Empowering CSO Networks in an Unequal Multi-Polar World

China's Rural Cooperative Finance Policies and Their Impact on Reducing Income Disparity among Rural Households

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General overview

Many reasons contributed to the inequality in rural areas in China. Rural financial system was one of them. Under the ill-structured rural financial system framework, private capitals of rural households cannot be used to support farmers' sustainable development thorough appropriate financial scheme, thus resulting in the capital outflow. While in this process, a proportion of capitals remained in the rural areas and was more targeted at the well-off or high social status households, with their poor counterparts receiving no effective financial service. This will further lead to the solidification and worsening of inequality in rural areas. Rural finance is exactly the core of modern economy. The income inequality among different households was actually a result of rural economy process with finance gradually taking the leading role. Thus to change this income inequality, the rural cooperative finance as a rural finance scheme becomes a solution to enhance the income equality among households.

The rural cooperative finance is an effective approach to progressively reduce the rural income inequality through an effective use of household capitals and the introduction of cooperative economic management so as to eventually address the capital needs of the poor households and improve their finance management ability. By increasing financial support to the poor household, it aims to promote their participation and management ability, improve the external environment for household economic development, increase their income and alleviate the income inequality.

China's rural cooperative finance development has gone through a tortuous process. Thanks to the non-governmental credit cooperative movement and the support to the credit cooperative from the Kuomintang and the Communist Party, the rural credit cooperatives (RCC) has witnessed a rapid growth in number as well as in operation quality since the establishment of new China. However, as a result of the planned economy and the excessive pursuit for a “large in size and collective in nature” rural production relations, RCCs were turned into the grass-root rural units of the national bank, losing its nature of cooperative finance. Since the reform and opening-up, the progressive growth of rural households as business entities and the sound development of rural market relations, have provided solid foundations for the cooperative finance. However, the government-run and formalized RCCs were hard to be transformed to the cooperative finance institutions. On the other hand, the non-government credit organizations received no substantial support from the authoritative units due to different perceptions. Though the policy environment for a long time was not favorable for rural cooperative finance to develop after the rural reform, the rural finance still managed to expand its coverage. Many rural cooperative finance forms existed, including the internal credit cooperatives originated from the specialized cooperatives, the fund cooperative societies created by the non-governmental cooperative finance entrepreneurs, the village-level cooperative fund to increase the financial support from the national poverty-alleviation system, as well as the alienated and later abandoned rural cooperative foundations. The rural cooperative finance evolvement has shown its objective necessity and also its roles in poverty alleviation. Today, China’s rural cooperative finance has gone beyond the policy restriction period and the 2014 No. 1 Document has clearly sent the message of speeding up rural cooperative finance development, and delivered supportive policies for RCCs and the rural cooperative fund societies (as the complete rural cooperative financial institution) to undertake credit finance. Moreover, the Document has highlighted the role of supervision and management for the sound management. Rural cooperative finance will play more significant roles in reducing income disparities.

This report first reviews the policy evolvement of different rural cooperative finance institutions since the establishment of new China. Then it analyzes the rural finance development environment and the cooperative finance policies. Lastly, the report evaluates their impact on the rural inequality and proposes direction for policy reform.

I. Current status of China's rural finance development

It has been a common issue in China that poor population received no effective financial service. And for a long time they gained no benefit from the rural finance development. Whether the rural finance development can improve the income of poor households depends on whether the supply pattern of rural finance improves their accessibility to the capitals, and whether the rural finance profit is fairly shared among them. In this regard, rural cooperative finance becomes an important approach for poverty reduction by finance means with its positive impact, and whether it can develop in the current context becomes the key indicator for its poverty reduction impact. To understand the rural cooperative finance development and its impact on poverty reduction, the overall situation of rural finance development should be explained.

The Third Plenary Session of the Seventeenth Central Committee in 2007 has clearly stated that "rural finance is the core for modern rural economy", showing the government resolution on fully applying rural finance as a contributing component of modern rural development. And in specific measures, the government proposed to "innovate the rural finance scheme, relax restrictions on rural finance entrance policies, and speed up the establishment of rural finance system characterized by abundant capitals, high performance, better service and safe operation, by integrating commercial finance, cooperative finance and policy finance." The cooperative finance has thus formally been regarded as a significant element of rural finance system.

