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Cooperatives in China—A Promising Player in Chinese Economy

Guest Editor:
Kay-Wah Chan
Macquarie University
and
Mary Ip
University of New South Wales

M.E.Sharpe

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GUANGWEN HE AND LYNETTE H. ONG

Chinese Rural Cooperative Finance in the Era of Post-Commercialized Rural Credit Cooperatives

Abstract: *Rural credit cooperatives have become increasingly commercialized over the last decade. However, this does not spell the end of cooperative finance in rural China. Various new cooperative credit organizations have sprung up in recent years with endorsement from the central and local governments. They are designed to meet the wide-ranging credit demand of rural households and microenterprises that are increasingly left behind by formal credit institutions. Rural mutual aid funds* (nongcun zijin huzhushe) *are a cornerstone of cooperative finance in rural China, filling in the market gap left behind by commercialized financial institutions.*

Rural credit cooperatives (RCCs) were cooperative credit institutions established in the 1950s to serve financial demands of farmer-members. However, since Deng Xiaoping's Reform and Opening in 1979, RCCs have become increasingly commercialized. Their main operational objective, to maximize profits while serving credit demands of farmer-members, is often rendered to second place. This is in line with the general orientation of increased commercialization of all financial institutions

Guangwen He is a professor and director of the Center for Rural Finance and Microfinance Research at the College of Economics and Management, China Agricultural University; email: heguangwen@sina.com. Lynette H. Ong, corresponding author, is an associate professor in the Department of Political Science and Asian Institute, Munk School of Global Affairs, University of Toronto; email: lynette.ong@utoronto.ca.

in China. Although cooperative in name, their corporate governance structure is void of any cooperative nature. They were an extension of the state-owned Agricultural Bank of China from 1980 to the mid-1990s and became local credit institutions loosely managed by the local People's Bank of China (PBoC) offices from 1997 to 2003. Since the institutional reform in 2003, RCCs have become largely commercial entities pursuing the objective of profit maximization (Ong 2012; G. He 2006; Y. Li 2011).

The rural credit market in China has some distinctive characteristics that differentiate it from urban credit markets. Some of these characteristics are country-specific while others are rural sector-specific. Rural land in China is collectively owned, rather than individually or household owned. Farmers have user rights but not ownership over the land on which they reside and farm. Since land is often the most valuable asset rural households possess, lack of ownership implies that they cannot use it as collateral in loan transactions. This is a major impediment that prevents farmers from borrowing from formal credit institutions that often require some sort of guarantees, physical or otherwise, from borrowers. Generally, the credit market is also beset by information asymmetry, since borrowers often have more information on the riskiness of the project and the likelihood of repayment than they are willing to share with the lender. Additionally, because rural areas are sparsely populated, with some of the borrowers living in remote locations, it is relatively more costly for rural lenders to service their clients than for urban lenders to do so. Therefore, the unit operational cost is relatively higher for rural credit institutions compared to their urban counterpart.

These innate characteristics imply that informal and grass-roots credit organizations—as opposed to formal credit institutions, specifically the RCCs—may be better positioned to serve rural borrowers. This is an important background reason explaining why newly emerged cooperative credit organizations—the subject of investigation in this paper—are not an insignificant development. These institutions, which are largely established by members or users of credit, are able to utilize social mechanisms such as trust among members, social capital, and peer pressure to enforce prompt repayments. These mechanisms help to lower information asymmetry between lenders and borrowers and supplant the need for formal collateral or guarantee.

The pertinent and relevant question is what constitutes cooperative finance in rural China? Why are the remaining institutions serving poor rural households and microenterprises often left behind by commercial banks? What are the myriads of emerging credit institutions in rural China, and in what ways are they meeting diverging credit demands of rural clients? What roles does the government play in these emerging credit institutions? These are some of the key questions in the rural credit landscape that this paper seeks to address and answer. This paper is based on field research and surveys of rural credit institutions conducted by the authors from 2004 to 2012. It also draws upon data in existing studies, literature, and relevant policies with respect to rural credit.

