed management measures and bye-laws on the basis of local specific conditions.

In August, 1992, to further strengthen the management of RCFs, the Ministry of Agriculture set up the Administrative Office of Rural RCFs to be in charge of guiding, managing, monitoring, coordinating and serving the development of RCFs. Since then, the office has done much work to normalise the behaviour of RCFs, helping them to establish the necessary regulations, guiding and monitoring them to operate harmoniously with the relevant laws, regulations and policies, helping to link RCFs with the relevant government department and other involved institutions in order to protect the legal rights and benefits of RCFs, training their staff, and so on.
In 1992, the finance portfolio of RCFs sharply increased although their number was slightly less than in 1991. By the end of 1992, 17,400 townships and 112,500 villages, accounting for 36.7 percent of all townships and 15.4 percent of all villages, respectively, had established RCFs whilst the raised funds totalled 16.49 billion yuan RMB with the annual cumulative fund lending being 17.85 billion yuan RMB. Compared with 1991, annual growth rates were 65 percent and 75.5 percent, respectively. In Sichuan and Jiangsu Provinces both the funds raised at the end of the year and the annual accumulative fund lending exceeded 2 billion yuan RMB. These two indexes in Shandong and Hebei were also close to 2 billion yuan RMB. Meanwhile the RCFs developed quickly in terms of the number of RCFs even in remote regions though its funds were still limited, by regulation, in those regions (Wei, 1995).

In 1993, the number of RCFs stabilised roughly at that of 1992, but its financing portfolio continuously increased. Up to the end of this year, in total 25.5 billion yuan RMB was raised and the annual accumulative fund lending totalled 30.5 billion yuan RMB (Xu, 1994).

Since 1993, the incidence of RCFs remained basically stable although their business portfolio continued to expand at quite a fast growth rate. It is reported that by September, 1996, the proportions of townships and villages where RCFs were established were still 38 percent and 15 percent, respectively (Duan, 1996) however the incidence of RCFs in specific provinces continued to increase. In Jiangsu, for instance, by the end of 1994, 84 percent of all townships in the province had established RCFs (Bao, 1996).

---

1 In 1992, after experiencing a mergence and adjustment, the number of townships was 7,000 less than in 1991. See Yearbook of Chinese Statistics (1991) (Zhongguo Tongji Nianjian) and Yearbook of Chinese Statistics (1992).
4. **Features and Business Operation**

RCFs grew up relying heavily on township and village cooperative economic organisation and on original collective capital, and were visibly community based. Their main forms currently include: RCFs at township level, RCFs at village level; RCFs joint-run by township and village levels, and a small number of county-level RCFs. In addition to these forms, there are also some specialised RCFs, which mainly dealt with farmer’s specialised cooperative economic organisations (SCEO), as well as professional associations (PA). They were usually organised by the members of SCEO or PA and other enterprises with similar business activities to the SCEO or PA. The capital of such RCFs was sourced mainly from their members on the voluntary principle and also utilised specifically by their members. Fishery Cooperative Funds in Huanhua City of Hebei Province and Shanwei City of Guandong Province, Forestry Cooperative Funds, Bee-raising Cooperative Funds, etc. are this style of RCFs.

4.1 **Features of RCFs**

Although various forms of RCFs exist in practice, there remain some common features:

4.1.1 **Combination of managing and financing the original rural collective capital**

RCFs initially aimed to monitor the use of collective capital, preventing the enormous erosion. To achieve this target, RCFs financed the collective funds by changing the use of collective capital with no interest into use with return of interest, as well as changing the idle collective capital into productive cycle funds, hence helping farming households and rural enterprises to develop and widen their business.

4.1.2 **Characteristics of its community and introversion**
RCFs were generally established on a basis of the rural cooperative organisation, which was formed on the principle of rural land communal ownership. The funds of RCFs were commonly limited to be raised from and loaned to the members of the particular cooperative organisation with no allowance for opening its business to households and enterprises outside.

4.1.3 Combination of shareholding economy and cooperative economy

RCFs possess features of both shareholding and cooperative style economics. Its shareholding style feature was manifested in that farmers can get membership of an RCF by putting his own funds into the RCF (taking share). In many circumstances where RCFs were established, the original collective capital was converted into households within a CEO as a basic share. Cooperative economy resulted from the such features as the principle of voluntariness, reciprocity, admission and withdrawal with freedom, equal members’ rights (a vote each member, but each share), etc.

4.1.4 Focus on serving ‘three Nongs’

‘Nongcun (rural areas)’, ‘Nongye (agriculture)’ and Nonghu (rural households)’

4.1.5 Non-profitability

RCFs do not target profit-generation. After deducting the necessary operative costs and drawing some development funds and risk capital, RCFs return their profits to the share-takers, accounting for about the half of the net profits.
4.1.6 No establishment of its own exchequer

The receipt and payment of RCFs were run through the rural formal banking system and therefore its business operation was supervised by the formal financial institutions.

