

# China's Monetary Reform: the counterrevolution from the countryside

CARSTEN A. HOLZ\*

*Until the late 1990s, the rapid development of rural cooperative funds as semi-formal financial institutions in the countryside attracted little attention. In many provinces, these funds took over large swathes of rural finance, before the State Council in March 1999 issued a secret decree requesting that they be immediately dissolved. This paper explores the reasons for the rapid development of rural cooperative funds in many localities, examines why this has been an issue of contention, and explains why it has taken the central government such a long time to come up with a coherent—and, furthermore, drastic—response. Although rural cooperative funds are now being dissolved across the country, they may already have achieved their purpose of revolutionizing financial intermediation in the countryside.*

## Introduction

China's rural economy has only limited access to formal financial sector funding. Throughout the 1990s, the contribution of township and village enterprises (TVEs) to national output exceeded their share of formal financial sector loans by three to four times. Agriculture is no better off; its share of gross domestic product throughout the 1990s exceeded its share of loans four-fold.<sup>1</sup> The discrepancy need not necessarily imply a lack of external funds, but it implies a potential scarcity of formal financial sector funding in the countryside.

One significant development in the 1990s was the rapid spread of various forms

---

\* Carsten A. Holz is an Assistant Professor in the Social Science Division of the Hong Kong University of Science and Technology. At the time this manuscript was accepted for publication he was a Visiting Assistant Professor in the Department of Economics at Cornell University. The author gratefully acknowledges financial support through a Direct Allocation Grant of the Hong Kong University of Science and Technology. He would also like to thank Thomas P. Lyons, David Zweig, Anita Chan, Jen-Chi Cheng and the anonymous reviewers for their comments.

1. The formal financial sector includes the four state commercial banks (Industrial and Commercial Bank of China, Agricultural Bank of China, Construction Bank of China, and Bank of China) and all other nationwide and regional commercial banks, savings deposit agencies of postal offices, housing savings banks, urban and rural credit cooperatives, urban cooperative banks, financial trust and investment agencies, and finance companies. For data see *Zhongguo Nongcun Jinrong Tongji Nianjian 1996* [Statistical Yearbook of China's Rural Finance 1996] (Beijing: Zhongguo Tongji Chubanshe, 1996), pp. 70, 614; *Zhongguo Tongji Nianjian 1999* [Statistical Yearbook of China 1999] (Beijing: Zhongguo Tongji Chubanshe, 1999), pp. 55, 412, 624; *Zhongguo Tongji Nianjian 1996* [Statistical Yearbook of China 1996] (Beijing: Zhongguo Tongji Chubanshe, 1996), p. 614; *Zhongguo Tongji Nianjian 1993* [Statistical Yearbook of China 1993] (Beijing: Zhongguo Tongji Chubanshe, 1993), pp. 51, 664; *Zhongguo Xiangzhen Qiye Nianjian 1993* [China Township and Village Enterprise Yearbook 1993] (Beijing: Zhongguo Nongye Chubanshe, 1993), p. 147.

of semi-formal 'rural cooperative funds' (*nongcun hezuo jijinhui*, also translated as 'rural cooperative foundations') in many localities across the country.<sup>2</sup> While rural cooperative funds (RCFs) were originally set up in the late 1980s to manage the financial property of the disbanded communes and production brigades, by the early 1990s the RCFs, under the protective shield of the Ministry of Agriculture (MoA), had their eyes set on much grander development schemes. In many provinces, RCFs took over large swathes of rural finance. In March 1999 the State Council (SC) issued a secret decree to immediately dissolve the RCFs. By mid-April, the RCFs were reported to have been dissolved in Sichuan Province, by mid-September in Hebei Province. Other provinces were slow to follow suit, and RCF may yet survive in many localities for some time to come.

RCFs have received only limited attention. Discussion within China was largely restricted to specialized journals before it disappeared when the SC in 1997 began to question the continued growth of RCFs.<sup>3</sup> Newspaper coverage of RCFs throughout the mid-1990s was minimal and then turned increasingly negative. For example, the failure of three RCFs in Lanxi Municipality, Zhejiang Province, triggered a severe and much publicized criticism by the State Council.<sup>4</sup> Few scholars outside China have taken notice of the RCFs. Park *et al.* (1997) document a negative impact of RCFs on the development and profitability of formal financial institutions in a locality. Tsai (1999) investigates the relationship between local government attitudes towards the private economy and the development of different informal financial institutions. Cheng *et al.* (1998), in a case study, look at the governance of RCFs and the innovations that RCFs introduce to rural lending practices. Du (1998) and Chen *et al.* (1998) give general overviews over the rise of the RCFs.<sup>5</sup>

---

2. Other sources of funding in the countryside include loans between individuals (*minjian daikuan*), loans extended by private banks and government departments, bank loans lent on by state-owned enterprises, as well as off-balance sheet financing from the formal financial sector. For more details see, for example, Zhu Delin and Hu Hai'ou, *Zhongguo De Huihe Jinrong: Shichang Fengyun Yu Lixing Sikao* [China's Grey and Black Finance: Fast-changing Market and Reasons for its Evolution] (Shanghai: Lixin Kuaiji Chubanshe, 1997); Jiang Xuchao, *Zhongguo Minjian Jinrong Yanjiu* [Informal Finance in China] (Jinan: Shandong Renmin Chubanshe, 1996); Huang Weiting, *Zhongguo De Yinxing Jingji* [China's Invisible Economy] (Beijing: Zhongguo Shangye Chubanshe, 1996), section 10.4; Xu Xiaobo and Deng Yingtao, *Zhongguo Nongcun Jinrong De Biange Yu Fazhan 1978–1990* [Transformation and Development of China's Rural Finance 1978–1990] (Hong Kong: Oxford University Press, 1994). Hu Biliang and Zhang Yuanhong, 'Zhongguo Nongcun Jinrong Bumen De Gaige Yu Fazhan' ['Reform and development of China's rural financial institutions'] (Academy of Social Sciences, Beijing, manuscript, 1998), describe the recent reforms in the rural financial sector.

3. See, for example, the agricultural journals *Nongcun Jingji* [Rural Economy], *Nongcun Jingji Yanjiu* [Rural Economic Research], and *Nongcun Hezuo Jingji Jingying Guanli* [Rural Cooperative Economy Management and Administration], or the financial sector journals *Jinrong Yanjiu Baogao* [Financial Research Report] and *Jinrong Cankao* [Finance News]. Many of the reports in these journals are survey reports of individual localities, often individual townships. Journals associated with the agricultural departments adopt a positive tone, while those associated with the formal financial sector tend to be highly critical of RCFs.

4. *Renmin Ribao* [People's Daily], (25 November 1996).

5. Albert Park, Loren Brandt and John Giles, 'Giving credit where credit is due: the changing role of rural financial institutions in China' (Working Paper No. 71, The William Davidson Institute, March 1997); Kellee S. Tsai, *Banking Behind the State: Private Entrepreneurs and the Political Economy of Informal Finance in China, 1978–1998*, (Ph.D. dissertation, Columbia University, 1999); Cheng Enjiang, Christopher Findlay and Andrew Watson, "'We're not financial organisations!": financial innovation without regulation in China's rural cooperative funds', *MOCT-MOST* 8(3), (1998), pp. 41–55; Du Zhixiong, 'The dynamics and impact of the development of rural cooperative funds (RCFs) in China' (Working Paper No. 98/2, Chinese Economics Research Centre, The University of Adelaide, March 1998);

This paper explores the reasons for the rise of the RCFs in the early 1990s and then their fall in 1999. In the early 1990s, formal financial sector lending in the countryside became increasingly scarce and fiscal funds saw a relative decline. Consequently, local government and Party departments usurped and expanded the existing communal RCFs in an attempt to fill the gap in rural financial intermediation. While RCFs are locally established institutions with little nationwide co-ordination through the MoA, all share some common characteristics, and to some degree they all impact on the rural economy and the nationwide financial system. RCFs prevent the outflow of funds from rural areas for lending to urban, primarily state-owned industrial enterprises, and they serve many of those rural enterprises and households that the formal financial sector neglects.

But the growth of the RCFs also implies stagnating if not falling deposits at formal financial institutions in the countryside and thus a reduction in their profitability; when bad loans at formal financial institutions cannot be recovered to meet household deposit withdrawals, formal financial institutions face bank runs. Poorly managed RCFs themselves may experience liquidity problems with ensuing bank runs on RCFs. The People's Bank of China (PBC) as central bank by 1997 was no longer willing to idly stand by. Moreover, it had been assigned the task of reorganizing the approximately 50,000 county- and township-based rural credit cooperatives (RCCs) that until 1996 were little more than branches of the Agricultural Bank of China (ABC), but then became independent. Resuscitating the RCCs proved a major challenge not least due to the fierce competition from the unregulated RCFs. Since March 1999 the PBC, with support from the SC, is merging the largest RCFs with the RCCs, and thus opening the door to potentially far-reaching changes in formal financial intermediation in the countryside.

This paper draws on nationwide as well as provincial and sub-provincial tier evidence. Central and provincial documents are available from a number of law collections and bulletins. Chinese journals provide numerous case studies. Interviews were conducted throughout 1997 and 1998 in several counties of Shaanxi Province (western region), Hebei and Henan Province (central region), Jiangsu Province (coastal region) as well as in Beijing. Local government documents were frequently on display in the RCFs in an attempt to create an image of respectability, at times in competition with other local RCFs. Much of the detailed data are from Shaanxi Province. While no claim is made that Shaanxi is representative of the whole country, the secondary literature on RCFs suggests that Shaanxi is at least as good a locality to study as any other. Shaanxi has a wide range of different RCFs, and the author was able to secure a rich collection of documents.<sup>6</sup>

This paper is organized as follows. The next section documents the scarcity of funds in the countryside in the early 1990s as the prime explanation for the rise of the RCFs. The third through to the fifth sections examine the characteristics and extent of RCFs, explore how far RCFs meet the needs of the locality, and examine

---

*Footnote 5 continued*

Chen Zhen and Liu Shucheng, 'Mingque Zhuguan Bumen Zhize, Gaohao Hezuo Jijinhui Guanli' ['Clarify the responsibilities of the superordinate departments in order to manage the RCFs well'], *Nongcun Hezuo Jingji Jingying Guanli* 4, (April 1997), p. 22.

6. Five detailed interview case studies are available on request.

why their growth gave rise to central government concern. The sixth section traces the indecision at the center throughout the 1990s on how to cope with the RCFs. The last section concludes.

### **The decrease in formal financial sector lending in the countryside**

The degree of financial intermediation in China's countryside has always been low due to systemic reasons—deficiency in financial intermediation. Until the mid-1990s, all banks except the ABC served exclusively the urban, mainly state-owned economy. Up to 1998, lending by the formal financial sector was ruled by an imperative credit plan that left little quota for lending other than to the state sector. With an implicit government guarantee on loan repayment it was safe to lend to the state sector. No such implicit repayment guarantee existed for lending to customers other than state-owned enterprises, such as TVEs, or rural households. The formal financial sector controlled and mostly owned by the central government thus had an in-built bias towards lending to the, all to some degree centrally controlled, state-owned enterprises.

The task of providing financial intermediation in the villages and townships fell primarily to the RCCs, yet in the Cultural Revolution the RCCs turned into mere branches of the ABC and remained part of the distant formal financial sector until they were split off from the ABC in 1996.<sup>7</sup> While the credit planning system allowed RCCs some leeway in who to lend to, until 1996 they had to deposit up to half of their funds at the ABC. Their lending in the countryside thus remained relatively small, and much of it was driven by central government policies. The outcome was a potentially under-funded rural economy. Neither township nor village government or individuals were able to establish financial institutions as the central government retained tight control over the financial system. Lending became particularly scarce after 1992 when the economy began to overheat and the central government took a host of contractionary measures, including a recentralization of the formal financial sector.

Within each formal financial sector institution, the recentralization led to a lack of decision-making authority, a lack of lending allowance (quota), and a lack of funds at the lowest-level bank branches. Decision-making authority on lending moved up from the lowest-level branches to the municipal tier branch and above. A larger share of the credit quota was retained by higher-level branches for their own lending. Lower-level tier bank branches then were starved of funds to lend as each bank branch was required to deposit a 'second-tier minimum reserve' at the next-higher level branch to fund the higher-level branches' lending. In addition, since 1994, all refinancing of financial institutions by the PBC occurs on central tier, further starving local bank branches of funds.