This paper is structured as follows. The next section describes the historical evolution of the RCCs, recent reforms, and their financial performance. After the 2003 institutional reform, RCCs became quasi-state credit institutions. However, they are still the predominant credit institutions in rural China. Section 3 provides an overview of rural cooperative credit institutions in the postcommercialized RCC era. They are formal, quasi-formal, and informal rural cooperative credit institutions. The first two are either explicitly approved or implicitly promoted by the government, while the last are grass-roots organizations entirely initiated and set up by rural households and microenterprise owners. This section also incorporates our fieldwork investigation into these various new cooperative credit organizations. Terms and uses of loans issued by different institutions indicate they serve different segments of the rural clientele, but they all play an indispensable role in supporting the local rural economy. The final section concludes.

Rural Credit Cooperatives (RCCs)

The rural credit cooperatives (RCCs) were first established before the founding of the People's Republic of China (PRC) in 1949 in order to protect farmers against widespread usury. They were initially organized by farmers and to serve farmers' credit demands. In 1979, when the Agricultural Bank of China (ABC), which was rendered dormant during the Cultural Revolution, was restored, the central government put RCCs under the auspices of the ABC. Between 1979 and 1995, the credit cooperatives functioned as grass-roots branches of the ABC, and their employees were managed as part of the bank's bureaucracy. RCCs' relationship with the ABC was formally severed in 1996 as part of the central government's move to restructure the rural financial system. This restructuring divided the sector up among three institutions with distinct tasks. The ABC was left in charge of commercial loans, the Agricultural Development Bank of China (ADBC) was put in charge of agricultural policy loans, and the RCCs were put in charge of household credit. In the subsequent period between 1996 and 2003, RCCs were managed indirectly by the central bank, the People's Bank of China (PBoC). During this period, the central bank set up additional credit unions at the county level to manage the grass-roots credit cooperatives.[1]

In the late 1990s, it became abundantly clear to the central government that without a capital injection, the RCC system was simply unsustainable. Official statistics reveal that the overall nonperforming loan rate reached a peak of 50 percent in 1999, and the collective liabilities of the RCCs exceeded assets by 330 billion yuan. Further, 55 percent of RCCs nationwide were "technically bankrupt." In other words, asset values of these RCCs were smaller than the sum of their liabilities and equity, which implies that they would have closed for business if they had operated under market conditions. However, because RCCs are both the primary holders of rural households' savings and the primary providers of rural households' credit, closing them was out of the question from the central government's perspective.

The year 2003 marked a major milestone for RCCs, which saw an institutional reform in which three major changes were introduced by the central bank. First, as part of the 2003–2005 reform, the central bank provided two forms of financial subsidies to help RCCs with negative net worth dispose of their bad assets and historical losses. The main subsidy, larger in magnitude and more popular among RCCs, was the 165.6 billion yuan conditional debt-for-bills swaps (*zhuanxiang piaoju*). The central bank bought bad assets from RCCs at book value, and upon maturation of the bills in two to four years' time, RCCs could swap the bills for cash, subject to them fulfilling certain institutional reform, which I will turn to later in the essay.[2] The second was the 830 million yuan earmarked for central bank loans (*zhuanxiang daikuan*). Together, the bailout accounted for about 10 percent of RCCs' loan portfolio in 2003. In addition, the central government also cut RCCs' corporate income tax and business turnover tax rates to help raise their profitability.[3]

Second, RCC management rights were transferred from the PBoC to the provincial governments, with the intention of making regional governments financially responsible for the credit cooperatives in their jurisdictions. The provincial RCC unions are administrative organizations (*xingzheng jiguan*) that do not take deposits or give loans. They represent the respective provincial governments in managing the credit cooperatives in their territories. Their functions are similar to those of the pre-reform county credit unions, except that their control over local credit cooperatives is stronger. The prerogatives of the provincial RCC unions range from personnel appointments, appraisals and dismissals, the setting of province-wide remuneration systems, veto rights on large loans, and approval rights of major expenditures to auditing and service provisions, such as province-wide management and support of IT systems and personnel training.[4]

Third, subject to certain conditions, RCCs can choose to adopt one of three institutional models: the rural commercial banking model, the rural cooperative banking model, or retention of the existing rural credit cooperative model. At the beginning of the reform, only RCCs in highly industrialized locales with better financial performance could become rural commercial banks. They conduct business like any urban commercial bank and are similarly bound by few policy requirements.