The features above were generalised from current RCFs but they do not mean that each RCF has all the features. Meanwhile the features of RCFs have been continuously changing as they continue to evolve.

4.2 Business Operation

4.2.1 Membership and organisation

The township and village’s collective economic organisation and its members, who input their funds into RCFs, get membership. In some regions, anyone can become a member as long as they put their funds in RCFs. Membership has rights such as taking a share of RCFs by funds deposited, enjoying priority of access to loans from RCFs, participating in the management and obtaining a dividend. Meanwhile, membership imposes homologous responsibility. They have to abide by the charter of rules, implement the resolutions, accept monitoring and supervision by RCFs on the loan’s use, repay loans and interest on time, and so on. The more established RCFs were organized with a member’s delegates meeting, a board of directors, a board of supervisors, and its executive group. Currently, there are many RCFs that have no board of supervisors set up, and/or the board of supervisors are not skilled at supervising even though it was set up.

4.2.2 The sources of raised funds

For most RCFs, the initial starting capital consists of a sole source, viz, collective funds remaining from the collective era. After experiencing more than ten years’ development, the funds raised by RCFs are comprised of the
original and newly accumulated collective funds, the funds of households taking a share in RCFs, the funds from township units managed by RCFs, their own accumulated funds and the supportive funds from some departments of local authority. Although its capital sources varied the collective funds, including original accumulation funds, equity arrearage gradually retrieved, compensation fees to collective land lease and occupation, and ‘Tiliu’ ‘Tonchoufei’, still dominated before 1992. In 1990 and 1991, collective funds accounted for 64.2 percent and 55.6 percent of the total funds raised by RCFs in the same year (Hong, 1992). However, the fund components have changed since 1992. There is evidence in recent years to suggest that in some specific provinces, in comparison with the collective funds, funds raised from households had become much more important. In the statistics for Sichuan, for instance, by the end of 1994, in the total provincial funds of RCFs, there were 1.221 billion yuan RMB of collective funds, a contrast to 1.054 billion yuan RMB in 1992, and although only 167 million yuan RMB increases occurred, the share of collective funds to the total raised funds declined from 31 percent in 1992 to only about 18 percent in 1994 (Guo, et al., 1995).

4.2.3 Target and tendency of its loans

RCFs give priority to meeting the demands on working capital of the household’s agricultural production and focus on cropping and livestock projects mainly as small and short-term loans, meanwhile, RCF’s loans need to be coordinated with the local industrial development plan and pattern, and pay equal attention to economic profits and social benefits. Lending to purchase fixed capital was not permitted. Under these conditions, the member of an RCF was given priority of access to loans at a relatively favourable interest rate.

Initially, TVEs could not obtain loans from RCFs, but as the funds of RCFs increased, TVEs have increasingly been permitted to borrow from RCFs. Moreover, in some provinces in recent years TVEs have become the main destination of RCF’s loans. Of the loans by RCFs in Sichuan by the end of
1994, those to cropping and animal husbandry accounted for a quarter and more and more loans went to TVEs (Guo, et al., 1995).

4.2.4 Interest rates of loans

In general, RCFs determined the interest rate of their loans independently. Although they claimed repeatedly that the interest rates of their loans were determined with reference to that charged by the rural formal banking system, in fact most RCFs adopted a higher interest rate on loans and in some extreme circumstances even exceeded more than 50-100 percent of that charged by ABC and RCC on similar types of loans in some specific regions (Wei, 1995).

4.2.5 Information and risk control

To get sufficient information on the client’s real usage of loans, almost all RCFs investigated the situation before the loan appropriation, auditing at the moment of loan appropriation, and monitoring afterwards. Meanwhile, to control risk and to avoid the loss of bad debt, hypothecation and collaterals for loans were required; furthermore, the client was also required to pay interest prior to getting their loans. In certain cases in some regions, nearly 10 percent of loans was kept in RCFs as the risk capital (*Fengxian Baozhengjin*). Because of its strict measures to limit risk, the rate of repayment and interest abstraction of RCFs’ loans excelled that of the rural formal banking system. In the total RCFs’ loans in 1990 and 1991, bad debt accounted only for 2.5 percent and 1.8 percent, respectively. However, the evidence later suggested that the bad debt and the risk arising from it sharply increased along with the RCFs’ dramatic expansion of business and the over-intervention by the local community leaders (Guo, et al., 1995).

4.2.6 Inner management

Most RCFs established relatively strict internal management regulations, such as a post responsibility system (*Gangwei Zerenzhici*), democratic management
system, loan and repayment of funds system, hypothecation and hostage system, financial system, accounting system, auditing system, record system and so on. Some RCFs adopted the contract system, which included all members’ contracts and the managers’ personal contracts, to maintain their good performance by linking RCFs’ fund risk with individual profit.