The data in Table 1 document the increasing relative scarcity of formal financial sector lending in the countryside. Lending by the ABC and RCCs to agriculture (including state- and collective-owned farming as well as agricultural households)

---

7. For details on the development of the RCCs in recent years see Andrew Watson, 'Conflict of interest: reform of the rural credit cooperative in China', *MOCT-MOST* 8(3), (1998), pp. 23–40.

Table 1. Formal sector lending to township- and village-run enterprises

	1990	1991	1992	1993	1994	1995	1996	1997
<b>Annual growth rates in bank lending (in %)</b>								
Total loans by all formal financial institutions		20.68	23.36	25.15	23.88	23.84	21.00	22.50
Loans to agriculture:								
By Agricultural Bank of China (ABC)		23.54	21.78	1.26	2.21	27.93		
By rural credit co-operatives (RCCs)		22.84	22.56	- 33.14	22.56	35.41	36.40	24.01
By ABC and RCCs		23.16	22.20	- 17.21	11.04	31.51		
Loans to TVEs:								
By Agricultural Bank of China (ABC)		7.84	16.87	32.98	21.14	17.81		
By rural credit co-operatives (RCCs)		29.92	42.17	37.73	27.74	22.07	17.45	12.92
By ABC and RCCs		21.15	33.22	36.25	25.74	20.83		
<b>Township- and village-run enterprise balance sheet:</b>								
<b>bank loans from formal financial sector</b>								
Annual growth rate (in %)		27.80	35.68	72.38	11.29	9.24	15.20	- 5.57
Share in total liabilities and equity (in %)					22.08	18.89	18.53	19.46
Growth rate of this share						- 14.45	- 1.86	4.98
<b>Output-lending ratios</b>								
GDP/total loans of formal financial sector	1.0490	1.0131	1.0120	1.0513	1.1458	1.1571	1.1101	
Annual growth rate (in %)		- 3.42	- 0.11	3.88	8.99	0.99	- 4.06	
Township- and village-run ent. gross output value/bank loans	6.3268	6.0803	6.8267	6.8962	9.5774	11.6460		
Annual growth rate (in %)		- 3.90	12.28	1.02	38.88	21.60		
Township- and village-run ent. value-added/bank loans					2.1084	2.5848	2.4628	2.5174
Annual growth rate (in %)						22.60	- 4.72	2.22

Notes: All data on township- and village-run enterprises, whether balance sheet or output data, exclude Guangdong Province since no 1994 data are available; value-added data in 1994 for Shanghai are also not available and thus excluded. In 1995, Shanghai contributed 3.32% of nationwide value-added (excluding Guangdong Province); if the share was the same in 1994, then the ratio of township- and village-run enterprise value-added to bank loans in 1994 is 2.18.

Sources (calculated from):

Formal financial sector lending: *Zhongguo Jinrong Nianjian 1997* [Financial Yearbook of China 1997] (Beijing: Zhongguo Jinrong Chubanshe, 1997), p. 464; *Zhongguo Jinrong Nianjian 1998*, p. 508.

ABC and RCC loans: *Zhongguo Nongcun Jinrong Tongji Nianjian 1996* [Statistical Yearbook of China's Rural Finance 1996] (Beijing: Zhongguo Tongji Chubanshe, 1996), pp. 12, 15, 56; *Zhongguo Nongcun Jinrong Tongji Nianjian 1995*, pp. 15, 21, 29, 77f; *Zhongguo Nongcun Jinrong Tongji Nianjian 1993*, pp. 43, 87; *Zhongguo Jinrong Nianjian 1997*, p. 564; *Zhongguo Jinrong Nianjian 1998*, p. 621.

Township- and village-run enterprise loans, assets, gross output value, and value-added: *Zhongguo Xiangzhen Qiye Nianjian 1998* [China Township and Village Enterprise Yearbook 1998] (Beijing: Zhongguo Nongye Chubanshe, 1998), pp. 112, 223, 225; *Zhongguo Xiangzhen Qiye Nianjian 1997*, pp. 129, 242, 245; *Zhongguo Xiangzhen Qiye Nianjian 1996*, pp. 254-256, 258; *Zhongguo Xiangzhen Qiye Nianjian 1995*, p. 90; *Xiangzhen Qiye Caifu Tongji Huizong Ziliao 1994* [Township and Village Enterprise Financial Statistics Material 1994] (Beijing: Nongye Bu, 1995); *Zhongguo Xiangzhen Qiye Nianjian 1994*, pp. 179, 369; *Zhongguo Xiangzhen Qiye Nianjian 1993*, pp. 153, 239; *Zhongguo Xiangzhen Qiye Nianjian 1992*, pp. 144, 207; *Zhongguo Xiangzhen Qiye Nianjian 1991*, pp. 144, 200; *Zhongguo Tongji Nianjian 1996*, p. 389.

GDP: *Zhongguo Tongji Nianjian 1998* [Statistical Yearbook of China 1998] (Beijing: Zhongguo Tongji Chubanshe, 1998), p. 55.

**Table 2.** Ratio of county tier share in provincial expenditures to county tier share in provincial revenues

	1993	1994	1996	Growth rates (%)	
				94/93	96/94
Henan	1.12	1.00	0.94	- 11.12	- 5.46
Xinjiang	1.49	2.15	1.80	44.05	- 16.24
Yunnan	1.55	1.41	1.00	- 8.73	- 29.25
Zhejiang	0.56	1.17	1.82	108.21	55.46
Ningxia	1.26	1.50	1.07	18.99	- 28.67
Anhui	1.09	1.70	1.32	56.03	- 22.38
Sichuan	0.10		0.79		
Shaanxi	0.98	0.95	0.89	- 2.87	- 6.84
Jiangxi	0.73	1.35	0.78	83.96	- 42.35
Hebei	1.29	2.17	0.78	68.63	- 63.85
Tianjin	6.44	0.97	0.98	- 84.94	1.21

Sources: Calculated from individual provincial statistical yearbooks. For all excluded provinces the data are not available in their statistical yearbooks.

dropped sharply in 1993 and recovered only in 1995. Lending to TVEs began to slip in 1994 and fell below the growth rate of all lending by formal financial institutions in 1995; RCC lending to TVEs, for which later data are also available, continued to grow at a rate below the nationwide average only.<sup>8</sup>

The low growth rate of lending in the countryside can also be documented for one particular group of TVEs, the township- and village-run enterprises.<sup>9</sup> According to their consolidated balance sheet, the annual growth rate of their borrowing from any formal financial sector institution fell below the nationwide formal financial sector loan growth rate in 1994 and stayed at a below-average level ever after (Table 1). Yet these enterprises expanded so rapidly that the share of bank loans in their total liabilities and equity fell by 14% in 1995 and by another 2% in 1996. Viewed differently, the nationwide ratio of GDP to formal financial sector lending remained remarkably constant between 1.01 and 1.16 in the period from 1990 to 1996, with a small rise from 1.05 in 1993 to 1.15 in 1994 and to 1.16 in 1995. Township- and village-run enterprises, on the other hand, not only add twice as much value per formal financial sector lending than the nationwide average, but

8. In 1991 the volume of TVE loans was approximately equal to the volume of agricultural loans; in 1995 the first was approximately 50% larger than the second. ABC and RCC tend to lend the same amount to agriculture, but RCCs lend about twice as much to TVEs than the ABC. See *Zhongguo Nongcun Jinrong Tongji Nianjian 1992* [Statistical Yearbook of China's Rural Finance 1992] (Beijing: Zhongguo Tongji Chubanshe, 1992), pp. 7, 68; *Zhongguo Nongcun Jinrong Tongji Nianjian 1996*, pp. 3, 51.

9. Township and village enterprises (TVEs) comprise the collective-owned 'township- and village-run enterprises' as well as joint enterprises (owned jointly by several individuals) and individual-owned enterprises, all in the countryside. Township- and village-run enterprises accounted for 58% of total value-added by TVEs in 1996. See *Zhongguo Xiangzhen Qiye Nianjian 1997* [China Township and Village Enterprise Yearbook 1997] (Beijing: Zhongguo Nongye Chubanshe, 1997), p. 129. Balance sheet data for joint enterprises and individual-owned enterprises in the countryside are not available; formal financial sector lending to these enterprises is likely to be very small.

furthermore show a much stronger rise in the ratio of output to their formal financial sector borrowing—by 39%—in 1994, continuing into 1995.<sup>10</sup>

While the bias of the formal financial sector is starving local enterprises and farmers of development funds, rural economic development continues to be of major concern to local governments and Party committees. The unusually sluggish growth of TVEs in many provinces in recent years has contributed to a sense of urgency, but localities increasingly lack government funds to promote economic development. The 1994 tax reform massively raised the share of total revenues collected by the center (from 22.02% in 1993 to 55.70% in 1994), which then redistributed the funds to provinces to an extent that the local share of expenditures fell only two percentage points (from 71.74% in 1993 to 69.71% in 1994).<sup>11</sup>

Yet the county tier was hard hit by the changes in revenue allocation. As Table 2 shows, in six out of ten provinces for which county tier data are available, the ratio of the county tier share in total provincial expenditures to the county tier share in total provincial revenues increased significantly in 1994 over 1993, while in three other provinces the ratio decreased, but only slightly. The last provincial-level entity, Tianjin, appears to have conducted a major redistribution of revenues to the county tier.<sup>12</sup> The general increase in the county-tier share of expenditures relative to revenues was primarily due to a disproportionate decrease in revenues rather than a disproportionate increase in expenditures (Table 3). Budgets on county tier and below tend to be very tight;<sup>13</sup> this suggests that the county tier faced very strong pressure in 1994 to find new ways to finance local economic development. It was only by 1996 that the pressure eased.

In search of new sources of funds in 1994, government and Party leaders in many localities did not have to look far. By the early 1990s, approximately one third of all townships had established a RCF. The purpose of these early RCFs, the first of which were established in Sichuan Province as early as December 1986, was to prevent the dissipation of formerly collective-owned assets. Their primary task was to collect assets due to the former commune. These RCFs often consisted of no more than a set of accounts, all business was conducted through the formal banking system.<sup>14</sup> At a time of scarce bank as well as fiscal funds but renewed

10. The 1994 vs. 1993 comparison is based on gross output value data as value-added data are not available; the relative changes in the gross output value ratio and the value-added ratio in 1995 over 1994, when both time series are available, are almost equal (a 21.6% rise vs. a 22.3% rise, or an 18.6% rise if the lacking Shanghai data in 1994 were approximated as outlined in the notes to Table 1). This suggests that relative changes in the ratio of gross output value to formal sector lending prior to 1995 are likely to be a good approximation to the relative changes in a ratio based on value-added.

11. *Zhongguo Tongji Nianjian 1998* [*Statistical Yearbook of China 1998*] (Beijing: Zhongguo Tongji Chubanshe, 1998), p. 281.

12. The mean ratio of 1994 is statistically significantly different from the mean ratio of 1993 at the 5% significance level (two-tailed test, excluding Tianjin); i.e. on average there has been a significant increase in the county tier share of provincial expenditures relative to revenues.

13. These budgets are frequently described as 'daily necessities' (*chifan*) budgets, barely sufficient to cover administrative costs, with little or no discretionary spending.

14. See, for example, *Renmin ribao*, (29 May 1992). On the first RCF see *Jinrong shibao* [*Financial Times*], (9 July 1999). Shaanxi Province claims to have founded its first RCF even earlier, in November 1985. See Fan Lianshe and Wang Mingshun, 'Jiji Yindao, Guifan Guanli, Cujin Nongcun Hezuo Jijinhui Wenjian Yunxing' ['Provide active guidance, standardize administration, and promote the steady operation of the rural cooperative funds'], *Jinrong Yanjiu Yu Fenxi* 6, (1997), pp. 1–3. By the end of 1988 Shaanxi Province had approximately 370 such cooperative funds

buoyancy in the aftermath of Deng Xiaoping's tour through South China in spring 1992, local government and Party leaders approved the expansion of the RCFs into quasi-financial institutions.<sup>15</sup>

### Characteristics and extent of rural cooperative funds

Although RCFs are far from uniform institutions, they share a number of basic characteristics.<sup>16</sup> RCFs do not regard themselves as financial institutions (*jinrong jigou*)—which require approval by the central bank—but mutual aid organizations (*huzhuzu*) without profit objective. In order to distinguish themselves from financial institutions, they sell shares (*rugu*) rather than attract deposits, pay user fees (*zhanyongfei*) on these shares rather than interest (*lilu*) on deposits, and offer 'borrowing' (*jiekuan*) to their members (shareholders) rather than loans (*daikuan*) to the public. In practice, these differences are semantic; shares can be sold back to the RCF at any time (equivalent to a deposit withdrawal), user fees can be fixed (equivalent to interest rates), and potential borrowers can easily become members before they 'borrow'.<sup>17</sup>

RCFs are run and regulated by a founding government or Party department on township or county tier, occasionally even on the municipal tier. Most RCFs are registered with the agricultural departments in the county, sometimes the municipal tier. Some cooperative funds may not bother with registration, or register with (receive approval from) superordinate departments in their own bureaucracy; these cooperative funds frequently also call themselves 'rural' cooperative funds, even though they are not registered with the agricultural department. In the following, the term 'RCF' is used as a generic term to cover cooperative funds with the characteristics outlined in this section, independent of registration. Examples of RCFs are RCFs run by the TVE bureau, by the 'financial guidance station' (*caiwu zhidao zhan*) of the rural work department (*nongcun gongzuo bu*) of the Party, by the fiscal departments, by the supply and marketing cooperatives, or by the local civil affairs administration.