Rural cooperative banks are a hybrid of rural commercial banks and credit cooperatives. While they can raise equity by bringing in individual and enterprise investors, they are required to allocate a certain proportion of their loan portfolios to agricultural projects. A majority of RCCs nationwide, particularly those in the central and western regions, have chosen to become rural cooperative banks. The institutional reforms were still ongoing as of April 2013. Over time, more RCCs have converted to rural cooperative banks and rural commercial banks. As the conversion requires improvement in financial performance as a prerequisite, the institutional reform has become an ultimate objective of RCCs the performance of which is below the par.

The RCC system as a whole grew tremendously between 2003 and 2013. As seen in Table 1, their total assets and liabilities grew by 6.8 and 6.3 times, respectively, during the period. Shareholders' equities and profits also went from negative to positive territories, although this was, in no small part, due to financial injections and subsidies from the PBoC. As of the third quarter of 2012, total deposits and loans of RCCs were 11.5 trillion and 7.8 trillion yuan, respectively. They each accounted for 12.8 and 12.6 percent shares of total deposit and loans nationwide, respectively. The nonperforming loan rates fell from 7.4 percent in 2009 to 5.5 percent in 2011.

All three types of rural credit institutions have seen improvement in return on assets and return on equity, as shown in Table 2. Individually, the improvements are most remarkable in the case of rural cooperative

Table 1

The Performance of Rural Credit Cooperatives in China 2003–2011 (in billions)

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Assets	2,689	3,133	3,721	4,420	5,599	7,144	8,640	10,658	12,860
Liabilities	2,703	3,057	3,555	4,215	5,438	6,803	8,209	10,065	12,074
Shareholders' Equities	−13	76	165	204	261	341	431	593	786
Profits	0	10	18	28	29	40	51	69	123

Sources: *CBRC Annual Report*, CBRC, 2006 and 2011.

Table 2

Return on Assets (ROA) and Return on Equity (ROE) of Rural Credit Institutions (2007–11)

		2007	2008	2009	2010	2011
Rural Commercial Banks	ROA	0.70	0.79	0.80	1.01	1.20
	ROE	12.97	13.71	13.36	13.83	15.43
Rural Cooperative Banks	ROA	0.84	1.03	1.05	1.19	1.30
	ROE	13.29	15.87	15.85	16.05	17.06
Rural Credit Cooperatives	ROA	0.45	0.42	0.41	0.36	0.74
	ROE	10.36	9.87	9.72	8.34	15.30

Source: *China's Rural Financial Services Report (2012)*, PBoC.

banks and rural credit cooperatives, rather than in rural commercial banks. The reason for this is not entirely clear; however, it is reasonable to assume that since rural commercial banks had better financial performance to start with, they started from a higher base. Hence, the scope for improvement is less in their case.

Nevertheless, growth of RCCs does not necessarily mean that they have a greater capacity to meet credit demands of rural clientele as a whole. Quite the contrary, by handing them over to the administrative control of the provincial governments, the 2003 institutional reform has made them quasi-state credit institutions (*difang zhunguoyou qiye*), and they have become increasingly divorced from their *cooperative* nature. That said, to be sure, RCCs' operation and loan decisions, like other banks in China, are already influenced by local authorities to some extent.[5]

At the time of this writing, the central government was pushing for transformation of all county RCC unions into shareholding system, paving their way to becoming rural commercial banks.[6] The rationale is to make the credit institutions more accountable to the shareholders and, hence, make the employees more sensitive to the bottom line. The central government's underlying motive is to make RCCs self-sustainable commercial institutions. The institutional restructuring and financial injection in the mid-2000s could be seen as a bailout by the central government in order to allow the RCC system to start with a clean slate. Commercial self-sustainability of the RCCs is, therefore, a crucial objective of the central government.

The institutional reform has also led to higher share concentrations in RCCs. On the one hand, this means that the previous highly dispersed shareholding structure has become more concentrated, providing the fewer and larger shareholders greater voice. On the other hand, a more concentrated shareholding structure has proved to be a disadvantage to smaller farmer-shareholders as most of them have been squeezed out to make way for larger shareholders. Consequently, RCC shares are now held by large and wealthier individuals and institutional shareholders (G. He 2005).