4.2.7 Distribution of its profits and dividends

The distribution of profit varied from RCF to RCF in practice. In many circumstances they distributed the net profits into three categories, viz, dividends, accumulations and operation fees. To raise more funds almost all RCFs distributed larger parts of their net profits as dividends while the interest paid to the raised funds were guaranteed. That means that for an owner of the raised fund, besides the income gained from the interest, they could get an additional income (dividend) from their funds input into an RCF. The second category, accumulations, usually included the risk funds (Fengxian JiJin), development funds (Fazhan JiJin), etc.; and the third was comprised mainly of the operation costs, bonus funds (Jiangli JiJin), etc. The proportions of these three distributive categories to the total net profits varied from region to region and from RCF to RCF. In general, although it got changed over the years, the dividend proportion dominated in the net profit distribution of RCFs in various regions, accounting for at least 40 percent of the whole net profits of RCFs. For example, the net profits of all RCFs totalled 475 million in 1990 and 434 million in 1992, respectively. Of this, 228 million in 1991 and 220 million in 1992, being 48 percent and 51 percent of the whole profits, went to the owners of funds in RCFs as the dividend (Wei, 1995).
5. Contribution and Existing Problems

5.1 Contribution

The establishment and development of RCFs have played significant roles in promoting the development of the agricultural and rural economy. Its positive contributions were mainly located in:

5.1.1 Enhancing management and utilization of the original collective funds, enhancing CF’s sustainability as well

It was reported, on incomplete statistics, that between 1990-93, RCFs helped to recover totally more than 2.6 billion yuan RMB of the original collective funds that were lent but not repaid, and made the funds available for productive activities (Wei, 1995). To some extent, those resurrected collective funds were helpful in meeting the enormous demands by rural households and enterprises, especially in their initial development stages.

5.1.2 Increasing the capital input into agricultural production, promoting the adjustment of the rural production pattern and promoting the development of the rural economy

During 1990-93 in the whole nation, RCFs provided 24.1 billion yuan RMB of loans to the agricultural production, 30.77 billion yuan RMB to TVEs and financed 4.08 billion yuan RMB to the rural socialisation service sector as well, accounting for 39.3 percent, 50.3 percent and 6.7 percent of RCFs’ total loans respectively in the same period (Wei, 1995). Another statistic reported that, in 1991, the loan portfolio to agriculture by RCFs was equivalent to twice of the local agriculture expenditure that was listed as agricultural support funds in the central government’s fiscal budget (Wei, 1995).
5.1.3 Restraining the rise of civilian credit’s interest rate of lending, and to some extent confining the overflow of usury and other illegal financial activities

A typical investigation suggested that, in some local communities where RCFs were established, the interest rate of civilian credit decreased by about 50 percent (Wei, 1995). In addition, the convenient loans of RCFs, available in small amounts and for short periods also injected stimulatives into both the development of the rural capital market and the improvement of service by the rural formal financial system.

5.1.4 Increasing the incomes of farmers, communities and state taxes

By financing the households and TVEs RCFs promoted the development of households and enterprises’ productive activities as well as improved returns to their business and, as a marked consequence, farmers incomes were greatly increased. On the other hand, RCFs distributed their profits to their share-takers, the owner of RCFs’ funds, which also partly increased the farmer’s income. From 1990-93, farmers in all of China obtained totally more than 2.65 billion yuan RMB of income from the dividends of RCFs’ profits. RCFs can increase the income of the community and country tax too. A typical survey in Menxian County of Henan Province showed that a 100 yuan RMB loan by an RCF was able to increase the gross value of production to 147 yuan RMB, a state tax of 7 yuan RMB and community income of 6 yuan RMB, respectively (Qiu, 1995).

5.1.5 Inducing the reform of the rural financial system

Over the past decades, the state-run banking system, namely ABC, RCC and the Agricultural Development Bank in recent years, has monopolised financial activity in rural China, and any other institution is rigidly restricted from it. The appearance of RCFs has changed this situation, and made governments at various levels adjust their attitudes towards rural financial policy changes and
has tended to allow the non-state-run financial institutions to compete with the formal banking system in some financial areas. Although RCFs are still restricted from the business of raising rural saving deposits, which means RCFs were not permitted by government’s policies to operate as a real financial institution (RCFs declares itself not to be a financial institution), undoubtedly the expansion of RCF’s business and its circuitous development in practice, after 1991 in particular, has been challenging the conventional rural financial system and managerial strategy. In other words, it has induced a potential innovation of rural financial institutions and the policy of government. The competition resulting from the continuous innovation of rural financial institutions between the formal and the informal banking system will usefully promote the formation of a real rural capital market reviving long repressed market power, improve the quality of rural financial services as well, and encourage rural fund borrowers to apply for loans at a more reasonable interest rate from both the formal and informal financial systems in the future. Moreover, the further development of RCFs will be a catalyst for the fundamental reform of the Chinese rural financial system.