Both the theoretical and the practical fields agreed the fundamental issue of the current rural finance system had been the conflict between financial supply and demand. And the current system failed to provide effective financial service to farmers. According to the NPC Standing Committee's report on the rural finance development delivered by Chairman Shang Fulin, China Banking Regulatory Commission (CBRC) on June 27, 2013, the above issues were "particularly visible in the mid and west rural counties". The disparity was shown in three aspects. First, the urban-rural disparity, with the county loan-to-deposit ratio far below the urban level; Second, the regional disparity, with the mid and west county loan-to-deposit ratio far below the eastern ones, and the phenomenon of "collecting from the poor to support the rich" is wide spread; Third, the disparity in agriculture supply chain, with the increase of loan from agriculture, forestry, animal husbandry, and fishing far below that of urban enterprises engaging in agricultural production, and the loan increase was slow in the front supply chain. With the development of agricultural modernization and urbanization, the supply and demand disparity in certain areas will further enlarge.

The above analysis presents the situation that financial demand was not met. Let's then take a look at the supply condition. The big picture is the financial supply has witnessed a great development, while the supply to rural households remained very much to be improved. Regarding the finance supply, by the end of 2012, the financial institutions have covered all counties (cities) and most towns, and the financial services have covered all towns. By the late 2012, the agricultural-related loans amounted to 17.6 trillion RMB, and the average annual increase was 23.6% since 2008, a rise of 4% compared to all types of loans in the same corresponding period. Out of all loans, the farmer loans reached 3.6 trillion RMB, a growth by 1.7 times than that of the late 2007. More than 82.54 million households received credit loans, with the coverage reaching over 30%. In 2012, 970 million mu (approximately 64.7 million ha.) farming land was covered by the agricultural insurance, accounting for 40.2% of the total farming land for main crops in China. From 2007 to 2012, more than 55.1 billion RMB was provided to 113 million farmers as insurance. From 2007 to present, nearly 50 agricultural enterprises were listed on the main-board market and growth enterprise market, with the accumulated capitals reaching 49.1 billion RMB. The agricultural commodity futures now included 15 types, nearly half of the total commodity types.

However, a comparison of financial supply and demand reveals a huge insufficiency of supplies to the rural households. At present, no mechanism was available to transfer the household surplus capitals to credit input. And the agriculture related credit loans had no sharing mechanism to protect farmers from natural disaster risks. The mortgage system was backward, with a scarcity of professional institutions for capital assessment, mortgage registration and guarantee, and the bank mortgages disposal was not smooth. The same was true for the information sharing platform of agricultural commodity futures, with no price guidance support provided to rural households featured by decentralized production and operation, making them vulnerable to market risks. Moreover, the “agriculture, farmer and rural area” mechanism related to the rural finance institutions was still in the initial stage, and many problems were prominent, including the complicated approval procedures and insufficient exploration of potential needs. The above analysis has testified the insufficient supply of rural financial services. As for its reasons, the traditional explanation included the small scale production and operation of rural households, weak risk-resistance to the natural disasters and agriculture market, scarcity of mortgages for formal finances and lack of requested conditions for financial supply. However, how to find the finance service approach suitable for farmers is the real key to address the above issues.

The contrast of improved financial supply in the rural areas and the insufficiency of financial supply for rural households, has indicated that the poor rural population was left in a disadvantaged position under this context. And in the continuous expansion of rural finance over the past years, rural cooperative finance has gradually solidified its current position. Regarding the poverty reduction mechanism through rural finance approaches as this paper studies, providing effective financial support to the targeted households becomes the first key step in this process. Therefore, it becomes necessary to first study how to expand the financial services to cover rural households, especially the poor households, and then to strengthen the rural inequality-reduction mechanism in the supply of financial services. This paper reviews the policies to promote all types of cooperative finance Institutions and their impacts.

II. Policy evolvement of China's cooperative finance institutions and the resulted impact

2. 1 Rural Credit Cooperatives

Before new China was established, RCC has developed to a certain degree in the KMT and the Communist Party controlled areas respectively. When new China was established, domestic economy was in depression and people's livelihood was on the verge of collapsing. The government decided to revive the nation's economy for future economic development. At the time, two significant challenges existed: first, means of production have been severely damaged after the war-torn period; second, people were in extreme poverty and had no capitals for production and development. Under this grim situation, the government has adopted the mutual assistance and cooperation from three aspects: production, supply & marketing, as well as credit to help farmers to overcome difficulties. In this way, the cooperative finance has won support from the national level and obtained its legality.