To situate things in perspective, RCCs are still, by far, the predominant credit institutions in rural China. As of 2011, there were nearly 49,034 RCC branches spread across the country, followed by 19,910 rural commercial bank branches and 5,463 rural cooperative bank branches (Table 3). By way of comparison, there are forty-nine rural mutual aid funds, the alternative form of cooperative financial organizations. They are the focus of investigation in the rest of the paper. In passing, it is noteworthy that village and township banks and bank-invested credit companies, which have only emerged after the rural credit sector reform in the late 2000s, have also grown tremendously. However, they will not be discussed in the paper due to their noncooperative nature.

Rural Cooperative Credit Institutions in the Post-Commercialized RCC Era

Various research has shown that existing commercial credit institutions are not able to meet financial demands of rural households and microenterprises in rural China (G. He and Li 2005; L. He and Turvey 2009; X. Li, Gan, and Hu 2011; Zhu, Si, and Wang 2011). This concern lies behind

Table 3

Coverage of Rural Financial Institutions (2011)

Institutions	No. of legal entities	No. of branches	No. of staff
Rural Credit Cooperatives	1,927	49,034	502,829
Rural Commercial Banks	337	19,910	220,042
Rural Cooperative Banks	147	5,463	55,822
Village & Township Banks	800	1,426	30,508
Bank-Invested Credit Companies	14	14	111
Rural Mutual Aid Funds	49	49	421
Total	3,274	75,896	809,733

Source: People's Bank of China, *China Rural Finance Service Report*, 2012.

the policy rationale of the central government's 2004–2013 No.1 Document that pushes and advocates for the establishment of a wide range of microcredit institutions and endorses setting up mutual aid funds run by private individuals and funded by private capital.[7] During Hu Jintao's reign, for ten consecutive years, between 2002 and 2013, the central government emphasized development of the agricultural economy and betterment of the rural communities' livelihood, with reform of the rural credit sector as a crucial aspect of the policy vision. Since 2007, a whole host of grass-roots and informal cooperative financial organizations have emerged. Various government departments, such as the Department for Industry and Commerce, have also promoted and helped to establish cooperative financial institutions. Table 3 summarizes various rural mutual aid funds *(nongcun zijin huzhushe)* according to their operation, management, and mode of supervision. They can be divided into formal, quasi-formal, and informal institutions, according to their relationship with the government.

This section contains publicly available secondary data as well as primary data collected from field research. One of the authors had conducted extensive field research of these new cooperative financial organizations. The field sites and time of research were Lankao county in Henan and Lishu county in Jilin in May 2006; Yancheng city in Jiangsu in August 2007; Guangshan county in Henan in June 2008; and Puding and Leishan counties in Guizhou, Chuxiong City, and Tengchong county in Yunnan in July–August 2012.

Table 4

Major Categories of Rural Mutual Aid Funds in China

	Motivation	Forms	Source of funds	Approval from the CBRC	Registration	Scope of operation
Formal	According to the regulations of the CBRC	Independent With cooperative financial institutions	Absorb savings	Yes	Department for Industry and Commerce	Villages, Townships, or Towns
Quasi-formal	Endorsed by the local government	Exist within a cooperative	Absorb savings indirectly	No	No, or at Department of Civil Affairs	Villages, Townships, or Towns
	Endorsed by the central government	Exist within a cooperative	Do not absorb savings	No	No, or at Department of Civil Affairs	Villages
Informal	Established by farmers voluntarily	Independent	Do not absorb savings Absorb savings indirectly	No	No, or at Department of Civil Affairs	Villages or across villages
		With cooperative economic institutions	Do not absorb savings Absorb savings indirectly	No	No, or at Department of Civil Affairs	Villages or across villages

Source: Authors' summary.

Formal Mutual Aid Funds

Formal rural mutual aid funds *(zhenggui zijin huzhushe)* are approved by the China Banking Regulatory Commission (CBRC) and registered with the local Administrative Department for Industry and Commerce *(gongshang guanliju)*. Typically, those established in a township or village can only operate within their respective township or village. No cross-regional operation is allowed. Owing to their state nature, these institutions are essentially community-based mutual aid banking institutions *(shequ huzhuxing yinhang jinrong jigou)*.