5.2 The Existing Problems

In the light of RCFs’ existing development situation, its fundamental importance in the rural finance market should not be neglected. Meanwhile, for RCFs there remain still some common problems. In practice, the main common issues include the following aspects:

5.2.1 RCFs extended fund-raising and lending

On the basis of the central government’s existing policies, RCFs should not raise funds from farming households, rural enterprises and other organisations outside the community, all of which, however, were basic to the RCF’s establishment. In fact, to mobilise more funds and enlarge their business opportunities, some RCFs have broken the policy restriction and operated like a bank. Currently, RCFs frequently extend their business to other community
areas. In some extreme circumstances, RCFs establish their branches even in urban areas to absorb the deposits from urban residents. From statistics provided by the Hunan Province branch bank of the People’s Bank of China, by June 1995, there were 165 RCFs’ affiliations set in urban areas, 84 more than the previous year (Li, 1996).

5.2.2 RCF’s enhancement of profit-generating

In contrast to the operation in its early periods and to the government restriction of profit-generation, in reality RCFs became more and more concerned about profit generation along with business expansion in recent years. This concentration on profit probably resulted in RCFs’ loans away from agriculture and animal husbandry, as well as the raising of funds from outside the community. It seems that constraints on RCFs’ profit-generating resulted from the recognition of their cooperative economy feature. However some elements have led RCFs to pay more attention to profit-generation. Firstly, RCFs also have features of a shareholding economy. They have to distribute their profits to the owners of the funds, and to attract more funds they need a higher return rate; secondly, profit generating is required to offset the higher operational cost of RCFs, and therefore to maintain their sustainability. It is known that the operational cost of financial activity in rural areas is much higher than that in urban areas, and an agricultural loan costs more than the loan to other industries (Padmanabhan, 1988). To finance agricultural production with sufficient funds, it is necessary for RCFs to maintain an appropriate profitability to offset the higher costs incurred.

5.2.3 Siphon the capital to non-agricultural activities

Apart from enhancing the management of the original collective funds, another initial intention was that RCFs were permitted to be established to finance agriculture with more capital. Indeed, this aim was achieved in the early period of RCFs’ development, but partly failed later. Although RCFs’ share of loans to agricultural production and animal husbandry was still generally higher than
that of other rural financial institutions, as suggested by a variety of investigations, it fell sharply after the end of the 1980s. In the total loans of RCFs, the share to agriculture and animal-breeding was 22.1 percent in Hunan in the middle of 1995 (Li, 1996), 27.36 percent in Sichuan at the end of 1994 (Guo, et al., 1995), and less than 40 percent in Henan at the end of 1994 (Qiu, 1995). RCFs had become a new channel to siphon funds to activities unconnected with the development of agriculture and animal husbandry.

5.2.4 Excessive intervention by local government and local community authority

Another critical issue is that, in many circumstances, local community leaders interfered in RCF’s business. A number of investigations suggested that to differing extents, local community leaders more or less arbitrarily transferred funds without respecting RCFs’ independent right; furthermore, some local leaders regarded RCFs as a township or village-run ‘enterprise’ and required them to pay the township or village some of their profit as a right. Intervention has also existed in that some local community leaders guarantee the loan to a specific individual or enterprise using their own leader’s position, which has frequently led to a risky RCF loan. Finally and most detrimentally, in some regions, the local community leaders regard RCFs as their own ‘cash cow (Yaoqianshu)’ and force RCFs to pay the bills and fees in various names for them. Consequently, greater loan risks and more operational costs etc., arise from the intervention.

5.2.5 Insufficiency of risk monitoring and control

Although most RCFs have set up an information and risk control system in terms of the risk types, as well as relevant regulations, enormous risks still existed in most RCFs due to regulations not being strictly implemented and the excessive intervention by local community leaders in particular. In some RCFs there were no formal credit contracts between the RCF and fund borrower, and/or no collateral from the borrowers was kept by the RCF. Instead, in many
circumstances, there was only an oral bargaining agreement. The risk not only existed in its abnormal loan transaction, but probably also resulted from the RCF’s lack of implementation of the reserve fund system. In the government policy regulation (it was also included into RCFs’ Charter of Rules) RCFs were required to keep in tact at least 13-15 percent of its raised funds as the reserve fund (Fengxian Baozhengjin), but in practice, in some regions, many RCFs lent 100 percent of its raised funds without any reserve funds.