In the rapid growth phase of the RCFs in the mid-1990s, the organizing institution if not the local government and Party committee helped attract start-up funds by organizing public meetings to promote the RCF and by assigning depositing tasks to subordinate departments. RCFs are formally owned by their members (shareholders). Members range from government departments to collec-

---

*Footnote 14 continued*

with total liabilities of 40m yuan, compared to total deposits at state banks and rural credit cooperatives of 21,033m yuan. See *Shaanxi ribao* [*Shaanxi Daily*], (13 May 1989), and *Shaanxi Tongji Nianjian 1990* [*Statistical Yearbook of Shaanxi Province 1990*] (Beijing: Zhongguo Tongji Chubanshe, 1990), pp. 407, 409.

15. The replacement of budgetary funds through bank lending is not a novelty for China. It has been extensively documented for higher-level tiers by Kaja Sehrt, *Banks vs. Budgets: Credit Allocation in the People's Republic of China, 1984–1997* (Ph.D. dissertation, University of Michigan, 1999).

16. This section is primarily based on interviews. Michvey reports in Chinese journals support this evidence.

17. In some RCFs membership is limited to specifically defined institutions or individuals. Party-run RCFs are often not open to the public and then go by a name such as 'internal fund circulation work' (*neibu zijin rongtong yewu*). Further examples are RCFs run by the administration of economic development zones. An altogether different category is the traditional neighborhood funds (*hehui*) with their various accumulation and distribution principles. See, for example, Jiang, *Zhongguo Minjian Jinrong Yanjiu*, chapter 2, or Tsai, *Banking Behind the State*.



**Table 3.** Growth rates of local fiscal expenditures and revenues (in %)

	1994 vs. 1993				1996 vs. 1994			
	Provincial level		County level		Provincial level		County level	
	Exp.	Rev.	Exp.	Rev.	Exp.	Rev.	Exp.	Rev.
Henan	14.82	- 32.94	13.34	- 25.52	50.51	73.60	60.17	95.42
Xinjiang	12.94	12.94	13.42	- 21.26	48.79	48.79	77.35	111.74
Yunnan	1.55	- 62.57	10.09	- 55.55	32.72	69.50	65.64	198.98
Zhejiang	22.38	25.65	12.85	- 44.35	39.65	39.33	135.21	50.95
Ningxia	- 0.11	34.52	4.31	18.05	52.36	- 13.13	38.58	10.76
Anhui	29.53	48.87	24.51	- 8.29	91.60	77.22	207.84	266.82
Sichuan	13.26	- 50.93			4.17	55.06		
Shaanxi	13.42	- 32.29	10.84	- 31.87	42.42	58.73	34.20	60.55
Jiangxi	12.37	35.02	12.98	- 26.21	43.27	- 13.06	46.23	53.93
Hebei	13.05	12.00	2.31	- 39.90	44.18	- 7.00	- 13.11	55.02
Tianjin	41.07	- 33.10	36.17	328.78	56.53	57.60	51.59	50.81

Notes: For comparison, total fiscal expenditures in all of China in 1994 increased 24.78% over 1993, total revenues 19.99%. The two growth rates in 1996 (over 1994) were 37.03% and 41.97%.

Sources: Calculated from individual provincial statistical yearbooks. For all excluded provinces the data are not available in their statistical yearbooks. Nationwide data are from *Zhongguo Tongji Nianjian 1998* [*Statistical Yearbook of China 1998*] (Beijing: Zhongguo Tongji Chubanshe, 1998), p. 281.

tive-owned enterprises and individuals. The particular ownership configuration varies from province to province (Table 4) but individuals tend to hold between a quarter and three quarters of all shares. Although long-term shareholders supposedly have the authority to, at an annual shareholder meeting, determine the leadership of the RCF, the RCF is run directly out of the government or Party department to which it is attached. Managers are frequently former, if not current, government or Party employees, while the Board of Directors and the Supervisory Committee (if existent) comprise concurrent government and Party staff.<sup>18</sup>

RCFs offer a choice of at least two types of shares; on the one hand a share which is equal to deposits in all but name and freely redeemable, and on the other hand a 'basic' (long-term) share. The distinction carries implications for voting rights at the shareholder meeting and for the return on the share; the deposit-type share carries no voting right and only pays interest (and/or a fixed 'dividend'), while the basic share comes with voting rights and pays interest and a profit-dependent dividend.<sup>19</sup> The return on all types of shares is determined by the superordinate department and in the early years tended to be on average twice as high as on a bank deposit of corresponding maturity. After a first period of consolidation in 1997, in many RCFs in Shaanxi Province the interest rate on quasi-deposits was set 10% above the corresponding bank interest rate (i.e. multiply the bank interest rate by a factor of 1.1). The spread between loan and deposit interest rates is usually low at 1–2%, but higher penalty interest rates come into effect once a loan turns overdue.

Loans extended by RCFs are primarily short-term working capital loans of 3–6 months duration. Across provinces, approximately half of all lending typically goes to the agricultural sector and another third to township- and village-run enterprises. Farmers receive a large share of the agricultural loans as well as of the residual loans, and across different provinces account for between 40 and 96% of all lending (Table 4).

Some RCFs have extensive branch networks covering several townships and villages where branches are set up according to their economic viability. Branches have virtually no decision-making authority on loans. This authority rests with the head office in the township or county seat and thus often, given the personnel overlap, with the superordinate department. In localities where several RCFs coexist, final authority on interest rates and on general policies, such as institutional expansion, tends to be concentrated in one government department. This is usually the agricultural department, by local government decree, even if some cooperative funds are not registered with it.

---

18. In 1995, 51% of the 8236 employees of RCFs in Henan Province concurrently held other positions. See 'Dui Nongcun Hezuo Jijinhui Ying Geiyu Chongxin Dingxing: Henan Sheng Nongcun Hezuo Jijinhui De Diaocha' ['The character of the RCF should be newly determined: a survey of RCFs in Henan Province'], *Jinrong Yanjiu Baogao* 12, (11 April 1996), p. 2.

19. The 33 RCFs in Dali County, Shaanxi Province, distinguish between three types of shares: basic shares which carry risk, pay dividends and are usually not to be sold (they accounted for 2.5% of all external funds at the end of 1996); 'fixed shares' which carry risk, pay usage fees (interest) and dividends, and can be redeemed after one year (37.3%); and non-fixed shares which are deposits in all but name (20.1%). See Dali County RCF administrative office and joint RCF, 'Jianchi Buxie De Zhuahao Guifanhua Guanli' ['Persevere in implementing standardization'], *Nongcun Hezuo Jingji Jingying guanli* 7, (July 1997), pp. 24f, 21; no information is provided about the residual.

Table 4. RCF deposit and lending structure

Province Year	Sichuan		Guangxi		Hunan		Guizhou		Henan		Shaanxi		Yunnan		Xinjiang		Nationwide 1991
	1996	1996	1996	1996	1996	1996	1996	1996	1995	1995	1995	1995	1996	1993	1996	1993	
<b>Total deposits at RCFs</b> (m yuan)	21599	1774	7400	250	2257	1470	3093	414.39	936.57	~	309	99900					
share in %:																	
collective				41.4	(cum.)				35.0	59.6	26.6	54.1					
individuals				24.0	22.2				48.3	19.6	20.9	20.9					
reserves					63.0				3.4	2.3	5.3	8.5					
'others'									13.3	18.5	68.1						
<b>Number of RCFs</b>	5464	848		300	807	923	2058	449	274	408							
Average deposits per RCF (m y.)	3.95	2.09		0.83	2.80	1.59	1.45	0.92	3.42	0.76							
<b>Cumul. annual lending<sup>a</sup></b> (m y.)	185.41 <sup>b</sup>	2070	10600	280	3388	2030	4951	876.86									
share in %:																	
agriculture	52.8 <sup>b</sup>	46.5	60.38	40.7		54.7	33.0	80.3									
farmers				(48.8)	(47.2)	(56.7)	(39.5)	(75.7)									
tsb.- and village-run ent.	31.2 <sup>b,c</sup>	31.9 <sup>c</sup>		30.4	35.4	23.6	33.3	(95.8)									
other sectors		21.6					33.6	5.6									
Source: provincial yearbook	1997, 110	1997, 181	1997, 124	1997, 293	1996, 176	1996, 121	1997, 138	1994, 179	1997, 160	1996, 169f							
(year, page)																	

Notes: <sup>a</sup> Lending can be categorized according to economic sector (agriculture, industry, services, etc.) or according to borrower (farmers, township- and village-run enterprises, etc.). This distinction is not consequently maintained across the sources.

<sup>b</sup> The data are year-end data rather than cumulative.

<sup>c</sup> The data cover all township and village enterprises, not only township- and village-run enterprises.

Sources: Provincial yearbooks and provincial economic yearbooks of the years 1994–1997. If a province is not included in the table this implies that none of the four yearbooks carried any evidence on RCFs (with the exception of Tianjin where the data were too sparse to warrant an entry in the table). Nationwide data are from *Renmin ribao* [People's Daily], (29 May 1992).

By 1998 some municipal agricultural departments had set up coordinating RCF offices, but provincial-level coordination is rare. In the case of the 32 township and village enterprise (TVE) RCFs in Shaanxi Province the provincial TVE bureau only promotes their cause and circulates development guidelines but does not issue instructions on how to run a RCF; nor does it exercise any supervision. No nationwide uniform regulatory framework for RCFs exists.<sup>20</sup>

At the end of 1994 more than one third of all townships and slightly below one fifth of all villages nationwide had a RCF (or a RCF branch).<sup>21</sup> While the spread of RCFs is not uniform across the country, no particular explanatory pattern of why they exist in one locality but not in another is evident. RCFs thrive in coastal as well as interior regions, in poverty-counties (*pinkun xian*) as well as in rich counties, and in predominantly agricultural as well as in predominantly industrial areas.<sup>22</sup> The only common explanation appears to be local government and Party dissatisfaction with the degree of formal financial intermediation in the particular locality.

Data on the extent of RCFs is available for the early years, when provincial yearbooks and occasionally newspapers reported on their spread, although nationwide figures were no more than rough estimates. When, in 1997, the SC requested a detailed report on the state of the RCFs from the MoA and it became apparent that their survival was in danger, public reporting on the extent of RCFs ceased. Data only became available again in late 1999 once RCFs in Sichuan and Hebei Province were being dissolved. As Table 5 shows, RCFs began to take off in several provinces in 1994, but RCFs never became a significant rival to the formal financial system in total. Even in the province in which RCFs were most widespread, Sichuan Province, deposits at RCFs never exceeded an amount equal to 10% of deposits in the formal financial system. Nationwide, this ratio was at best 3% (second to last column in Table 5).<sup>23</sup>

---

20. The MoA handles RCF matters within its Rural Cooperative Economy Guidance Office (*nongcun hezuo jingji zhidaosi*) which has established a Rural Economic Administration Station (*nongcun jingji guanli zongzhan*) as a semi-independent administrative facility (*shiyue danwei*). The PBC covers RCFs in its Rural Cooperative Finance Administrative Bureau (*nongcun hezuo jinrong guanli ju*).