Along with saving deposits, they also provide loans, settlements, and other banking services to their clients or members. As of June 2014, the CBRC has licensed 49 rural mutual aid funds (RMAF). They are located in Gansu, Qinghai, Jilin, Liaoning, Shanxi, Shandong, Jiangsu, and Anhui provinces.

These funds can absorb savings from either any rural household or only from members. (Households have to become members of a mutual aid fund before making a deposit.) Those that are member based tend to be larger in scale because as members' income grows over time, their contribution to the funds also rises. For instance, Jufuyuan RMAF in Yaodianzhi township, Yishu county in Shandong province was set up in March 2008 by forty-eight members with registered capital of 537,000 yuan.

Local Government-Promoted Quasi-Formal Mutual Aid Funds

Quasi-formal rural mutual aid funds *(zhun zhenggui zijin huzhushe)* are usually endorsed by local governments. In order to ease credit constraints faced by rural households and microenterprises, some local authorities, such as those in Jiangsu, Zhejiang, Hebei, and Beijing, have endorsed and promoted the development of grass-roots rural mutual aid funds based on voluntary capital contribution by members. In 2006, under the endorsement of Jiangsu's Yancheng municipal government, several quasi-formal institutions sprang up in Haifeng township in Dongtai city and Biancang township in the Tinghu district. In contrast to the formal mutual aid funds that are registered with the CBRC, these are registered with the Department of Civil Affairs *(minzhengju)* and loosely regulated by the local PBoC branch office. They absorb savings indirectly and operate within a given village or township.

We visited Enrich Farmers mutual aid funds in Sanlong township, Dafeng city in Jiangsu province, which was registered with the civil affairs bureau in April 2008. There were twelve shareholders with a total registered capital of 520,000 yuan. Eight of the shareholders each contributed 50,000 yuan, while the other four contributed 30,000 yuan each. The local government endorsed its establishment because formal credit institutions in the locale were not able to meet credit demands of rural households and microenterprises. In our definition, the state endorsement makes it a quasi-formal or -state institution.

Table 5 shows the uses and terms of loans given by Enrich Farmers cooperative. Seventy percent of its loans were used as business capital, 12 percent for animal farming, and 7.7 percent for farming. Half of its loans were of a one-year term, and the other half were of a six-month term. This mutual aid fund has several advantages over formal credit institutions that have helped build its clientele base. Because it is a grassroots organization, the degree of informational asymmetry between the institution and clients or borrowers is significantly reduced. Therefore, most lending decisions can be made on the basis of trust or interpersonal relationship. By way of contrast, almost all the formal credit institutions require collateral and/or guarantors from borrowers, which many rural households and microenterprise owners have difficulties supplying.

It is also noteworthy that its nonperforming loan rate is low, usually below 5 percent. This is attributable to the fact that, because of geographical proximity, members know each other relatively well and that trust and social capital have effectively imposed peer pressure on borrowers. Additionally, the mutual aid funds also impose higher lending rates as penalty for late repayments as a deterrent against delinquent loans.

Central Government-Promoted Poverty Alleviation Mutual Aid Funds

The other type of quasi-formal mutual aid funds is promoted by the central government for the purpose of poverty alleviation. In May 2006, the State Council Leading Group Office of Poverty Alleviation and Development (CPAD) and the Ministry of Finance (MoF) jointly selected fourteen provinces to carry out pilot experiments of the program. These provinces were Hebei, Shanxi, Inner Mongolia, Heilongjiang, Anhui, Jiangxi, Henan, Hunan, Sichuan, Guizhou, Shaanxi, Gansu, Ningxia, and Xinjiang. The government selected one to two counties within

Table 5

Uses and Terms of Loans by Enrich Farmers' Cooperative, Dafeng City, Jiangsu Province

Uses of Loans (2009–2010)			Terms of Loans (2008–2009)		
	Loans (Thousand Yuan)	Share (%)		Loans (Thousand Yuan)	Share (%)
Business	5,010	70.8	Four months	647	2.1
Animal Farming	870	12.3	Five months	156	0.5
Farming	542	7.7	Six months	14,234	46.0
Land Contract	300	4.2	One year	1,590	51.4
Construction	250	3.5	–	–	–
Housing	100	1.4	–	–	–
Total	7,072	100.0	Total	16,628	100.0

Source: Enrich Farmers' Cooperative, Dafeng City, Jiangsu.

each province, and ten poverty villages were then selected within each county for the pilot program. These funds were supervised by relevant county poverty alleviation offices. As of December 2012, this program had reached about 15,000 villages. Each village received 150,000 yuan from the central poverty alleviation funds. Rural households in these poverty villages can also pay to become members of the poverty village development mutual aid funds that enable them to borrow money from these funds. In some places, these funds can also absorb savings from rural households.