5.2.6 Uncertain status of RCF’s legal position and insecurity of member benefits

At present, based only on the government’s relevant policies, almost all RCFs operate with no Financial Activity Licence and Business Licence, implying that RCFs do not possess a legal status. This makes RCFs unable to undertake civil responsibility and therefore unable to guarantee the legal rights of fund owners in extreme circumstances, bankruptcy in particular.

These issues need to be attended to otherwise they will dim the prospects of RCFs.

6. Prospects of RCFs

As an effective measure to manage and finance the original and the newly-accumulated collective funds, the share funds paid for by its members and other funds, the development of RCFs to date has had a positive impact on the rural economy, increasing the capital input to agricultural production as well. Its practice has also helped as a catalyst to the reform of the rural financial system and the formation of a real financial market in rural China. Not the same as the traditional RCC, nor the other rural commercial financial

---

2 According to the relevant laws and regulations in China, the former should be approved and issued by the People’s Bank of China at least at county level, and the latter by the local government departments in charge of industrial and commercial administration.
institutions which targeted profit-generation, RCFs have a irreplaceable function both now and in the future.

In view of the evolutionary tendency of the Chinese rural financial system, ADB, acting as a policy bank for agricultural development, will mainly provide loans to purchase agricultural products and by-products, to provide a national reserve of grain, to exploit the technology of agriculture and forestry, to alleviate special poverty situations, provide not only agricultural infrastructure but working capital for agricultural production and the urgent demands of farmers’ livelihood. ABC and the proposed Rural Cooperative Bank, which will be transformed from the existing RCC, will be reconstructed into totally commercial banks. To maintain the relatively higher profitability of their loans, the two commercial banks will potentially have a loan priority towards more profitable secondary and tertiary industry although they will be required to concentrate their loans to clients in rural areas. It is predictable that the gap between loan supply by the rural formal banking system and the demand for agricultural working capital in small quantities and for short periods will further enlarge. RCFs, utilising the idle funds from the collectives and farmers, insisting on the principle of mutualism, community and nonprofit, can effectively fill the vacancy. With the particular characteristics of mutualism, reciprocity and cooperativeness, RCFs are more likely to provide loans for agricultural production with its greater natural and market risk and lower profitability as well as satisfying the frequent demands for small loans by farmers. Moreover, with the existence of supervision on loan use between the member, RCFs can effectively resolve the issues of higher operational cost, in particular the overseeing cost, associated with agricultural production loans. Besides competing with it, RCFs therefore are complementary to the rural formal financial system with respect to serving the agricultural and rural economy. This should become the basis of the future policies towards RCFs.

However, the existence and development of RCFs will in the future depend on whether they can retain these features and resolve the problems currently existing in practice. As mentioned above, compared with the rural formal
financial system, the inimitable function and advantage of RCFs are in serving the rural and agricultural economy, and that will disappear if its features deviate from their origin.

More attention should be paid to the fact that it was deviation from its original features that brought about the main problems. The increasingly enhanced target of profit-generation, more funds siphoned to non-agricultural activities, the insecurity of benefits for members, and so on, are harmful for the RCFs’ function of serving the ‘three Nongs’—‘Nongcun (rural areas)’, ‘Nongye (agriculture)’ and ‘Nonghu (rural households)’. In particular, the transformation of RCFs into a profitable financial institution will probably eliminate its cooperative characteristic, and will therefore deprive RCFs of an essential and beneficial feature.

Whether or not RCFs can further expand will also depend on resolving the other problems they face.

With regard to the RCF’s capital raising and loans outside its own community, it seems inevitable if some elements were considered. Firstly, RCFs were not established in every community but the idle funds existed everywhere in rural areas. The comparatively higher deposit interest rate, promise of loan approachability, appropriate dividend expectation and convenient financial services provided by RCFs could easily attract funds from neighbouring communities. Secondly, the professional capacity of RCFs’ staff and its reputation, hence the security and possible returns to the contributor’s funds, vary from RCF to RCF and the fund-contributor, of course, preferred to choose a higher reputed RCF to deal with their funds. Finally, the distance from where the fund-contributors live to where the RCF is located will also influence the fund-contributor’s decision of which RCF was chosen. However, this extended business obviously concealed a risk potential. Due to the uncertain status of the RCFs’ legal position, a business dispute between an RCF and its clients within the same community was usually mediated by the local community authorities. But under the existing rural administrative
management system, once a dispute between an RCF and its client in a different community occurs, the local community has no authority to intercede in the dispute. It is probably the main reason why the government at various levels has severely and repeatedly restricted the business extent of RCFs. To reduce this potential crisis, RCFs need to limit their own business extent on the one hand and on the other hand, now that it is reasonable that RCFs expand their business to the outside community, the government at various levels should legalise their position and give permits for financial activity to RCFs, while inducing RCFs to keep to normative operations by deepening the rural financial system.