In June, 1923, China's first RCC-Xianghe County 1st Credit Cooperative was established in Fuyingtang, Xianghe County, Hebei Province. With all famers in Xianghe County as its members, it was established with the support from China

International Famine Relief Commission for delivering loans and helping farmers on agricultural production. The Commission was built in 1921 for the purpose of disaster relief, yet only delivered very little relief and the Commission has come to realize that the disaster prevention overweight the disaster relief in real practice. Also at the same time, the frequency of disasters had made farmers willing to unite and to help themselves, from which the Xianghe County 1st Credit Cooperative was born. Upon its establishment, there were 31 farmer members with 56 RMB as the collected capitals, and the operation applied the unlimited responsibilities to enhance the mutual trust among its members. Wang Yutang was elected as the Cooperative chairman and Ruan Yuheng was the supervision Chairman. The Commission provided 500 RMB to the Cooperative as the low-interest loan, which was redistributed by the Cooperative to its members to support the agricultural production and construction, winning generous support from farmers. From then on RCC developed rapidly, growing from 9 RCCs with 403 members in 1924 to 94 RCCs with 3288 members in 1926. Within three years RCCs have amounted to nearly 100 in number.

Since its entry to China, RCC was led and managed by the People's Bank of China with the government-run background and the cooperative property at the start. In May 1951, the People's Bank of China held the first session of the National Rural Financial Work Conference for the wide promotion of RCC and released the "Rural Credit Cooperatives Guidelines and Regulations <Draft>" and "Rural Credit Mutual Assistance Group Convention <Draft> ". These Drafts included the following content: (1) Forms of credit cooperative institutions can be diversified, including credit cooperatives, credit departments, credit groups, credit and loan middle agencies and credit associations, etc, to provide non-governmental loans and credit assistance as a way for rural capital flow. (2) It clearly stipulated that RCC was the cooperation organization created by farmers for mutual capital support, and profit was not the key purpose. (3) One member, one vote. (4) RCC is to be managed in a democratic way. (5) It stipulated the proportion of earnings distributions. (5) It identified the supporting policies to RRC. This is the first of its type in China regarding RCC development with the property of cooperation. In 1955, the People's Bank of China again issued the Rural Credit Cooperative Guideline. Under the new policy, a new tide of cooperative finance development has swept across the whole country. By the end of 1957, RCCs in China has reached 88,368, with the deposit amounting to 2.06 billion RMB and member shares reaching 310 million RMB. [1]

However, the necessity of cooperative finance was not well recognized from the perspective of inevitable requirement of small-scale peasant economy. Thus when China highlighted the development of planned economy in the late 1950 to pursue the path of developing rural productivity through the socialization of production means, people have misinterpreted the necessity and appropriate form of cooperative finance development. Later, RCC has lost its property of cooperative finance under the great background.

In December 1958, the Central Government and State Council have jointly released the "Decision on Reforming Rural Finance and Trade Management System to Adapt to the People's Communes", and applied a new finance and trade system with "two placement (staff and organizations), three unifications (unified policy, unified planning and unified capital flow management) and one responsibility (financial tasks)". Based on this Decision, the rural finance organizations were transferred to the local people's commune for management, and the National Bank agency and RCC in the commune were combined to form the commune credit departments. It was designed to empower the commune credit departments, while it failed to motivate the local government and people's commune as expected. Later, the commune credit department was co-managed by the People's Bank and commune steering committee, though more under the leadership of the former. The credit departments had to follow relevant policies and regulations in policy development, business planning and regulation development requested by the People's Bank; the commune

[1] Xie Ping: China's Commercial Banks Reform. Beijing: Economic Science Publishing House. 2002. P41.

party committee and the commune management committee were responsible for supervising its delivery of national tasks as well as political and ideological work in line with national policies. They were requested not to withdraw any capitals from the credit department or use capitals for commodity sales on credit or credit payment in advance, without the approval of the provincial party committee. Moreover, and the capital transactions between credit departments and the People's Bank, were all treated as internal bank processing with no interest charged. Each production unit may set up a credit sub-division, which was under the leadership of the production brigade. The transaction between the credit sub-division and the commune credit department (i.e. the bank branch) was treated as deposit and loan relationship with interest calculated. Gains and losses that occurred in the credit business were under the unified management of production brigade. [②]