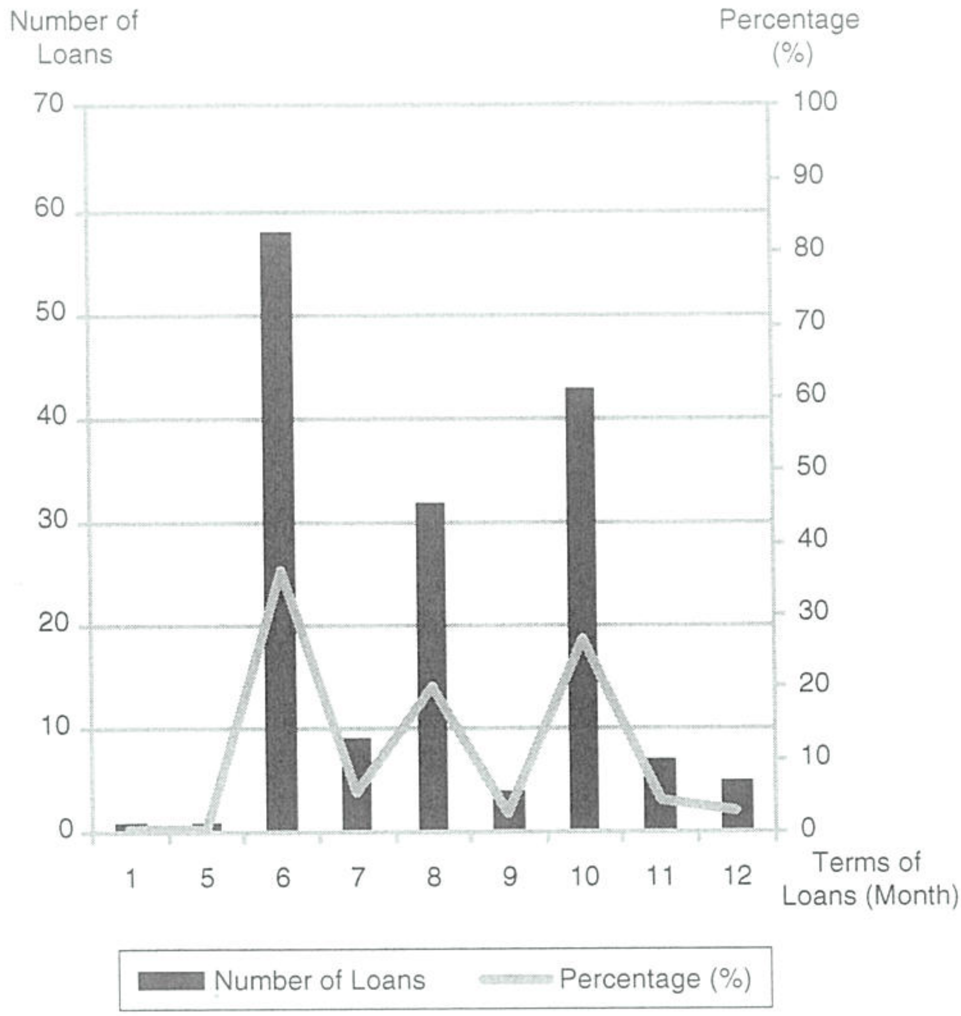
In August 2012, we conducted field research in twenty-four villages located in twelve poverty-stricken counties across six provinces—Yunnan, Guizhou, Liaoning, Shandong, Jiangxi, and Anhui.[8] These villages were either "central government-designated poverty villages" (guojiaji pinkuncun) or "provincial government-designated poverty villages" (shengji pinkuncun). These villages were usually located in remote areas, populated by low-income households with income level around the national poverty line, that is, with annual per capita income of 2,300 yuan. The sources of funds were either from the central government's poverty alleviation funds or villagers' voluntary contributions.