Another problem is the interest rate of RCFs. Since 1995, the central government, especially the formal financial institutions, have tended to slow down the development of RCFs. Besides other reasons, the main consideration probably resulted from concern about the higher interest rate of RCFs, fearing that its uncontrolled business expansion would be a blow to the formal banking system in rural areas and disorder the rural financial market. Indeed, because of the higher interest rate of RCFs it appeared that in some regions rural residents vied with each other to transfer their deposits from the ABC and RCC into RCFs, resulting in a sharp decrease of farm savings in the ABC and RCC. Not only the higher rate of interest, but the fact that the interest paid was guaranteed and that dividends were also paid attracted the transfer. The higher interest rate for deposits of RCFs is accordingly linked with the higher interest rate of its loans. It is this higher interest rate of its loans that can offset the higher fund cost. As mentioned in section 4.2.4 almost all RCFs adopted a higher interest rate for loans than did the rural formal financial institutions although RCFs claimed they conformed to it. It is in vain to simply blame RCFs for charging a higher interest rate on their loans. In China, the loan interest rate implemented by the rural formal financial institution was decided by the financial administrative department of the central government. It is doubtful whether the interest rate could reflect the reality of rural capital scarcity. Almost all the field investigations suggested that although higher, sometimes much higher than that of the rural formal financial institution, the
interest rate of RCFs’ loans is still lower than that of usury. To the borrower a procurable loan at comparatively more cost is more acceptable than the unattainable loan at a more favourable interest rate. It should be a significant task in the reform of the rural financial system to adjust the formative mechanism for the rural loan interest rate loan in the rural capital market, and specifically to give the rural financial institutions the right to decide the interest rate for loans. Before the rural financial system reform is completed RCFs need to constrain their behaviour in the interest rate of loans.

In addition, further improving the professional capability of its staff, enhancing the inner management, normalising its business transactions, continuously focusing on financing agriculture, etc., will also be critical factors deciding whether RCFs can develop rapidly and healthily.

7. Conclusion

RCFs in rural China were developed to accommodate the requirements arising from the reforms of the rural economic system in the middle of the 1980s. Its features, especially the feature of farmers’ fund cooperation make it more able to undertake the financing of the ‘three Nongs (rural areas, agriculture, and rural household)’. This is complementary to the function of the rural formal financial system although it also challenged it. RCFs have expanded rapidly since the beginning of 1990s under the policy support of the Chinese central government and the business guidance of the rural formal banking system although a number of problems still exist in its practice. The operation of RCFs to date has had a positive impact on the rural economy and the development of agriculture. Further development of RCFs will depend heavily on the retention of its original features, its feature of farmers’ fund cooperation in particular, and on the resolution of existing problems. Meanwhile, the increasing deepening reform of the rural financial system will also help to optimise the developmental environment of RCFs.
Bibliography

Bao Zhongshun (1996), The Financial Situation of Rural Residents and the Development of RCFs (Nongcun Juming Rongzi Zhuankuang Yu Nongcun Hezuo Jijinghui De Fazhang), Chinese Rural Economy (Zhongguo Nongcun Jingji), No. 5.

China, the Ministry of Agriculture (1989), Increasing Agricultural Input by Enhancing the Management of Collective Funds, Business and Management of Rural Cooperative Economy (Nongcun Hezuo Jingji Jingyin he Guanli), No. 11.

China, the Ministry of Agriculture (1991), Notification on Some Issues of Enhancing the Standardizational and Institutional Construction of RCFs (Guanyu Jiaqian Nongcun Hezuo Jijinghui Guifanhua Zhiduhua Jianshe Ruogan Wenti De Tongzhi).


Chinese Communist Party Centre Committee (CCPCC) and State Council (1986) Opinions on Liquidating Rural Collective Assets (Guanyu Qingli Nongcun Jiti Chaichan De Yijian).


Guo Xiaoming et al., (1995), History, Current Situation and Prospect of RCF, Agriculture Economy (Si Chuan), No. 8.

Hong Fuzheng (1992), The Practice and Development of RCFs, Works and Research of RCFs (Nongcun Hezuo Jijinghui Gongzuo he Yanjiu), No. 1.


Shen Longyan (1989), The Civilian Free Credit Flourished in Sichuan Province Becoming the Main Source of Farmer Loans, Financial Times (Jinrong Shibao), 25th July.

The Political Bureau of the CCPCC (1987), Guidance to Deepen the Rural Reform (Ba Nongcun Gaige Yinxiang Shenru).

Wei Daonan (1995), The Current Situation and its Prospect of RCFs, History Date of Chinese Agricultural Cooperation (Zhongguo Nongye Hezuoshi Ziliao), No. 50.