In other words, after 1958 "Great Leap Forward" and the people's commune movement, RCCs for a long time has been delegated to the people's communes and production brigades for leadership and management. Influenced by the "ultra-leftist" ideology, farmers were forced to join the RCC by the administrative power, which contradicted to the principle of voluntary enrollment. In addition, the financial management and business operation of RCCs was led by the people's commune, which integrated the function of government administration and economic management. After the government intervention, RCCs lost its independent operating status. A large proportion of RCC capitals were embezzled and the deposits reduced rapidly. The democratic management of RCCs was under the shock.

During the "Cultural Revolution", the tendency of RCCs controlled by external forces continued. In this period, RCCs in some places were managed by the poor peasant associations, with rules and regulations broken, finance in chaos, and business stopped, which entirely contributed to the collapse of RCC's democratic management.

[②] Guan Yanchun, 2005. Modern China Rural Cooperative Finance Study. Doctoral thesis paper of Humanities Academy, Zhejiang University.

Later, the government began to manage them as grassroots bank agencies. In November 1977, "Decisions on Reorganizing and Strengthening Bank Business” by the State Council stipulated that “rural credit cooperative is not only a collective financial organization, but also the grassroots organization of the national bank." This dual nature confused the difference between the national bank and the credit cooperative, turning RCCs into grass-roots organizations of the national bank with tightened state control. As a result, RCCs gradually lost their independence, their unique organization structure based on collective choices, democratic management and operational flexibility. The “non-governmental” RCCs turned into "governmental" ones.

After the reform and opening up, the government was aware of RCC’s loss of credit cooperative function, and tried to revive it by introducing reform on the cooperative principle. This endeavor failed in its original purpose, only making RCCs more competitive and profitable and approaching the commercial bank operation. RCC existed in name only. Reform of this period can be divided into three stages. The first was the RCC adaptation stage (1980 to August 1996); the second was the RCC independent development stage (from August 1996 to June 2003), and the third was the RCC reform deepening stage (June 2003 to present).

In 1980, the CPC Central Committee and the State Council concluded in the banking conference: it was wrong to delegate RCCs to the commune, or to turn its nature to the "official" one, both of which were not treating RCCs as real collectively operated financial organizations. RCC should be under the leadership of the bank, with functions of independent accounting and self-financing. It should be flexible and play the role of private loans, not necessarily to be bound by the bank regulations. If RCCs, supply and marketing cooperatives as well as the agricultural responsibility were revived and integrated, together with household sideline productions, the rural economy would surely benefit. This has highlighted RCC’s nature and direction of development, which was exactly the basic guideline for credit cooperative reforms. [③] In August 1984, the State Council approved the report from the Agricultural Bank of China on the reform of credit cooperative management system, and proposed three principles of collective organization, democratic management, and flexible operation. RCCs were requested to reform to the direction of credit finance, led by the Agricultural Bank of China. In March 1993, the Agricultural Bank of China issued the "Suggestions on Promoting the Pilot Programs of Rural Shareholding Credit Cooperative System", and clearly noted the main purpose of these pilots was to clarify property rights, restore and maintain the nature and features of the collective RCC organizations. It was to separate government administration and enterprise management, separate ownership and operation right, enhance independent operation and self-financing, and to strengthen the economic ties between RCCs shareholders. In December the same year, the "Decisions on Financial Reform" released by the State Council required rural cooperative banks should be systematically organized on the foundation of RCCs to address the needs of rural commodity economy. Also, "Rural Cooperative Bank Act" should be developed, and RCCs should be separated from the Agricultural Bank of China to become the joint organizations of grassroots credit cooperatives.

In August 1996, "Decisions of the State Council on Rural Financial System Reform" (hereinafter referred to as the Decision) clearly stated that the guiding ideology of the rural financial system reform was to establish and perfect the rural finance system, with cooperative finance as the core, and commercial finance as well as policy finance as the coordination approaches. One of the reform highlight was to restore RCC’s cooperative nature. The Decision also noted that the RCC reform’s core task was to progressively transferring RCCs to the cooperative finance organizations with farmers holding shares and democratic management. In this way RCCs will be reorganized and regulated based on the cooperative principles. According to the

[③] Luo Jun, 2010. An Analysis on Cooperative Finance. Chengdu: Sichuan University Publishing House. P224.