Among the 610 rural households we interviewed, villagers had borrowed from both formal and informal sources. Term of loans from mutual aid funds averaged about ten months, while those from commercial banks averaged about fifteen months. Loans from quasi-formal mutual aid funds were of a short-term nature. Figure 1 shows that among the 160 loans issued by the mutual aid funds in Tengchong county, Yunnan, that we had investigated, none was longer than twelve months. Because of the small scale, informal loans are typically smaller and meant to meet urgent and short-term credit demands of rural households that are unable to obtain finance from formal institutions. Related to the issue of loan term is interest rate. Loan rates issued by these mutual aid funds were jointly set by the members. This led to diverging lending rates among villages. Generally, mutual aid funds are allowed to raise lending rates to a maximum of 2.3 times that of the central bank's base rate, although most of them set their rates with reference to prevailing rates in the formal banking system, which is usually in the range of 120–180 percent of the base rate. Our findings also indicated that because loans issued by the poverty alleviation mutual aid funds are used for basic production and consumption purposes, they play an essential role in helping poverty households maintain a subsistence living without which many of them may sink further into poverty.

Informal Cooperative Financial Organizations

By comparison, informal rural mutual aid funds *(fei zhenggui zijin huzhushe)* are grass-roots organizations initiated and established by farmers without approval of or backing from the central or local governments. They usually emerge when formal credit institutions are unable to meet credit demands of rural households and microenterprises. Hence, users of credit recognize the need in taking initiatives to organize something for themselves. There are various such informal institutions in Henan, Anhui, Shandong, Jilin, and Jiangsu provinces. Some of them operate within a village while others operate across villages. The common feature of these organizations is that they are not approved by the CBRC. They are, hence, illegal, strictly speaking. Owing to their illegal status, these informal institutions cannot absorb savings, which means their capital has to come from members. However, some of them still do so, although in an indirect manner or roundabout way, such as in the name of share contributions by members. The government has implicitly allowed these institutions to operate in spite of their lack of legal recognition because they are able to provide useful services to some rural communities, which

Figure 1. Terms of 160 Loans Issued by the Mutual Aid Funds in Tengchong County, Yunnan Province (2007–2012)



Source: Mutual aid funds in Tengchong county, Yunnan.

the existing formal organizations are unable to offer. The latter tend to be geared toward large enterprises and borrowers, to the disadvantage of microenterprises and smaller borrowers.

One such informal institution is a cooperative in Funing county, Jiangsu, which was set up in March 2006 as a production and marketing cooperative. Its officially declared business activities include agricultural production and pest control; credit services or mutual aid funds were not among them.[9] However the cooperative members have set up a mutual aid fund by pooling surplus capital (each contributed 50 yuan) and lending to each other with interest accrued. As of December 2012, of the 689,000

Table 6

Loans from Rural Mutual Aid Funds in He village, Nanmazhuang village, and Huzhai village, in Lankao County, Henan Province, and in Baixin village, Lishu County, Jilin Province

Village	Total Capital (yuan)	Average Loan Size (yuan)	Number of Loans	Non-performing Loans (%)	Average Loan Size to GDP Per Capita (%)	Max Term (months)	Max Loan Size (yuan)	Min Loan Size (yuan)
Hecun	38,000	2,158.5	41	0	106.6	6	5,000	500
Nanma-zhuang	33,350	1,471.1	52	0	72.6	9	3,000	200
Huzhai	35,400	1,764.7	17	0	87.2	6	3,000	500
Baixin	22,800	2,539.3	28	0	29.4	9	5,000	1,000

Source: Authors' survey.

professional cooperatives nationwide registered with the Department of Industry and Commerce, about 16,000 of them, or 2.7 percent, operate some form of cooperative finance where members contribute to a pool of funds, which can be lent to other members in need of credit. It is worth mentioning that these are *not* credit institutions in their entirety; finance is merely a subdivision within the cooperatives.