Zhang Huanchen (1989), Promoting the Development of RCFs, Rural Prospect (Nongcun Zhanwang) (Heilongjian) No. 10.
Chinese Economies Research Centre Working Papers

90/1 China's Economic Growth, Changing Comparative Advantages and Agricultural Trade  
Kym Anderson

90/2 Rural Industrialization in China: A General Equilibrium Analysis  
Wu Yanrui

90/3 Urban Household Subsidies and Rural Out-Migration: The Case of China  
Kym Anderson

91/1 The Classification of China's Industries by Factor Intensity and the Corresponding Trade Pattern of China  
Zhang Xiaohe

Zhang Xunhai

91/3 China's Tea War  
Keith Forster

91/4 The Urban-Rural Isolation and its impact on China's Production and Trade Pattern  
Zhang Xiaohe

91/5 Scale, Factor Intensity and Efficiency: Applications to the Chinese Coal Industry  
Wu Yanrui

91/6 Who Provided Industrialization Funds in China?  
Sheng Yuming

91/7 The "Real" Chinese Gross Domestic Product (GDP) in the Pre-Reform Period 1952/1977  
Harry X Wu

91/8 China's Urbanization and Rural-to-Urban Migration: Estimates and Analysis in a Perspective of Economic Development in Pre- and Post-Reform Periods  
Harry X Wu

Harry X Wu

91/10 Government Control of Grain Production in China  
Li Qing-zeng

91/11 Efficiency Differential and its Potential Sources in Chinese Iron and Steel Industry  
Wu Yanrui

91/12 Private Business and the State in China's Reforming Economy  
Susan Young

91/13 Grain Production and Regional Economic Change in China  
Li Qing-zeng  
Andrew Watson  
Christopher Findlay

91/14 The "Wool War" and the "Cotton Chaos": Fibre Marketing in China  
Zhang Xiaohe  
Lu Weiguo  
Christopher Findlay  
Andrew Watson

91/15 Oil Price Shocks and Policy Responses in the  
Peng Zhaoyang
Post-Reform Chinese Economy

91/16 One State - Two Economies: Current Issues in China's Rural Industrialisation
Will Martin

Chen Chunlai
Andrew Watson
Christopher Findlay

92/1 Using a CGE Model to Analyse External Shocks in the Reformed Chinese Economy: A Background Paper
Peng Zhaoyang
Will Martin

92/2 Productivity Changes and Regional Disparities in Chinese Agriculture since 1980
Hong Yang

92/3 Growth of Rural Enterprises, Urban-Rural Relations in China's Foreign Trade
Christopher Findlay
Zhang Xiaohe
Andrew Watson

92/4 Issues in Fiscal Contracting in China
Christopher Findlay, Andrew Watson

92/5 China's Rural Economic Performance during the Reform Decade: Estimates and Assessments
Harry X Wu

92/6 The "Industrialisation" of China's Rural Labour Force Since the Economic Reform
Harry X Wu

92/7 Productivity Performance of Chinese Rural Enterprises: A Comparative Study
Wu Yanrui

93/1 The Measurement of Efficiency: A Review of the Theory and Empirical Applications to China
Wu Yanrui

93/2 One Industry, Two Regimes: The Chinese Textile Sector Growth, Reforms and Efficiency
Wu Yanrui

93/3 Domestic Distortions, Production and International Trade in China: An Analytical Framework
Zhang Xiaohe

93/4 The Sequencing of Economic Reform
Richard Pomfret

93/5 A Method for Estimating China's Rural GDP
Harry X Wu

93/6 Modelling China's Rural Economy
Zhang Xiaohe

93/7 China's Experiment with a Quasi-Land Market: The Sale and Transfer of Land Use Rights
Jiang Bing

93/8 China's Dual Land Ownership System: Formation and Problems
Jiang Bing

93/9 The Impacts of Economic Reforms on Chinese Agricultural Performance
D T Nguyen
Harry X Wu

94/1 The Role of Prices in China's Grain Production During the Post Reform Period
Hong Yang

94/2 Rural Reforms, the Weather, and Productivity Growth in China's Grain Sector
Bin Zhang
Colin Carter

94/3 Market Reform and Agricultural Development
in China

94/4 China's Agricultural Reforms: Experiences and Achievements of the Agricultural Sector in the Market Reform Process Andrew Watson

94/5 Productivity Growth, Technological Progress and Technical Efficiency Change in China: A Three-Sector Analysis Wu Yanrui

94/6 Productivity and Source of Growth in the Reforming Chinese Economy Harry X Wu

94/7 A Potential Inconsistency in "Dynamic" Socialism Steven Lim

94/8 Rural Industry - Interactions with Agriculture and State Industry Steven Lim