21. See *Nongcun Hezuo Jingji Jingying Guanli* 10, (October 1995), p. 13.

22. Some data on their spread are the following. By the end of 1995, 65% of all municipalities and 56% of all counties in Sichuan Province had established 'joint' cooperative funds (*hezuo jijinhui lianhehui*), each coordinating several RCFs. By the end of 1996, 712 townships in Shaanxi Province, accounting for 32% of all townships, had established RCFs. In Henan Province, 63% of all counties, 32% of all townships, and 65% of all villages had established one or more RCF by September 1995. In Xinjiang Province, 44% of all townships and 45% of all villages had some form of RCF by the end of 1996. On Sichuan Province, see Guo Xiaoming and Yang Gang, 'Nongcun Hezuo Jijinhui Fazhan Zhong De Wenti Yu Duice' ['Problems of RCF development and counter-policies'], *Nongcun Jingji* 5, (May 1997), pp. 1-4; on Shaanxi Province Shaanxi Province Government (21 July 1997, Shaanzhengfa #31/1997), 'Shaanxi Sheng Renmin Zhengfu Pizhuan Zhongguo Renmin Yinhang Shaanxi Sheng Fenheng, Shaanxi Sheng Nongyeting Guanyu Qingli Zhengdun Nongcun Hezuo Jijinhui De Yijian De Tongzhi' ['Shaanxi Government circular approving the suggestions of the People's Bank of China Shaanxi Province branch and the Shaanxi Province Agricultural Bureau on cleaning up and rectifying rural cooperative funds'], *Shaanxi Zhengbao* 15, (15 August 1997), pp. 18-20; on Henan Province see 'Dui Nongcun Hezuo Jijinhui Ying Geiyu Chongxin Dingxing'; on Xinjiang Province *Xinjiang nianjian 1997* [*Yearbook of Xinjiang Province 1997*] (Wulumuqi: Xinjiang Renmin Chubanshe, 1997), p. 160.

23. The range from 0.73 to 2.92% of total deposits at all financial institutions in China in mid-1997 reflects the unofficial estimates of economists in the central bank (the lower estimate) and of economists in the MoA (the upper estimate).

But these data ignore that RCFs only existed in approximately 1/3 of all townships, and that their deposit share in individual townships thus could be quite large. In one municipality in Shaanxi Province, Weinan Municipality, deposits in RCFs by 1997 were equivalent to almost 27% of deposits in the formal financial system.<sup>24</sup> Compared to the deposits at their main competitors, the RCCs, RCFs are likely to have been dominant players in *rural* Sichuan and possibly also across parts of rural Hebei, Hunan, Yunnan, Xinjiang and Shaanxi Province (last column in Table 5).<sup>25</sup>

### RCFs meet the needs of the rural economy

RCFs meet several needs of the rural economy. They prevent the outflow of funds from rural areas and lend to borrowers neglected by the formal financial sector. RCFs also present an effective buffer against usury.

RCFs increase the degree of financial intermediation in a locality because RCFs offer a larger amount of loans to the locality per local deposits than formal financial institutions. The volume of RCF loans is equal to 60–90% of deposits, with the remainder being held as reserves either in cash or with the formal financial sector. One hundred percent of this lending occurs within the locality. The formal financial sector, on the other hand, retains much fewer funds in the locality. Table 6 illustrates the degree of leakage in the formal financial sector out of rural into urban areas by focusing on the two formal financial institutions in the countryside, the ABC and RCCs.

Rural credit cooperatives in 1995 extended loans equivalent to 72% of deposits, but only a small share of these loans were guaranteed to remain in the locality; these are the 'TVE loans' which in 1996 were equivalent to 45% of total deposits only. Most of the 'agricultural loans' (equivalent to 17% of total deposits) are likely to serve agricultural procurement, i.e. are used for the transfer of agricultural resources to urban households and state-owned industry. 'Other loans' may in part go to individuals but also include loans to state-owned enterprises. Overall, of total deposits collected almost exclusively in the countryside, RCCs re-lend perhaps no more than 50% in the countryside. The overall as well as individual shares have been on a steady decline since 1993 that continued into 1997, suggesting an increasing transfer of funds through the RCCs out of the countryside.<sup>26</sup>

The Agricultural Bank of China in 1995 had a loan-to-deposit ratio of 0.95.

24. Data on the 1997 increase in deposits in the formal financial system vs. the RCFs confirm the size of the RCF sector in Weinan Municipality. See PBC Weinan Municipality, 'Dui Weinan Shi 1997 Nian Chuxu Zengzhang Qingkuang De Diaocha' ['An investigation of the increase in household deposits in Weinan Municipality in 1997'], *Shaanxi Jinrong* [Shaanxi Finance] 3, (March 1998), p. 28f; Wu Xiju, 'Dui Weinan Jinrong Zhixu De Jidian Kanfa' ['Some views on the financial order of Weinan'], *Shaanxi Jinrong* 9, (September 1997), pp. 6–7.

25. The comparison in Table 5 neglects that RCFs do not exist in all townships, while RCCs most likely do; the data thus underestimate the share of RCFs in rural finance in those townships where they exist. The other formal financial sector institution in the countryside, the ABC, on average attracts slightly fewer deposits (in both urban and rural areas) than RCCs (in rural areas); province-specific data are not available, so the comparison is conducted between RCFs and RCCs only. RCC branches also tend to be more numerous on township tier than ABC branches.

26. The ratio of agricultural household loans to agricultural household deposits at RCCs fell from 41% in 1984 to just 19% in 1998, even though RCCs are 'owned' by the farmers and supposed to primarily lend to them. See *Zhongguo xiangzhen qiye bao* [China TVE Daily], (30 March 1999). On the outflow of funds from RCCs to urban areas also see Woo Wing Thy, 'Some observations on the ownership and regional aspects in financing the growth of China's rural enterprises' (Working Paper, University of California at Davis, 1999).

**Table 5.** Extent of rural cooperative funds

Locality	Date	RCFs (#)	Deposits (m yuan) at		<i>a/b</i>	<i>a/RCC</i> deposits
			RCFs [ <i>a</i> ]	Banks [ <i>b</i> ]		
<b><i>Nationwide</i></b>						
	1990		8–10,000	1,401,260	0.57–0.71	3.73–4.66
	1991		9990	1,807,900	0.55	3.69
	early 1990s					
	1994	17,800				
	1995		80,000	5,386,220	1.49	11.15
	1995		~ 72,700	5,386,220	1.35	10.14
	mid-1997		200,000	6,857,120	2.92	> 18.95
	mid-1997		50–70,000	6,857,120	0.73–1.02	> 4.74–6.63
	mid-1999		160,000	10,276,164	1.56	~ 13
<b><i>Provinces</i></b>						
Hebei	mid-1999	2139	20,900		~ 7	~ 20
Tianjin	1993	181	240	58,612	0.41	3.70
Zhejiang	1998		> 4900		~ 1	~ 5
Guangdong	1996	2300	6400	1,301,242	0.49	4.29
Sichuan	1994	4966	6000	183,800	3.26	19.76
	1995	5349	14,526	250,400	5.80	35.57
	1996		21,599	298,659	7.23	41.05
	1998	4435	25,690		~ 8	~ 50
Henan	1993	426	476	114,366	0.42	2.50
	1994	548	569	160,295	0.35	2.07
	9/95	74	1828	213,169	0.86	> 4.88
	1995	807	2257	270,765	0.83	6.03
Hunan	1993		676.77	72,151	0.94	4.17
	1994		1968	98,453	2.00	8.20
	1995	2750	4000	124,436	3.21	12.55
Guangxi	1993	588	260	66,534	0.39	2.35
	1996	848	1774	136,117	1.30	9.10
Guizhou	1995	70	70	47,821	0.15	1.80
	1996	300	250	58,626	0.43	5.38
Yunnan	1993	449	414.39	59,356	0.70	5.84
	1994	1160	1280	84,115	1.52	13.54
	1995	1792	2000	118,724	1.68	15.92
	1996	2136	3093	153,959	2.01	18.46
Xinjiang	1993	408	128.72	44,068	0.29	5.31
	1994	1034	442.31	63,444	0.70	12.16
	1995	190	808.34	83,842	0.96	16.95
	1996	274	936.57	101,247	0.93	21.46
Anhui	1996	510	510	142,070	0.36	2.20
Gansu	mid-1999	935	319		~ 0.3	~ 3
Shaanxi	1988	370	40	21,034	0.19	1.13
	1993		323	92,382	0.35	3.34
	1994		764	120,682	0.63	5.89
	1995	923	1470	156,909	0.94	8.71
	1996	900	2000	205,399	0.97	9.33
32 TVE RCFs	mid-1997	32	250	205,399	0.12	> 0.92
<b><i>Municipalities within Shaanxi Province</i></b>						
Xi'an	mid-1997		~ 100	61,998	0.16	n.a.
Weinan	1996	214	1091	8530	12.79	n.a.
Weinan	1997	450	2300	8530	26.96	n.a.

Sources: For a detailed list please contact the author.

Table 6. Rural deposits and loans

	1990	1991	1992	1993	1994	1995	1996	1997
<b>Rural credit cooperatives (RCCs)</b>								
Total loans/total deposits	0.6588	0.6676	0.7056	0.7602	0.7336	0.7216	0.7153	0.6890
Agricultural loans/total deposits	0.3542	0.3459	0.3425	0.1839	0.1674	0.1759	0.1938	0.1747
TVE loans/total deposits	0.3805	0.3930	0.4514	0.4991	0.4735	0.4486	0.4256	0.3492
Other loans/total deposits	0.0326	0.0418	0.0619	0.2303	0.2241	0.2108	0.2006	0.1651
<b>Agricultural Bank of China (ABC)</b>								
Total loans/total deposits	1.9647	1.8664	1.7425	1.7084	1.0654	0.9454	0.9407	0.8664
Industrial, commercial, and investment loans/total deposits	1.3978	1.3359	1.2290	1.0625	0.5652	0.5063		
TVE loans/total deposits	0.2257	0.2032	0.1856	0.2016	0.1810	0.1593		
Agricultural loans/total deposits	0.2930	0.2835	0.2699	0.2232	0.1690	0.1616		0.1544
Other loans/total deposits	0.0482	0.0438	0.0580	0.2212	0.1501	0.1182		
<b>RCCs and ABC</b>								
TVE loans/total deposits	0.2790	0.2729	0.2837	0.3144	0.2962	0.2753		
TVE and other loans/total deposits	0.3165	0.3125	0.3380	0.5200	0.4672	0.4260		
TVE and agric. and other loans/total deposits	0.6154	0.6025	0.6145	0.7062	0.6221	0.5827		
<b>Household deposits</b>								
Estimate of deposits by rural households as share of total household deposits in formal financial institutions	0.6909	0.6866	0.6740	0.6530	0.6196	0.6083	0.6036	
Estimate of deposits by rural households/ABC and RCC household deposits	1.2097	1.2292	1.1981	1.2206	1.2283	1.2786		
ABC and RCC household deposits/total ABC and RCC deposits	0.7510	0.7544	0.7315	0.7506	0.7714	0.7801		
TVE loans by ABC and RCCs/estimate of deposits by rural households	0.2306	0.2220	0.2368	0.2576	0.2412	0.2153		
TVE, agric. and other loans by ABC and RCCs/estimate of dep. by rural hhs	0.5087	0.4901	0.5129	0.5786	0.5065	0.4557		

Notes: ABC data for 1994 and 1995 are not perfectly compatible with earlier data as most policy lending (together with PBC refinancing) was shifted to the Agricultural Development Bank of China in mid-1994. On the derivation of the estimate of rural household deposits please contact the author. Sources (calculated from):

RCCs: *Zhongguo Nongcun Jinrong Tongji Nianjian 1996* [Statistical Yearbook of China's Rural Finance 1996] (Beijing: Zhongguo Tongji Chubanshe, 1996), pp. 58, 60; *Zhongguo Jinrong Nianjian 1997* [Financial Yearbook of China 1997] (Beijing: Zhongguo Jinrong Chubanshe, 1997), p. 563; *Zhongguo Jinrong Nianjian 1998*, p. 621.

ABC: *Zhongguo Nongcun Jinrong Tongji Nianjian 1996*, pp. 16, 19; *Zhongguo Jinrong Nianjian 1997*, p. 530; *Zhongguo Jinrong Nianjian 1998*, p. 583.

Definitely extended in the countryside were again the TVE loans equivalent to 16% of total deposits, far down from a peak of 28% in 1992 and 27% in 1993. The largest share of ABC loans goes to state-owned enterprises either to finance industry and commerce (primarily related to agricultural procurement) or to fund capital construction and technological updating and innovation.<sup>27</sup> ‘Agricultural loans’ and ‘other loans’ may include some loans to individuals in the countryside, but the ABC is unlikely to bother with small loans to households.<sup>28</sup> Even if all agricultural loans and all other loans were viewed as having been extended in the countryside, their share together with TVE loans in total deposits would still not exceed 43%, by far less than the share achieved by RCFs.