We also investigated four grass-roots informal cooperative financial organizations between 2004 and 2006, three of which were located in Henan (Hecun, Nanmazhuang, and Huzhai mutual aid funds in Lankao county) and one in Jilin province (Baixin mutual aid funds in Lishu county). These farmer-initiated informal organizations face severe capital constraints. It is no surprise that the loans issued are typically in small amount and of a short-term nature. As indicated in Table 5, loan size ranges between 2,000 and 5,000 yuan, with the average hovering between 1,500 and 2,200 yuan. Due to the remote locations of these villages, rural households are beyond the reach and coverage of the commercial banking institutions. Formal credit institutions also face the problems of information asymmetry and moral hazards, given the high costs of obtaining information about credit-worthiness of borrowers in remote areas. As shown in Table 6, these institutions have zero nonperforming loan rates, which signify their enhanced capacity in assessing credit-worthiness of borrowers. About 60 percent of the informal loans was used for production purposes, such as buying seeds and fertilizers; animal husbandry; mushroom cultivation; and the purchase of agricultural vehicles and harvesters. The other 40 percent was used for consumption purposes, such as home construction, tuition fees, weddings, and funerals. Loans issued by informal institutions are usually based on trust between borrowers and creditors, in the absence of any collateral and guarantor. In the rare occasions of large loans or out-of-town borrowers, collateral or guarantor may be required.

Conclusion

This paper has described the commercialization process of RCCs, the formal credit institutions in rural China. Their increased profit orientation has left behind poor rural households, often located in remote areas, whose credit demands are unmet by any existing institutions. The paper has also described the emerging cooperative credit institutions or mutual aid funds that fill the gap in the rural credit sector left by commercialized

RCCs. There are formal mutual aid funds, quasi-formal and informal institutions. Some quasi-formal mutual aid funds are endorsed and promoted by local governments, while other are explicitly sanctioned by the central authority, such as those oriented toward poverty alleviation. Those promoted by local governments are typically larger in scale and located in economically more developed areas. They tend to issue loans for investment and productive uses of the economically disadvantaged group in relatively wealthy regions. In stark contrast are poverty alleviation mutual aid funds heavily subsidized by the central poverty alleviation office, which have the proclivity of issuing loans to meet basic productive and consumption credit needs of rural poverty households. Private-initiated informal mutual aid funds are set up when existing institutions are unable to meet the credit demands of the rural community. Therefore, the loans are used for a range of purposes, but mostly for productive and consumption uses. Informal loan transactions are usually based on trust, in which neither collateral nor guarantors are required.

In no small part, these mutual aid funds have emerged because of endorsement from the central government. Since 2007, the central government, through the State Council and the CBRC, has promulgated various regulations and policy statements to encourage and promote growth of grass-roots financial institutions run by private individuals and funded by private capital, such as the State Council's Documents No.1 released between 2002 and 2013, and similar documents by provincial governments. The myriads of institutions that have sprung up include township and village banks, microcredit companies, and rural mutual aid funds. The policy rationale is none other than to increase competition in the rural credit sector and to allow emergence of new institutions to serve clients whose credit demands are unmet by rural credit cooperatives and commercial banks. This is the key thrust of the twelfth Five-Year Plan with respect to rural credit sector. Under the Plan, we can reasonably expect these new institutions to continue increasing in number and grow in strength. This can only bring benefits to rural households that were previously served by monopolistic rural credit cooperatives and state-owned commercial banks in selected localities.

Notes

1. Ong (2012), 39–40.

2. Notably, this arrangement differs from the central government's arrangements for ridding the four big state-owned banks of their bad assets. In the latter case, the

central government established asset management companies to buy over bad assets from the state-owned banks.

3. Ong (2012), 156.

4. Ong (2012), 44.

5. See Ong (2012) for a history and analysis of how local governments were and had been able to influence RCC loan-making decisions from throughout the 1980s and 1990s.

6. The State Council, Document No. 66, "Opinions for the Pilot Programs to Deepen Rural Credit Cooperative Reform," August 17, 2004.

7. For instance, the latest Document No.1 released in 2013 is "Opinions on Accelerating Development of Modern Agriculture and Strengthening Rural Community Development" (guanyu jiakuai fazhan xiandai nongye jinyibu zengqiang nongcun fazhan huoli de nuogang yijian).

8. The research was conducted in conjunction with Professor Wanlong Lin at the China Agricultural University.

9. Even though it was *not* registered as a credit cooperative, it conducts credit activities.

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