94/9 Direct Foreign Investment in China Richard Pomfret

94/10 Rice Markets in China in the 1990s Wu Yanrui

94/11 Modelling Inter-regional Strategic Interactions within a General Equilibrium Framework Leong H Liew

94/12 Comparison of Chinese and International Grain Prices Cheng Enjiang

94/13 Financial Issues and the Forces for Grain Marketing Reforms in China Cheng Enjiang

94/14 Household Grain Consumption in China: Effects of Income, Price and Urbanisation Yanrui Wu, Harry X Wu

94/15 Reforms of China’s Foreign Exchange Regime: Behind Unification Harry X Wu


95/1 Market Reform and Integration in China in the early 1990s - The Case of Maize Cheng Enjiang, Wu Yanrui

95/2 Growth and Productivity in China’s Agriculture: A Review Wu Yanrui, Yang Hong

95/3 Cointegration Analysis of Chinese Grain Performance 1961-1992 Steven Lim

95/4 Household Income Determination and Regional Income Differential in Rural China Xin Meng, Harry X Wu

95/5 Fiscal Decentralisation, Regionalism and Uneven Development in China Christopher Findlay, Harry X Wu, Andrew Watson

95/6 Relocation of Farm Household Labour and Its Direct and Indirect Impacts on Grain Production in China Harry X Wu, Xin Meng

95/7 Trade Reforms and Integration of China’s Domestic and International Grain Markets since the middle 1980s - the Case of Wheat and Maize Cheng Enjiang, Christopher Findlay
95/8 Provision of Institutional Credit and Economic Transition in Rural China Cheng Enjiang, L R Malcolm
96/1 Multiple Deprivation in Rural China Wu Guobao, Sue Richardson, Peter Travers
96/2 Rural Poverty and Its Causes in China Wu Guobao, Sue Richardson, Peter Travers
96/3 Recent Developments in Foreign Direct Investment in China Chen Chunlai
96/4 Research on Rural-to-Urban Labour Migration in the Post-Reform China: A Survey Harry X Wu and Li Zhou
96/5 Economic growth and trade dependency in China Christopher Findlay and Andrew Watson
96/6 China’s steel imports: an outline of recent trade barriers Ian Dickson
96/7 Changing Patterns of Alcohol Consumption in Rural China: Implications for the grain sector Yanrui Wu
96/8 Challenges to China’s Energy Security Chao Yang Peng
96/9 Sources of Productivity Disparities in Regional Grain Production in China Yang Hong
96/10 Trends in China’s Regional Grain Product and their Implications Yang Hong
96/11 China’s Maize Production and Supply from a Provincial Perspective Yang Hong
96/12 China’s Rural and Agricultural Reforms: Successes and Failures D Gale Johnson
96/13 The Sino-Japan Steel Trade Negotiations Framework Ian Dickson
97/1 Grain Sector Reform in China Christopher Findlay
97/2 Internal Reform, Budget Issues and the Internationalisation of the Grain Market in China Christopher Findlay and Andrew Watson
97/3 Risks and documentary credits in China’s international metals trade Ian Dickson
97/4 China’s Grain Demand and Supply: Trade Implications Harry X Wu and Christopher Findlay
97/5 The Internationalisation of China and its Implications for Australia Bijit Bora and Chen Chunlai
97/6 Productivity of China’s Rural Industry in the 1980s Jin Hehui and Du Zhixiong
97/7 The Stock Market in China: Problems and Prospects for Domestic and Foreign Investment Lan Yisheng
97/8 Foreign Direct Investment and Economic Development in Guangdong: Problems and Prospects Lan Yisheng
97/9 China’s Fishery Industry: Production, Consumption and Trade Lan Yisheng and Peng Zhaoyang
97/10 Evaluation of China’s Urban Housing Reform  
Yuan Shiming

97/11 Foreign Direct Investment and Trade: An Empirical Investigation of the Evidence from China  
Chen Chunlai

97/12 The Location Determinants of Foreign Direct Investment in Developing Countries  
Chen Chunlai

97/13 The Composition and Location Determinants of Foreign Direct Investment in China’s Manufacturing  
Chen Chunlai

97/14 Comparison of Investment Behaviour of Source Countries in China  
Chen Chunlai

97/15 The Evolution and Main Features of China’s Foreign Direct Investment Policies  
Chen Chunlai

97/16 Provincial Characteristics and Foreign Direct Investment Location Decision within China  
Chen Chunlai

97/17 Testing the hypothesis of irrational exuberance in China’s steel imports, 1992-1996  
Ian Dickson
China’s myriad customs regimes and their implications for openness (with reference to steel imports)  Ian Dickson

Key issues in establishing a new housing system based on a market oriented economy  Yuan Shiming

The dynamics and impact of the development of rural cooperative funds (RCFs) in China  Du Zhixiong