These data confirm the large outflow of funds from the countryside and furthermore document a relative increase in this outflow since 1993. One shortcoming of the data is the fact that even in the early 1990s some deposits at the ABC may have been urban rather than rural, and the outflow calculated here thus may be exaggerated. An alternative then is to use (an estimate of) deposits by rural households with any formal financial sector institution, even though such a measure does not include deposits by rural enterprises.<sup>29</sup> Lending in the countryside by ABC and RCC also falls far short of this new deposit measure, reaching between perhaps 22 and 46% in 1995. The increased leakage of funds from rural to urban areas since 1993 is again confirmed.

Lacking exact data on the extent of RCFs, it is not clear whether the positive effect of RCF development on local financial intermediation outweighs the increase in formal financial sector leakage. But any depositing with RCFs—which extend all their loans in the locality—rather than with the formal financial sector improves the degree of local financial intermediation.

Besides retaining funds locally, RCF development also implies a change in the composition of the borrower pool in the countryside. RCFs target not only township- and village-run enterprises but as the data in Table 4 attests also, and often primarily, individual entrepreneurs or farmers, a borrower group almost utterly neglected by the formal financial sector. Throughout most of the 1990s, farmers were unlikely to obtain a loan from a RCC or ABC branch as such loans were deemed too risky and the costs of extending small loans too high. Yet farmers obtain approximately half of all RCF lending, with another one third going to TVEs.

RCFs can lend to what may be high risk borrowers for ABC and RCCs because of their frequently superior risk assessment capabilities and lower operating costs.

---

27. This share dropped significantly in 1994 as much lending related to agricultural procurement was shifted to the Agricultural Development Bank of China (ADBC). Along with these loans, PBC refinancing of the ABC (rather than deposits at the ABC) moved to the ADBC, causing the sharp drop in the ratio of (now reduced) loans to (unchanged) deposits. The ratio of total ABC loans to total deposits at the ABC is still relatively high as RCCs up to and including 1996 deposited all minimum and excess reserves with the ABC. These reserves are not included in the ‘total deposits’ at the ABC. Since the separation of ABC and RCCs these reserves are held with the PBC; the data discussed here are not affected by this re-organization.

28. According to *Jinrong Shibao*, (11 January 1999), 80% of all loans to agricultural households and 70% of all loans to TVEs are extended by RCCs.

29. Such rural enterprise deposits should be small as in the case of the ABC and RCC household deposits accounted for 78% of all deposits in 1995 (Table 6).



Directors of RCFs are likely to know the local enterprises well due to their frequently concurrent position in the government office co-operating with if not supervising the borrower. In one RCF in Shaanxi Province, enterprise personnel has been co-opted as RCF staff, in which case the RCF resembles an enterprise-internal finance department with direct access to household funds. In another RCF, government department retirees on behalf of the RCF pay almost daily, informal visits to the borrower to ensure proper use of the loan. Loan repayment can be enforced not only through the courts but perhaps more easily through the administrative government channels.<sup>30</sup> Farmers are recommended to the decision-makers in the RCF by the RCF staff at the village or township level.

RCF operating costs are extraordinarily low. RCFs are routinely subsidized by the local government which may provide offices for free and pay for half the employees (who concurrently hold positions in the government). RCF remuneration of non-government employees is minimal and does not carry any of the housing and social insurance benefits that employees in the formal financial sector enjoy. RCFs also have tax advantages. While the state commercial banks pay a 55% income tax to the state tax office (*guojia shuiwuju*), RCFs pay income taxes at a lower rate, and they pay these taxes to the local (provincial and subprovincial) tax office (*difang shuiwuju*).<sup>31</sup> Local governments in support of their RCFs frequently do not collect income taxes from RCFs, and allow them to retain all profit.<sup>32</sup>

By extending small loans to individuals, RCFs have made significant inroads into traditional usury practices in the countryside. For many households, the only alternatives to RCF loans are to make do without a loan or to borrow from other rural households at potentially far higher interest rates.<sup>33</sup> The establishment of a RCF in a locality is invariably accompanied by a sharp drop in the interest rates

---

30. One TVE RCF in Shaanxi Province with approximately 150 loans outstanding in mid-1998 was taking one borrower to court. This was the first case since the establishment of the TVE RCF in 1994 that is has taken a borrower to court.

31. State Tax Office (10 February 1995, Guoshui hanfa #58/1995), 'Guanyu Nongcun Huzuo Jijinhui Suodeshui Zhengguan Wenti De Tongzhi' ['Circular on the income tax of rural cooperative funds'], in *Zhongguo shuishou zhidu* [China's Tax System] (Beijing: Qiye Guanli Chubanshe, 1996), p. 576f. The maximum income tax rate for RCFs as non-financial institutions is 33%; since the operation of one cooperative fund is relatively small, the reduced tax rate of 27 or 18% may apply. (The income tax rate is 27% if the taxable income is 100,000 yuan or less, and 18% if the taxable income is 30,000 yuan or less.) See State Tax Office (18 May 1995, Guoshuifa #23/1995), 'Guanyu Qiye Suodeshui Zhengshou He Guanli Fanwei De Tongzhi' ['Circular on the collection and administration of enterprise income taxes'], in *Zhongguo shuishou zhidu*, p. 578f. Wang Zheng and Yang Wenli, *Shuijin Jisuan Yu Kuaiji Hesuan* [Tax Computation and Accounting] (Beijing: Zhongguo Jingji Chubanshe, 1997), the tax almanac used by local tax authorities in at least Xi'an Municipality, includes 34 pages of tax exemptions (pp. 400–434), including an exemption for RCCs in poverty areas (RCCs otherwise face an income tax of 33%), but on cooperative funds only states that the MoA is responsible for determining the relevant policies and laws and regulations (p. 423).

32. RCFs likewise tend to escape the various local government levies on rural enterprises; thus the TVE bureau rarely collects the administrative fee of 0.7% of income from TVE RCFs that it levies on TVEs. RCFs pay a business tax of 5% on interest income from lending activities to local governments as all other financial institutions do. See Wang and Yang, *Shuijin Jisuan Yu Kuaiji Hesuan*, p. 195.

33. See *Guojia Jixie Gongyeju Jijingwang* [State Machinery and Industry Net] (an Internet source), (11 November 1999), reporting on the dissolution of the RCFs. The author sees the dissolution of the RCFs as the cause of an upcoming return to usury practices and points out that just as reforms in the real economy began in the countryside in 1978, thus reform of the financial sector may have to come from the countryside with the establishment of a true market for funds (like the RCF).

households face. RCFs benefit rural households twice. First, they directly increase the supply of loans at relatively low interest rates. RCF lending rates may be as high as twice the interest rates in the formal financial sector, but they are below those of the informal financial sector, and RCF loans are readily available. Second, RCFs have positive externalities in rural financial intermediation for those borrowers neglected by the formal financial sector. The establishment of RCFs causes interest rates in the informal financial sector to fall and thus indirectly makes these loans more affordable, too.<sup>34</sup>

### Central government concern about the rise of the RCFs

The improvement in rural financial intermediation brought about by the RCFs comes at a price. RCFs carry negative externalities for higher-level governments and government departments if these have to be called in to prevent 'social instability' when a mis-managed RCF collapses.<sup>35</sup> RCFs also have a direct, negative impact on the operation of the formal financial sector.

Although RCF lending supposedly requires collateral or guarantees, in practice the quality of the RCF lending portfolio varies widely between RCFs. On average, the share of non-performing loans could be as high as 20%.<sup>36</sup> But even if 20% of all loans were unlikely to be ever repaid, the quality of RCF loans is still superior to the quality of the loans extended by the formal financial sector, where the share of bad loans is generally viewed as ranging between 20 and 50%.<sup>37</sup>

Yet there is a significant difference between RCFs and formal financial institutions. Formal financial institutions are supported by the PBC; RCFs as non-

34. For example, according to Fan and Wang, 'Jiji Yindao, Guifan Guanli, Cujin Nongcun Hezuo Jijinhui Wenjian Yunxing', the establishment of RCFs in Weinan Municipality, Shaanxi Province, led to a drop of the interest rate on loans between individuals to 30–50% (from an unspecified original level).

35. RCF failures are usually not publicized. One exception was the failure in 1996 of three RCFs in Lanxi Municipality, Zhejiang Province, which even received the attention of the State Council. See *Renmin Ribao*, (25 November 1996). Two reports in the Hong Kong press are in *Ming Pao*, 27 May 1998 and 3 April 1999.

36. This is the estimate of an official at the MoA. Only one of the RCFs interviewed in Shaanxi Province was willing to provide information on the quality of its loans: overdue loans accounted for two thirds of all loans and 55% of the total lending volume. The provincial RCF average in 1997 of total overdue, doubtful, and lost loans was 7.75%; most of these loans (6.5 percentage points) were overdue; see Fan and Wang, 'Jiji Yindao, Guifan Guanli, Cujin Nongcun Hezuo Jijinhui Wenjian Yunxing', p. 3. Deng Anzhi, 'Nongcun Hezuo Jijinhui De Wenti Yu Duice' ['Problems of RCFs and countermeasures'], *Nongcun Jingji* 9, (September 1998), p. 24f, in an article on RCF problems reports an average of 20% overdue and non-performing loans in all RCFs in Nanchong Municipality, Sichuan Province, at the end of May 1998. Xiang Huaifang and Ceng Rongsheng, 'Dui Gaoping Qu Nongcun Hezuo Jijinhui Zijin Yinyun De Diaocha Fenxi' ['An investigation and analysis of the use of funds by the RCFs in Gaoping District'], *Nongcun Jingji* 5, (May 1998), p. 34f, document the rapid growth of the overdue and non-performing loan rate in Gaoping District of this Nanchong Municipality with 8% at the end of 1995, 12% at the end of 1996, and 27.8% at the end of October 1997. Yu Jinguang, 'Guifan nongcun hezuo jijinhui jingying keburonghuan' ['To standardize the management of rural credit cooperatives requires immediate attention'], *Jinrong Cankao* 4, (April 1997), pp. 19–22, for 90 RCFs in the 12 counties of Ganzhou Municipality (Jiangxi Province) which had established RCFs (out of 18 counties) gives the share of overdue loans as 40.97% at the end of 1996. In individual RCFs the extent of overdue loans can be quite small, such as in the Shuidongjiang Township RCF in Shaodong County, Hunan Province, with 2.66% at the end of April 1997.

37. For example, a 'representative' survey of two counties in Langfang Municipality, Hebei Province, showed bad loans at RCFs to be 22 percentage points below the percentage share of bad loans in RCCs, which is not published. In Langfang Municipality's 14 financial institutions (presumably the complete formal financial sector) bad loans accounted for 35.8% of all loans in 1998; 86% of all loans to state-owned enterprises were bad. See *Zhongguo Jingji Daobao* [China Economic Guide], (2 June 1999). Langfang became famous for its RCFs in 1997 when the central television station broadcast a critical report.

financial institutions not approved by the PBC are not. Short-term liquidity problems in formal financial institutions are routinely bridged by the PBC as lender of last resort, and bad loans in formal financial institutions are no cause for alarm as these institutions are state-owned and thus backed by the central government. RCFs, on the other hand, have few means to bridge liquidity problems. Once depositors doubt the financial health of the RCF and start withdrawing their deposits, the ensuing liquidity crisis can quickly lead to the collapse of the RCF. Consequently, RCFs maintain 10–40% of their assets as deposits at state commercial banks.<sup>38</sup> RCFs, like formal financial institutions, also require depositors to give advance notice in the case of large cash withdrawals. These precautionary measures are sufficient for everyday business. They are, however, insufficient in the case of extraordinary events.

When a RCF collapses, local government finances invariably are insufficient to guarantee RCF deposits. In the much publicized case of the collapse of three RCFs in Lanxi Municipality, Zhejiang Province, the PBC was forced to lead support and rectification measures. In 1997, bank runs on RCFs in Langfang Municipality, Hebei Province, induced the municipal PBC to ensure that RCF reserves with the formal financial sector would be withdrawable at all times.<sup>39</sup>

Recourse to the PBC raises the issue of moral hazard. RCFs use their competitive advantage over the formal financial sector to gain market share and to advance local economic growth which benefits the local government. But should the RCF fail, the PBC is called upon and forced to step in by the sheer magnitude of impending local social unrest. RCFs thus may enjoy the best of two worlds: supervision-free, high-interest banking and a safety net in case of failure. Local government departments have incentives to push RCF development to the limit as the costs of failure fall incommensurably on the PBC and thus the central government.