Decision, the Agricultural Bank of China was no longer leading and managing RCCs, and their financial supervision shall be borne by the People's Bank of China. RCC county cooperatives will be responsible for the management, guidance, coordination, and services for the grassroots RCCs. The RCC self-regulatory organization will be established as well. Results of the second reform stage included: RCC’s self-development, self-restraint and independent decision-making operation mechanism was formed initially; the stakeholder relationship was clarified, including RCCs, the People's Bank, and local government; a new finance supervision system was initially established with the central bank responsible for regulation and industry for self-regulation.

In June 2003, the State Council issued the "Notice to Deepen Rural Credit Cooperatives Reform Pilot Program", by which introduced the supervision and management mechanism of "national macro-control and supervision, provincial government legal administration, responsible operation, RCC self-restraint and risk sharing scheme”, so as to meet the overall reform requirements of "clarifying property rights, strengthening the restriction mechanism, enhancing service functions, providing appropriate national support, and local government holding responsibilities". [④] This RCC reform focused on two issues. First, the legal person shall be taken as the basic unit to reform the property rights system to clarify property rights, and improve the legal person management structure. Also, the reform shall differentiate various types of situations, identify different forms of ownership, and adopt different development approach based on economic disparity; second, the RCC management system shall be reformed by empowering local governments and establishing provincial (city) RCC associated cooperatives. In the same year, the state established the Banking Regulatory Commission, and each province also established their provincial Banking Bureaus. As a result, the RCC regulatory functions were transferred from the People's Bank of China to the Banking

[④] Luo Jun, 2010. Cooperative Finance Development. Chengdu: Sichuan University Publishing House. P 227.

Regulatory Commission and the provincial Banking Bureaus. The RCC reform since 2003 has ended the long-term financial losses, improved the operating efficiency, and enhanced the risk resilience and industry competitiveness, ultimately resulting in a successful transformation of the commercialized organization with strong profitability.

Case study: Hainan Provincial RCC reform

Resources, market, and also technologies are all available, except capitals. Over the years, the weak financial service has always been one of the biggest bottlenecks for the "the agriculture, farmer and rural area" development in Hainan Province. On August 10, 2007, Hainan Provincial Rural Credit Cooperative was established as China’s last to participate in RCC reform as the province with the worst asset quality and the heaviest historical burdens. On December 2, 2008, Hainan's first county-level RCC with legal person status was established in Qiongzhong, signaling the transfer of county and township dual-level property rights system to the county (city) system. The Unified legal person reform not only helped Qiongzhong cooperative to have a successful capital increase of 60 million RMB as shares, but also supported the establishment of "Sanhuiyiceng" (shareholder’s meeting, board of directors, board of supervisors, and senior management) corporate governance structure in line with the strict modern enterprise system.

As of late July 2009, the provincial RCC’s deposit balance has reached 19.519 billion RMB, an increase of 81% over the time when first established; the loan balance has reached 10.903 billion RMB, an increase of 93.11% in two years; the balance of bad loans was 2.236 billion RMB, accounting for 20.51 % of the total, a decrease of 45.06%. From January to June 2009, Hainan Provincial Rural Credit Cooperative has offset balance to make profit, becoming the first of its kind in profit since the establishment of the economic zone.

With management, property and services, the so-called "three arrows", micro-credit is the magic tool for RCC. Hainan RCCs granted the approval right to farmers, who were encouraged to establish a five-household joint credit group on voluntary basis. After 5-7 days of training from the loan officer, farmers can obtain the loan without having to go through approval or mortgage, if the loan is less than 20,000 RMB. This greatly improved the access to loans by farmers. Also, local RCCs created a special "integrity deposit" scheme for microcredit business, which delivered the right of loan interest pricing to farmers. In other words, the timely loan repayment will result in a higher integrity reward. The better the repayment credit, the higher the rate of integrity reward. This will lead to the gradual increase of loan amount. Through this approach, the integrity awareness of farmers is raised and their interest burden is reduced. In the case of huge disasters or special occasions, if farmers fail to repay the loans, they only have to pay extra interest and their loans will not be regarded as bad loans. This greatly alleviated the farmer’s burdens and helped farmers develop good repayment habits. As for banks, they collect annual interest as incomes, and the overall operation will not be affected.

