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Are Modern Credit Cooperatives the Best Way to Serve China's Rural Poor?

By Ralph Swoboda and Zhang Ruibin



China is home to the world's largest credit cooperative movement, serving an estimated 200 million households, most of them poor farmers. For more than 50 years, that system has been the primary source of basic financial services for China's rural poor. Even within the modern economic powerhouse that China has recently become, the rural credit cooperatives (RCCs) hold 12% of all bank deposits. They account for more than 90% of legitimate agricultural lending in an economy where almost half the workforce still farms the land.

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Now in the midst of a major government-engineered reform, RCCs are undergoing profound changes. The outcome of those changes will determine whether RCCs can develop into true mutual institutions or will have to sacrifice their cooperative structure to become a collection of relatively small commercial banks. World Council of Credit Unions (WOCCU) and the People's Bank of China (PBC), the country's central bank, have partnered to assess the progress of RCC modernization and identify the best policy framework for its completion.

A central question posed by PBC's senior leadership is whether the RCCs can be successfully transformed into true member-owned and directed cooperatives. Based on field research in China's southwestern Guizhou Province, where the reform started in 2003, and interviews with RCC managers, government officials and academics elsewhere in China, the WOCCU/PBC team is optimistic that they can.

While progress to date has been impressive, major challenges remain. For the most part, those challenges flow from persistent weaknesses in RCC governance and staffing and from the risks and scale diseconomies of lending small amounts to poor farmers.

Creating a "Harmonious Society"

Rebuilding the RCCs is a critical priority for the Chinese government as a way to help balance the country's new wealth, which flows disproportionately to commercial and manufacturing centers like Shanghai, Guangzhou and Beijing, where a growing middle class thrives from foreign investment and international trade. The resulting disparity between urban and rural incomes is widening yearly and carries the growing threat of social instability, historically the greatest fear of Chinese leaders.

As a result, the central government has put a high priority on rural development, with the goal of creating a "harmonious society" in which farmers gain a greater share of the nation's prosperity. China's leaders recognize that affordable credit is essential to achieving that objective, giving RCC reform and modernization major importance.

With a population of some 40 million, Guizhou is one of China's poorest provinces, where per capita rural incomes average less than US\$270 per year. By the time reform began there in 2003, its RCCs had been losing money and accumulating bad loans.

Just four years later, the improvements are striking. The Guizhou Provincial Rural Credit Cooperative Union (RCCU) was set up to manage the change process and provide centralized investing, liquidity, information technology, training and auditing. New managers with modern banking experience were recruited, and 2,000 village RCCs were merged into 84 county-level RCCUs and four rural cooperative banks (RCBs). By 2005, the Guizhou Rural Credit Unions, as they now call themselves, made a small net profit overall. Last year each of them operated in the black, and the system's total assets grew by 37% to nearly US\$9 billion.

All the same, the challenges remain formidable. While profits are generated by a growing portfolio of loans to small businesses, two-thirds of RCC lending is to farming households in amounts averaging US\$550. Annual interest on a loan that small barely covers administrative costs, let alone the risk of default arising from the vagaries of weather and agricultural markets. Bad debt levels, down overall, are still as high as 10% in some counties.

A Question of Mutual Status

The big debate on which policy-makers, academics and RCC people themselves are divided is about which ownership and



Guizhou Rural Credit Union, in the Guizhou city of Guiyang, is one of a growing number cooperative institutions.

governance structures will best suit rural RCCs going forward. In most eastern cities, the new rural commercial banks have completed their demutualization process and are no longer cooperative, even in name. But for rural areas, many question whether profit-motivated commercial banks will be willing to make low-margin, high-risk microfinance loans to poor farmers.

At least in Guizhou, the RCCs have been moving in the direction of becoming real member-governed cooperatives. Although RCC people themselves acknowledge that governance is still weak, it's as democratic as one finds in many cooperative



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Residents of Anshun, in Guizhou Province, stop and smile on the street.

systems elsewhere in the world. Moreover, even in wealthy parts of China, some of the urban RCCUs have remained mutual institutions. Though tempted by the perceived advantages of a public-company structure for raising capital, RCC leaders recognize that ties to their individual member-owners offer a big competitive advantage.

For example, in the prosperous eastern cities of Guangzhou and Tianjin, many RCC customers are former farmers who have become factory workers or shopkeepers but retain loyalties to the RCC that always gave their family a loan. Outside the city centers, the rural cooperative banks rank high in market share, often well ahead of local branches of the much larger state-owned banks. The tie to the customer that comes from mutual ownership has proven to be a real value for these RCCs.

It's difficult to predict whether true credit cooperatives can establish themselves in modern China. The signs are encouraging, however, and WOCCU and PBC are working together to see whether the cooperative ideal, properly implemented, will be the best way to provide affordable financial services to China's rural poor. 🌐

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WOCCU's Efforts in China

Oct. 2006

People's Bank of China (PBC) deputy governor Wu Xiaoling meets in Beijing with WOCCU CEO Pete Crear and WOCCU China advisor Ralph Swoboda, requesting that WOCCU assess the progress of RCC reform and advise on whether RCCs can be transformed into real credit unions.

Dec. 2006

Swoboda and a team of economists from PBC's Research Bureau visit RCCs in rural Guizhou and Sichuan Provinces in southwestern China. Their joint report concludes that RCC reform is on the right track and recommends a follow-up project by WOCCU.

March 2007

Meetings are held between WOCCU officials, PBC and the Chinese Banking Regulatory Commission in Beijing and with RCC officials in Guizhou to review the assessment and plan the next stage for WOCCU's work in China.

June 2007

WOCCU leads a delegation of credit union leaders from the United States and Canada to visit government officials in Beijing and RCC organizations in Guizhou and the northeastern city of Tianjin.

Aug. 2007

WOCCU and PBC sign a cooperation agreement for the first phase of a project in China. The objective is to achieve a deeper understanding of the technical assistance needs of RCCs serving poor areas and to assist PBC in developing a policy framework for the RCC sector.

Aug.-Sept. 2007

A joint WOCCU/PBC project team conducts in-depth visits and interviews at a cross-section of RCCs in Guizhou, developing a needs assessment from their review of staffing, operational procedures, governance, product and service offerings and financial results.

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Dec. 2007

Officials from PBC and Guizhou RCCs visit National Credit Union Administration, CUNA & Affiliates and WOCCU offices in Washington, D.C. to learn more about how U.S. credit unions are regulated and supervised. Later, the delegation learns how credit unions are supported by leagues and corporate credit unions during visits to the California Credit Union League, WesCorp and Arrowhead Credit Union.

Future Plans

Planning for the development and implementation of a WOCCU training program for RCCs through an ongoing partnership with U.S. credit unions is underway. The program will kick off with sessions offered in Chinese to RCC officials attending the 2008 World Credit Union Conference in Hong Kong. 🌐