Accumulation of dubious loans is facilitated by inexperienced financial management in the RCFs and a lack of supervision over RCFs. The Ministry of Agriculture only requires the employment of 'suitable' professional personnel; head and/or manager (*zhuren* and/or *jingli*), accountant, and cashier may not concurrently hold other positions.<sup>40</sup> In an earlier regulation, PBC and MoA required that the

---

38. Reserve practices vary from locality to locality and are specified either as maximum lending ratios or as explicit reserve ratios. Thus RCFs in the municipal-level Suizhou City, Hubei Province, may not lend more than 60% of the funds collected. See Pang Zhongping, Zhang Zhengliang and Li Chengzhi, 'Cujin Jiankang Fazhan, Jianchi Guifan Guanli' ['Accelerate the healthy development, adhere to standardized administration'], *Nongcun Hezuo Jingji Jingying Guanli* 5, (May 1997), p. 25f. RCFs in county-level Taixing City of Taizhou Municipality, Jiangsu Province, maintain a 15% reserve (and a 80% lending limit); 5% of reserves are kept as cash in the RCFs or as current deposits at banks and RCCs, 5% are invested in time deposits at banks and RCCs, and 5% are maintained by the municipal joint RCF for quick adjustment purposes. See Jiang Youde and Wu Yadong, 'Jiaqiing Fengxian Fangfan Guanli De Youxiao Shouduan—Taixing Shi Nongcun Hezuo Jijinhui Shixing Zichan Fuzhai Bili Guanli' ['Effective measures to strengthen risk management—trial implementation of asset-liability ratios in the Taixing City RCFs'], *Nongcun Hezuo Jingji Jingying Guanli* 2, (February 1997), p. 20f.

39. See *Hebei Jingji Nianjian 1998 [Hebei Economic Yearbook 1998]* (Beijing: Zhongguo Tongji Chubanshe, 1998), p. 60. The report does not state the cause of the bank runs on the RCFs; perhaps the formal financial sector was unable to repay RCF deposits with it in the first place.

40. Ministry of Agriculture (19 April 1995), 'Guanyu Kaizhan Nongcun Hezuo Jijinhui Dengji Gongzuo De Tongzhi' ['Circular on starting registration of rural cooperative funds'], in *Zhonghua Renmin Gongheguo Falu Quanshu [PRC Collected Laws]* (Changchun: Jilin Renmin Chubanshe, 1995), pp. 1128–1131, Art. 7.

member's congress (*daibiao dahui*) of the RCF elect a Board of Directors (*lishihui*) and a Board of Supervisors (*jianshihui*), with the Board of Directors choosing a head responsible for the day-to-day work.<sup>41</sup>

In practice, decision-making and control mechanisms vary drastically.<sup>42</sup> Few RCF directors have any banking experience, and on large loans the final decision-making authority in the RCFs tends to almost exclusively rest with government officials holding concurrent positions in the RCF. The Board of Directors and other leading personnel are usually handpicked by the township Party committee and government, approved by the county tier superordinate department, and then 'democratically elected' by the shareholders.<sup>43</sup> Few localities insist that township Party and government personnel may not hold any position in the RCF, most take the view that the RCF leadership needs to be identical with the leadership of the Rural Economic Administration Station of the agricultural departments.<sup>44</sup>

External supervision is often weak.<sup>45</sup> Local government departments that wish to maintain their control over RCF lending decisions insist that RCFs remain non-financial institutions outside the sphere of influence of the PBC.<sup>46</sup> While the MoA and the PBC specified in 1994 that the PBC supervises the RCF's business and together with the agricultural departments handles illegal deposit and loan business, the MoA in a regulation in 1995 only mentions the local agricultural departments as supervisory institutions.<sup>47</sup> The county agricultural department conducts an annual inspection of the implementation of the statutes and administrative system, this year's business, including profit and losses and profit distribution, and this year's

41. Ministry of Agriculture (1994, Nongjingfa #21/1994), 'Nongyebu, Zhongguo Renmin Yinhang Guanyu Jiaqiang Nongcun Hezuo Jijinhui Guanli De Tongzhi' ['MoA and PBC circular on strengthening the administration of the rural cooperative funds'], in Jiang, *Zhongguo Minjian Jinrong Yanjiu*, pp. 165–168, Art. 9.

42. In one extreme case in Shaanxi Province a full-time manager is responsible for the day-to-day work and the approval of small loans. The head of the RCF approves medium-sized loans; he is the chairman of a Board of Trustees (*dongshihui*), has no banking experience and concurrently holds a government position. Large loans need to be approved by the Board of Trustees in total. In this particular arrangement a Supervisory Board does not exist, nor is there an external audit. In a different RCF in Shaanxi Province, Board of Directors, Board of Trustees, and Supervisory Board have all been established. The full-time Board of Directors is responsible for the day-to-day management, and the part-time Board of Trustees for important decisions as well as recurrent supervision. The chairman of the Board of Directors is a retired banker. The county government auditing bureau carries out an annual external audit.

43. See, for example, Dali County, 'Jianchi Buxie De Zhuahao Guifanhua Guanli', and Yang Longsheng, 'Gaike Renyuan Guanli Zhidu, Baozheng Jijinhui Jiankang Fazhan' ['Reform the personnel administration system in order to guarantee the healthy development of the RCFs'], *Nongcun Hezuo Jingji Jingying Guanli* 2, (February 1997), p. 19.

44. See Chen and Liu, 'Mingque Zhuguan Bumen Zhize, Gaohao Hezuo Jijinhui Guanli', on the first position and Yang Zonglian, 'Guanyu Cujin Nongcun Hezuo Jijinhui Jiankang Fazhan De Jidian Shexiang' ['Some considerations on the healthy development of RCFs'], *Nongcun Hezuo Jingji Jingying Guanli* 1, (January 1997), p. 31f on the second position.

45. For example, in one particular RCF in Shaanxi Province the manager succeeded in evading all controls and to lend up to a third of the RCF's funds to a friend, with the loans subsequently not being repaid on time. The county government and Party committee had to refrain from taking legal or disciplinary action against the manager for the sole purpose of not publicizing the event. The RCF and the county government would not have been able to withstand a bank run. Similar cases of mismanagement are reported in other localities. See, for example, *Changjiang ribao* [*Changjiang Daily*], (10 January 2000).

46. Yang Zonglian, 'Guanyu Cujin Nongcun Hezuo Jijinhui Jiankang Fazhan De Jidian Shexiang', takes a particularly ardent view against any audit by external institutions except the agricultural departments.

47. Ministry of Agriculture, 'Nongyebu, Zhongguo Renmin Yinhang Guanyu Jiaqiang Nongcun Hezuo Jijinhui Guanli De Tongzhi', Art. 1, and Ministry of Agriculture, 'Guanyu Kaizhan Nongcun Hezuo Jijinhui Dengji Gongzuo De Tongzhi', Art. 15.

work in general. The RCF neither reports to the PBC nor receives direct PBC supervision.<sup>48</sup>

Auditing procedures vary from locality to locality. Some RCFs in Shaanxi Province conduct no special audit but may report their accounts to the agricultural departments at year-end. In Jimo Municipality, Shandong Province, the joint RCF conducts three complete audits per year and maintains audit files on each RCF.<sup>49</sup> In Xiangfan Municipality, Hubei Province, a municipal RCF office attached to the municipal agricultural department conducts an annual audit, sends inspectors to all RCFs once every quarter, and initiates unannounced examinations.<sup>50</sup> Auditing practice thus varies from solely internal financial reports to frequent external audits. However, no audit is ever made by any institution that is not also directly or indirectly involved in the running of the RCF, questioning the quality of the audit.

Poor management of RCFs augmented by moral hazard problems and a lack of supervision directly forces the hand of the central bank and thus the central government. But RCFs also affect the central government indirectly via the formal financial sector. An increase in RCF deposits implies that these funds are not being held with the formal financial sector. This implies stagnating if not falling deposits at formal financial institutions, and thus fewer loans and lower profits. Enterprises which know that they are unlikely to obtain a loan from the formal financial sector in the future, but that they can rely on RCF funding, may even go beyond switching deposits to the RCF and stop paying interest on their formal financial sector loans or not repay the principal. The formal financial sector is left with an increasing share of overdue loans and falling profitability. The PBC as lender of last resort is forced to bridge any liquidity problems in the formal financial sector, while the central government will in the final instance have to pay for the formal financial sector's bad loans.<sup>51</sup>

## Central government indecision

The rapid establishment and growth of RCFs in recent years was accommodated by a lack of agreement between central ministries on how to regulate RCFs. As early as 1986 Chen Muhua, then governor of the PBC, reached an agreement with the MoA to accept RCFs as non-financial institutions under the condition that they would not publicly solicit deposits and remain small, local mutual-aid organiza-

48. In at least one municipality in Shaanxi Province an unspecified degree of consultation takes place between the agricultural departments on municipal tier and the municipal PBC branch. This appears to be an exception. Secondary literature on higher-level tier coordination reports exclusively on the establishment of county tier and municipal tier RCF offices within the agricultural departments. See, for example, Chen and Liu, 'Mingque Zhuguan Bumen Zhize, Gaohao Hezuo Jijinhui Guanli', or Pang *et al.*, 'Cujin Jiankang Fazhan, Jianchi Guifan Guanli'.

49. Zhou Fangping, 'Yi Tai Wu Nong Xing Nong De "Zhutuiqi"' ['A boost to agricultural self-help'], *Nongcun Hezuo Jingji Jingying Guanli* 7, (July 1997), p. 23f.

50. Chen and Liu, 'Mingque Zhuguan Bumen Zhize, Gaohao Hezuo Jijinhui Guanli'.

51. RCFs also affect the PBC's control over the money supply. RCF deposits are unreported and therefore not included in money supply measures. If formal financial sector money supply growth is 10% per year but RCFs gain a market share of 5% of actual (formal and informal financial sector) deposits in the course of one year, then—assuming the absence of an informal financial sector before—money supply growth is in fact 15.5% rather than 10%. Money supply growth rates as published by the central bank thus may well be several percentage points off the actual money supply growth rates. Such a divergence could have a substantial impact on the effects of monetary policy.

tions. Two years later, the SC specified that the establishment of a RCF required approval by the PBC and registration with the Civil Affairs Administration; RCFs were to report on their finances to these two institutions annually, and to accept their supervision.<sup>52</sup> While RCFs were explicitly denoted ‘social organization legal persons’ (*shehui tuanti faren*), the question of whether they are financial institutions was not raised. PBC and Civil Affairs Administration were entrusted with the implementation of the SC decree; the MoA was not mentioned in this decree.

### *Shifting authority over RCFs to the MoA*

This arrangement remained unchallenged until the mid-1990s, when local governments began to promote their RCFs. The Eighth Plenum of the Thirteenth Central Committee in November 1991 confirmed the legitimacy of the RCFs (‘the rural cooperative funds shall be continued’).<sup>53</sup> Lower-level tier governments and Party committees responded with statements encouraging the establishment and growth of RCFs. For example, the Hebei Province Party Committee on 6 July 1992 urged all local governments and departments to ‘let the rural cooperative funds develop as quickly as possible’, and ‘localities which have not yet acted are to implement pilot projects and to do all they can so that cooperative funds will be widespread one or two years from now’. The SC in its blueprint for financial reform in late 1993 then added a new twist by stating that RCFs are not financial institutions, cannot collect deposits, and cannot extend loans.<sup>54</sup> In early 1994, the Chinese Communist Party Central Committee (CCPCC) and the SC clarified that ‘the rural cooperative funds shall be turned into social, mutual cooperative funding organizations (*shehuixing de zijin huzhu hezuo zuzhi*); they do not conduct deposit business but serve agriculture and farmers in the locality’.<sup>55</sup>

Authority over RCF matters gradually shifted to the MoA. MoA and PBC together restated that RCFs are not financial institutions and assigned responsibility for RCFs to the MoA.<sup>56</sup> In 1995 the MoA followed up with a regulation on the registration of the RCFs.<sup>57</sup> While the accompanying circular asked that the

52. State Council (17 September 1988, PRC SC decree #18/1988), ‘Jijinhui Guanli Banfa’ [‘RCF administration measure’], in *Yinhang fa quanshu* [Collected Banking Laws] (Beijing: Zhongguo Shangye Chubanshe, 1995), p. 63f.

53. Eighth Plenum of the Thirteenth Chinese Communist Party Central Committee (19 November 1991), ‘Guanyu Jin Yi Bu Jiaqiang Nongye He Nongcun Gongzuo De Jueding’ [‘Decision on further strengthening agriculture and rural work’], in *Zhongguo Gongchandang Dangnei FAGUI Zhidu Shouce* [Chinese Communist Party Party-internal Laws and Regulations Handbook] (Beijing: Hongqi Chubanshe, 1997), pp. 728–739.

54. State Council (25 December 1993, Guofa #91/1993), ‘Guanyu Jinrong Tizhi Gaige De Jueding’ [‘Decision on reform of the financial system’], in *Zhonghua Renmin Gongheguo Guowuyuan Gongbao* [PRC SC Bulletin] 31, (1993), pp. 1488–1496.

55. Chinese Communist Party Central Committee (1994, Zhongfa #4/1994), ‘Zhonggong Zhongyang, Guowuyuan Guanyu 1994 Nian Nongye He Nongcun Gongzuo De Yijian’ [‘CCPCC and SC suggestions on agriculture and rural work in 1994’].

56. Ministry of Agriculture, ‘Nongyebu, Zhongguo Renmin Yinhang Guanyu Jiaqiang Nongcun Hezuo Jijinhui Guanli De Tongzhi’.

57. Ministry of Agriculture, ‘Guanyu Kaizhan Nongcun Hezuo Jijinhui Dengji Gongzuo De Tongzhi’. RCFs may in practice have abandoned registration with the PBC much earlier. For example, Tai Xiangdong, ‘Tuixing gufentian he nongcun hezuo jijinhui, jiasu nongye chanyehua jincheng’ [‘Promoting the share-holding system for land holdings and promoting the RCF accelerates the progress of agricultural structural change’], *Shaanxi Zhengbao* 1, (January 1998), p. 30, reporting on the establishment of a RCF in Xiaoying Village (Liquan County, Xianyang Municipality,

superordinate department of the RCF strive for PBC support, the regulation states unambiguously that establishment of a RCF only requires approval by the township government and then registration with the county-level agricultural administration. Supervision over RCFs is exercised by the agricultural departments; no mentioning is made of the PBC which in the previous regulation<sup>58</sup> was still named as exercising supervisory authority.

The clarification that the RCF is a mutual aid (or cooperative) organization with as its superordinate department the MoA, opened the door for the explosive growth of RCFs. In more and more localities government and Party committee began to promote the establishment of RCFs. In 1995 the Shaanxi Province Party Committee and the Shaanxi government, for example, requested that by the end of the eighth Five-Year Plan 60% of all townships were to have established RCFs.<sup>59</sup>

### *PBC backlash*

The SC in a blueprint for rural financial reform subsequently admonished that RCFs may not collect deposits.<sup>60</sup> If they did, they were to be incorporated into the RCCs. The PBC and the MoA were requested to issue 'rural cooperative fund administration regulations' which, however, appear to have never been issued. The Rural Economic Administration Station that handles RCF matters within the Rural Cooperative Economy Guidance Office of the MoA was ordered to stop work and to report to the SC. While the central government searched for a policy, the growth of the RCFs continued unabated. For example, the Shaanxi Province TVE Administration Bureau in June 1997 encouraged the further growth of the TVE RCFs.<sup>61</sup>

Yet the PBC had new incentives to persist. In 1996 the RCCs were split off the ABC as supposedly independent banks; because RCCs then lacked a superordinate department and more often than not were insolvent, the PBC became saddled with the task of restructuring the RCCs and nurturing them back to health. RCFs, by attracting rural deposits, were in part to blame for low RCC profitability, and thus became increasingly the target of PBC criticism.<sup>62</sup> For example, the PBC branch of a poverty county in Shaanxi Province, after prompting by its superior municipal

---

*Footnote 57 continued*

Shaanxi Province) in 1990, does not mention any particular approval procedure. The county urgently needed funds to establish its 'dragon head' enterprises so it started a RCF open to the public based on the principle 'voluntarily purchase shares, freely withdraw shares'.

58. Ministry of Agriculture, 'Nongyebu, Zhongguo Renmin Yinhang Guanyu Jiaqiang Nongcun Hezuo Jijinhui Guanli De Tongzhi'.

59. Xi'an Municipality Government (27 April 1995, Shizheng banfa #52/1995), 'Xi'an Shi Renmin Zhengfu Bangongting Zhuangfa Shi Nongyeju Guanyu Jiji Fazhan He Banhao Nongcun Hezuo Jijinhui De Yijian De Tongzhi' ['Xi'an Municipality government office circular transmitting the suggestions of the municipal agricultural office on energetically developing and managing the rural cooperative funds'], *Xi'an Zhengbao* [*Xi'an Bulletin*] 5, (May 1995), p. 33f.

60. State Council (22 August 1996, Guofa #33/1996), 'Guanyu Nongcun Jinrong Tizhi Gaige De Jueding' ['Decision on the reform of the rural financial system'], in *Zhonghua Renmin Gongheguo Guowuyuan Gongbao* 26, (1996), pp. 1032-1038.

61. Shaanxi Province TVE Administration Bureau (10 June 1997), 'Guanyu Wo Sheng Shibao Xiangzhen Qiye Hezuo Jijinhui Qingkuang De Baogao' ['Report on the situation of the experimental TVE cooperative funds in Shaanxi Province'].

62. On the relative size of RCF deposits vs. RCC deposits see the last column in Table 5.

branch, wrote to the county government in late 1996 proposing that ‘the county government organize the relevant departments to, in accordance with the law, ban and investigate the illegal financial institutions in our county’.<sup>63</sup> It was, however, careful to point out that this excluded the ‘rural cooperative funds’ directly under the agricultural department; the TVE cooperative fund was illegal. As in other counties, the local government was highly protective of the only financing source of local economic growth under its control. In the absence of a conclusive central policy, the document had no immediate effects.<sup>64</sup>

In mid-1997 the PBC was finally given the green light to go ahead and ‘clean up’ the RCFs. In Shaanxi Province the provincial government on 21 July 1997 approved the suggestions of the provincial PBC branch and Agricultural Bureau on ‘cleaning up’ the RCFs between August and December 1997.<sup>65</sup> On 5 October 1997 the Shaanxi provincial government approved a further ‘adjustment of the financial order’ as suggested by the PBC. This led to a flurry of circulars by government departments on all tiers.<sup>66</sup> Some RCFs temporarily halted all lending in late 1997 until the investigations were completed.

In the end, those RCFs that were established after 1 September 1996 or without approval of the county tier agricultural departments (or the PBC) were to be dissolved. All other RCFs could continue operation but shares (deposits) were now to be held for at least a year. ‘Usage fees’ paid on shares were to be comparable to the interest rates of the banking system. Lending became limited to members. PBC and agricultural departments in Shaanxi Province also requested a clear internal administrative structure with shareholder meetings, Board of Directors and Supervisory Board, while local government and Party leaders were prohibited from holding leadership positions in the RCFs.<sup>67</sup>

The campaign began in August 1997 and was over by the end of the year. Few RCFs were liquidated. The return on deposits (shares) came down significantly,

---

63. A list of illegal financial institutions was attached. Twenty copies of the document were forwarded to the county Party committee, the county People’s Congress, the municipal PBC branch, and leading employees of the county PBC branch itself.

64. In response to the widespread growth of the RCFs, the PBC of the same municipality demonstratively issued golden plaques to all ‘legal’ financial institutions—but not to cooperative funds. The signs are displayed in prominent position above the banks’ front doors and read ‘X branch is a legal financial institution approved by the PBC. Deposits at this institution enjoy the protection of the laws of the state. [Signed:] PBC branch, Y municipality’. As of 1998 such plaques violate Art. 18 of a PBC regulation on deposit withdrawal which prohibits PBC branches from issuing any deposit guarantees. See People’s Bank of China (23 March 1998, Yinfa #49/1998), ‘Fangfan He Chuzhi Jinrong Jigou Zhifu Fengxian Zanxing Banfa’ [‘Temporary measure on carefully handling the risk of bank runs at financial institutions’], in *Zhongguo Renmin Yinhang Wengao* [*PBC Bulletin*] 2, (1998), pp. 3–9.

65. Shaanxi Province Government, ‘Shaanxi Sheng Renmin Zhengfu Pizhuan Zhongguo Renmin Yinhang Shaanxi Sheng Fenhang, Shaanxi Sheng Nongyeting Guanyu Qingli Zhengdun Nongcun Hezuo Jijinhui De Yijian De Tongzhi’.

66. See, for example, Shaanxi Province TVE Administration Bureau (29 November 1997, Shaanxiang qijingfa #179/1997), ‘Shaanxi Sheng Xiangzhen Qiyeju Guanche Sheng Zhengfu Guanyu Zhengdun Jinrong Zhixu Youguan Wenti De Pifu De Tongzhi’ [‘Shaanxi Province TVE Administration Bureau circular on the reply by the provincial government regarding the rectification of certain problems in the financial order’].

67. See Shaanxi Province Government, ‘Shaanxi Sheng Renmin Zhengfu Pizhuan Zhongguo Renmin Yinhang Shaanxi Sheng Fenhang, Shaanxi Sheng Nongyeting Guanyu Qingli Zhengdun Nongcun Hezuo Jijinhui De Yijian De Tongzhi’; *Jinrong Shibao*, (16 August 1997, 14 December 1997), and *Shaanxi Xinxibao* [*Shaanxi News*], (24 April 1997, 13 October 1997).



even though it still exceeded the bank interest rate by a few percentage points.<sup>68</sup> Limited lending to members had no effect as membership shareholding requirements were low. RCFs no longer advertised aggressively and newspaper coverage of RCFs ended.

### *Campaign against illegal financial institutions*

Decisive new policies were originally expected from the Fifteenth Party Congress in September 1997 but did not emerge. On 14 October 1998 the Third Plenum of the Fifteenth CCPCC, in a major decision on agricultural development, avoided placing any clear-cut constraints on RCF development and only stated that 'various types of economic entities organized by farmers in shareholding form are a new product of reform and shall be actively supported, receive correct guidance, and be gradually perfected'.<sup>69</sup>

Yet the SC on 13 July 1998 issued a regulatory framework banning illegal financial institutions and illegal financial activities.<sup>70</sup> While this regulatory framework did not specify which type of quasi-financial institution is illegal, the PBC (with the approval of the SC) was quick to issue a circular on 11 August 1998 identifying individual categories of illegal institutions and behavior.<sup>71</sup> This circular for the first time explicitly listed individual types of cooperative funds as illegal, and issued instructions on how to deal with them.

The circular requested that various funds and financial institutions, all run by governments and their departments, be 'cleaned up' and reorganized.<sup>72</sup> If any financial activities such as acceptance of deposits from the public or lending were undertaken, these had to stop by the end of June 1999. The circular reconfirmed the 1988 SC decision (without referring to it) that cooperative funds required PBC

68. The MoA and PBC required RCF 'usage fees' to be no higher than the corresponding bank interest rates. See Ministry of Agriculture, 'Nongyebu, Zhongguo Renmin Yinhang Guanyu Jiaqiang Nongcun Hezuo Jijinhui Guanli De Tongzhi', Art. 7. The RCFs can evade the spirit of this regulation by paying bank interest rates plus dividends on deposits. Interest rate caps on loans can easily be flouted through handling fees, compensating balances and repayment scheduling. In one particular county in Shaanxi Province, RCFs in April 1998 offered 'usage fees' of 8.28–9% per annum on '1-year shares' (without dividend payments), while the state-determined interest rate in the financial system on 1-year fixed-term deposits was 5.22%.

69. Third Plenum of the Fifteenth Chinese Communist Party Central Committee (14 October 1998), 'Zhonggong Zhongyong Guanyu Nongye He Nongcun Gongzuo Ruogan Zhongda Wenti De Jueding' ['CCPCC decision on some very important issues of agriculture and rural work'], in *Zhonghua Renmin Gongheguo Guowuyuan Gongbao* 26, (18 November 1998), pp. 996–1011.

70. State Council (13 July 1998, SC decree #247/1998), 'Feifa Jinrong Jigou He Feifa Jinrong Yewu Huodong Qudi Banfa' ['Measures to eliminate illegal financial institutions and illegal financial business'], *Shaanxi Zhengbao* 15, (15 August 1998), pp. 4–6.

71. State Council (11 August 1998, Guobanfa #126/1998), 'Guowuyuan Bangongting Zhuanfa Zhongguo Renmin Yinhang Zhengdun Luan Jizi Luan Pi Jinrong Jigou He Luan Ban Jinrong Yewu Shishi Fang'an De Tongzhi' ['SC office circular passing on the implementing scheme of the PBC on rectifying the disorderly raising of funds, the disorderly approval of financial institutions, and the disorderly conduct of financial business'], in *Zhonghua Renmin Gongheguo Guowuyuan Gongbao* 24, (22 October 1998), pp. 949–955.

72. The funds and other financial institutions include cooperative funds (*jijinhui*), mutual aid funds (*huzhuzuo*), savings funds (*chujinhui*), funds service departments (*zijin fuwu bu*), share service departments (*gujin fuwu bu*), clearing centers (*jiesuan zhongxin*) and investment companies (*touzi gongsi*).

approval and must be registered with the Civil Affairs Administration. All illegal activities and institutions were to be examined in a first step by the end of 1998 and then rectified in a second step by the end of March 1999; the PBC finally was to have checked on the rectification by the end of June 1999.<sup>73</sup>

However, the circular did not resolve the conflict between PBC and MoA. In a short sentence those RCFs registered with the agricultural departments—as well as ‘intermediate institutions’ of the fiscal departments—were explicitly excluded from the reorganization campaign. While the PBC thus managed to start a major campaign against various types of funds run by local governments, the vast majority of cooperative funds were excluded.

### *Demise of the RCFs?*

The PBC circular of 11 August 1998, although presenting a three-stage reorganization schedule to be completed by mid-1999, also gave a separate deadline of the end of 2000 for the whole campaign, one and a half years after completion of the three-stage rectification. The PBC may have realized that it was facing an uphill battle, but it also raised the possibility that the campaign may later enter a new phase to incorporate the RCFs under the agricultural departments.<sup>74</sup> By March 1999, the SC finally was ready to dissolve the RCFs.<sup>75</sup> In a secret decree it demanded that RCFs across the country stop all operation; the domestic media were neither allowed to report on the decision nor on the subsequent implementation. Large and healthy RCFs were to join RCCs, and all other RCFs were to be disbanded.

Sichuan Province was the first target, mobilizing 100,000 people to dissolve its 4435 RCFs. By July 1999, 1874 RCFs (accounting for more than half of all RCF assets) had been folded into RCCs. The remaining 2561 were reportedly disbanded, with 75% of the deposits already returned to the depositors, and the rest to follow

---

73. The Shaanxi Province government took up the issue on 9 October 1998 with the establishment of a leading group. See Shaanxi Province Government (9 October 1998, Shaanzheng banfa #71/1998), ‘Shaanxi Sheng Renmin Zhengfu Bangongting Guanyu Renzhen Kaizhan Zhengdun Jinrong “San Luan” Gongzuo De Tongzhi’ [‘Shaanxi Province government office circular on sincerely starting off the work on rectifying the “three disorderly” elements in the financial system’], *Shaanxi Zhengbao* 21, (15 November 1998), p. 28f. Municipalities (and prefectures) were required to likewise establish leading groups. Results of the reorganization were to be reported to the provincial government by the end of May 1999. Reports in the media on any financial matter, including on various types of local funds, required prior PBC approval.

74. The national supply and marketing cooperative in early 1999, for example, did not at all require the cooperative funds run by the local supply and marketing cooperatives to be disbanded. All it is concerned about is that funds be no longer ‘publicly’ collected. See *Jinrong Shibao*, (13 January 1999). A major difficulty in closing cooperative funds is the fact that the central bank has no authority over these institutions. Closure of illegal financial institutions requires action by public security organs in accordance with the criminal code; public security, on the other hand, may not be qualified to determine what constitutes an illegal financial institution. The PBC thus needs to first identify the particular institution to be closed and then report to public security for action. See *Xinbao* [*Hong Kong Economic Journal*], (21 November 1998), for the legal intricacies. In practice, local public security organs may well drag their feet, especially if so encouraged by the local government.

75. An article in *Guojia Jixie Gongyeju Jijingwang*, (11 November 1999), hints that the reason for the dissolution was the central government’s orders to close inefficient or polluting enterprises, and those enterprises that use backward technology. Since these enterprises were among the customers of the RCFs, the central government could no longer ignore the RCF issue.

within 3 years.<sup>76</sup> Other provinces followed suit after a lengthy delay. In Hebei Province, the province with the second-largest number of RCFs, all RCFs were reported successfully dissolved by 15 September 1999. In Heilongjiang Province the dissolution of RCFs went under way in August 1999, and in Gansu Province RCFs stopped accepting new deposits on 15 November 1999.<sup>77</sup> At the end of 1999, the SC decree was still awaiting implementation in most other provinces.

The PBC is firmly in charge of this final campaign. The SC requested the PBC to reach agreements with individual provincial governments on the dissolution of the RCFs. This suggests provincial variation in implementation that may take into account the ability and willingness of the governments on provincial and sub-provincial tiers to step in and reimburse depositors while loans are being recovered. But the PBC also has a second agenda, namely the resolution of the insolvent RCC problem that has been lingering on ever since the PBC was burdened with the RCCs in 1996.

## Conclusions

Since their establishment in the early 1990s, RCFs have served the rural economy well. They prevented the outflow of funds from rural to urban areas and served many of those enterprises and households neglected by formal financial institutions in the countryside. Yet the central government in 1999 requested that the 'counter-revolution' from the countryside be stopped in its tracks without so far addressing the cause of their rise: the demand for a higher degree of at least semi-regulated financial intermediation in the countryside. This may improve the fortunes of some formal financial institutions, yet in 1999 the rural economy was suffering from a lack of funds (at other than usury rates) as hardly ever before.

Furthermore, the dissolution of the RCFs proved costly to the countryside. The superordinate government departments on county and township tier that organized the RCFs, together with their governments, bear all the burden of the sudden dissolution. Not only do they have to guarantee the bad loans of their RCFs, but they also have to pay for the damage caused by quickly dissolving RCFs. Banks in 1999 did not lend to TVEs without a third-party guarantee or security; yet a valuation of enterprise assets by the relevant government departments is as expensive as 10% of the actual value of the assets. The share of TVE loans in total formal financial sector loans in China fell from close to 10% in the early 1990s to a low of 6.45% in 1998 and continued to fall during the first 10 months of 1999. Rural households again must rely on personal loans, all too frequently at usury rates.<sup>78</sup> The negative impact of the dissolution of the RCFs on the rural economy flies in the face of the decision reached by the Third Plenum of the Fifteenth

---

76. See *Jinrong Shibao*, (9 July 1999).

77. See *Jinrong Shibao*, (25 September 1999), *Heilongjiang Ribao* [*Heilongjiang Daily*], (8 August 1999), and *Xinhuashe* [*New China News Agency*], (17 November 1999).

78. See *Zhongguo Xiangzhen Qiyebao*, (30 November 1999), *Guojia Jixie Gongyeju Jijingwang*, (11 November 1999), and *Zhongguo Tongji Nianjian 1999*, p. 624.

Chinese Communist Party Central Committee on 14 October 1998 about promoting growth in the countryside.<sup>79</sup>

The SC's March 1999 decree may well not be the final word on rural financial intermediation. RCFs could be hard to eradicate in poor regions to begin with, where RCCs are so far reluctant to lend. RCFs, if abolished, could resurface as smaller, covert institutions. The PRC TVE Law furthermore allows county-tier and higher-level tier governments to establish TVE development funds.<sup>80</sup> While sources of funding comprise government funds, part of the increase in local TVE taxes, and retained profits, they also include other funds provided by rural collective organizations, TVEs—and farmers (Art. 21). The funds are to be used primarily to support TVEs, but the categories are broad enough to encompass other uses (Art. 22). This pits the PRC TVE Law squarely against the PRC PBC Law and the PRC Commercial Bank Law, which require PBC approval for all financial institutions.<sup>81</sup> Lower-level tier government departments could challenge the current dissolution of RCFs by setting up identically functioning, and perfectly legal TVE development funds.

Yet the central government could be planning further ahead. RCFs represent a monetary counterrevolution from the countryside in two respects. They lend locally (rather than channel funds to urban areas), and their lending practices diverge from formal financial sector rules such as on interest rates.<sup>82</sup> RCCs have the potential to rise up to both challenges. Since their separation from the ABC they no longer deposit up to half of their funds at the ABC, but only the 8% minimum reserve with the PBC as all other financial institutions do. RCCs also, uniquely among all formal financial institutions, could adjust their lending rates upward by up to 60% above the otherwise nationwide uniform rates until April 1996, and since then by up to 40%. By merging financially sound and innovative RCFs into the more often than not insolvent RCCs with their high overheads and traditional banking practices, the PBC may be injecting just the new blood the RCCs badly need. RCFs might continue to operate as before, only now as a department within the RCC specializing in small loans with the type of risk that RCCs formerly could not or were not willing to handle.

---

79. The PBC in late 1999 and early 2000 countered the trend towards rural financial dis-intermediation with a host of new regulations on RCC lending to rural households, including a regulation on small loans as well as one on mutual loan-guarantee groups. But whether these measures are successful remains to be seen.

80. National People's Congress (29 October 1996). 'Zhonghua Renmin Gongheguo Xiangzhen Qiye Fa' ['PRC TVE Law'], in Fang Weilian, *Xiangzhen Qiye Fa Shiyong Zhinan* [Guide on the Use of the Township and Village Enterprise Law] (Beijing: Zhongguo Nongye Chubanshe, 1997), pp. 192–197.

81. Art. 31 of the PRC PBC Law requires PBC approval for the establishment, transformation, and termination of all financial institutions. According to Art. 11 of the PRC Commercial Bank Law 'without PBC approval no unit or person may collect deposits from the public or conduct other commercial banking business'. See National People's Congress (18 March 1995), 'Zhonghua Renmin Gongheguo Zhongguo Renmin Yinhang Fa' ['People's Republic of China People's Bank of China Law'], in *Zuixin Zhongyang Yinhang Shiwu Quanshu* [Latest Central Bank Almanac] (Beijing: Zhongguo Jinrong Chubanshe, 1995), pp. 309–313, and National People's Congress (10 May 1995), 'Zhonghua Renmin Gongheguo Gongshang Yinhang Fa' ['People's Republic of China Commercial Bank Law'], in *Zuixin Zhongyang Yinhang Shiwu Quanshu*, pp. 313–321.

82. The RCF movement never represented a challenge to the state monopoly on banking. RCFs were run by local government and Party departments, not by private households. Yet from the point of view of rural financial intermediation, ownership appears far less relevant than fund flows and lending practices.

Ultimately, the PBC as central bank will want to divest itself of the RCCs; administration of approximately 50,000 RCCs is not a task the PBC is particularly well suited to fulfill. Yet the RCCs' history as quasi-branches of the ABC implies that the central government is responsible for bailing out the RCCs, whose aggregate net worth is, by now publicly admitted, negative.<sup>83</sup> County government and Party committees are responsible for the financial health of RCFs, but successfully refuse responsibility for the accumulated bad loans of the RCCs (and would, if forced to, accept responsibility, not be able to bear the financial burden).

The case of Hebei Province, one of the two provinces in which RCFs have been dissolved, provides a hint as to the reforms that may be about to unfold. In Hebei Province, the provincial government injected 1.576b yuan into the RCCs in an overall deal with the PBC on the abandonment of the RCFs.<sup>84</sup> The PBC thus strikes a bargain with individual provincial governments in which it de facto sells off the RCCs to the locality. In the first instance, the locality is the province, but in the end it may well mean the county government, as the provincial government is unlikely to have much interest in running RCCs that may then be exploited by the county government. This would allow the PBC to focus on its core supervisory task of all financial institutions. RCCs are currently establishing supra-organizations in the form of 'joint RCCs' (*lianshe*) on municipal and even provincial tier that greatly facilitate PBC supervision, but also create a more resilient rural financial institution by spreading risk across localities.

At the same time, selling off re-capitalized RCCs to—presumably in the final instance—the county tier gives local governments a degree of influence on local financial intermediation, which they had previously sought through the establishment of RCFs, and makes them responsible for the financial health of RCCs, which they were previously able to avoid. This would bridge the traditional chasm between the centrally controlled formal financial sector but the locally owned rural economy. A precedent exists. In 1998 the urban credit cooperatives, originally set up by the formal financial institutions, were merged into urban cooperative banks (later renamed urban commercial banks) with, as controlling owner, the municipal government, while the PBC is exercising rigorous supervision. The monetary counterrevolution from the countryside may not have been crushed after all. Rather, it may have accelerated the transition from a centrally controlled, exclusive and highly loss-making rural financial sector to a financially viable and more consumer-oriented one.

---

83. *People's Bank of China Quarterly Statistical Bulletin* 15, (1999), p. 25.

84. See *Jinrong Shibao*, (25 September 1999), which treats RCCs and RCFs as one issue. To judge by 1997 figures, this amount could be equivalent to up to 2% of RCC deposits. See *Zhongguo Jinrong Nianjian 1998 [Financial Yearbook of China 1998]* (Beijing: Zhongguo Jinrong Chubanshe, 1998), p. 622.