With “the soil smell”, these approaches have been welcomed by farmers. Today, it has become a common scene for loanees to pay back the loans well ahead the deadline in every Hainan RCC. These farmers have benefited from the reform and understood the value of credit, thus influencing more people.

In Qiongzhong, the balance of loans accounted for 79% of the county's rural credit cooperatives in the interbank market share, which accounted for 74% of the county's agriculture-related loans in the interbank market share. It is the major form of local service provided for "agriculture, farmers and rural areas". Provincial government explicitly requested the promotion of "Qiongzhong mode" microfinance across the whole province. Currently, the provincial rural credit cooperatives delivered 2.4 billion RMB micro-loans, benefiting 190,000 farmers.

Over the past six years, RCCs in Hainan have delivered more than 630,000 micro-loans, with the total sum amounting to 13 billion RMB to support farmers to develop specialized economy, benefiting 518,000 households. In 2013, microfinance programs have made a profit of approximately 1.85 million RMB. The Hainan RCC deposit balance reached 85.6 billion RMB, and the loan balance reached 56.5 billion RMB.

2. 2 Rural Cooperative Foundations

As early as the second half of 1983, some villages in Heilongjiang, Liaoning, and Jiangsu Provinces have tried the approaches of “village management of brigade’s collective capitals” and “township management of brigade’s collective capitals” for better use of collective capitals thorough rectified management. The collective capitals were lent to members of rural collective economic associations with interest charged as a way for internal financing. This approach has ensured the safety and value increase of collective capitals, but also opened a new channel for agriculture investment, which has won support from farmers and local agricultural and economic government departments. Since the formal establishment of rural cooperative foundations (RCF) in Lujiaying Town, Kangbao County, Hebei Province in 1984, many regions across the whole country have started pilots as well. By the end of 1986, villages in Heilongjiang, Liaoning, Hubei, Zhejiang, Guangdong, Sichuan, and Jiangsu Provinces have made some progress, and produced a prototype of rural cooperative financial organizations.

The central government encouraged this voluntary internal financing approach. The CPC Central Committee’s No. 1 Document in 1984 supported it by "allowing the free or organized flow of capitals owned by farmers or collectives." This formed the policy basis for the internal financing activities in rural areas. And RCF was formally accepted by the state government in the CPC Central Committee’s No. 5 Document in 1985, which supported the "development of diversified financing approaches".

However, the national financial authorities did not recognize its existence, and some of the local financial institutions even restricted its development.

As described in the Zhongbanfa No. 27 Document in 1986, "in recent years, a number of rural cooperative economic organizations have put the collective idle capitals together voluntarily, and supported the township/village cooperative economic organizations' development and agriculture commodity production by charging capital use fees. This approach, if not accepting external deposit and only operating on internal financing, shall be allowed to progress as a pilot." This document became the starting point for the local governments and relevant departments to recognize, encourage, and support RCFs. In the next few years, national policies continued to support and encourage RCFs, which promoted its overall development. By 1992, regarding the rural cooperative financial organizations already established, especially in the form of RCF, there were 17,400 township RCFs and 112,500 village-level RCFs, accounting for 36.7% and 15.4% of the total respectively. And the year-end capitals amounted to 16.49 billion RMB. Among them, Sichuan and Jiangsu provinces have exceeded two billion RMB. And Hebei and Shandong provinces were close to two billion RMB as well.

However, the real climax development of RCFs came after the 1992 Deng Xiaoping's southern tour speech. At that time, a new tide of investment has swept the whole county, and the capital supply and demand gap expanded dramatically in the short term, directly leading to the high interest rate in the capital market. Under this macro background, RCFs in its initial stage began to show conflicts in this expansion. With the local government intervention, many RCFs blindly invested large amount of capitals to the township village collective enterprises in urgent need of capitals. By the end of 1996, there were 21,000 township and 24,000 village-level RCFs with the raised capitals reaching 150 billion RMB.

This was a period of financial chaos, with many government departments, including the supply and marketing cooperatives, family planning divisions, civil affair departments, labor and social security departments joining to establish RCFs and capital stock foundations, and engaged in vicious competition in the high-interest capital market. RCFs attracted and delivered capitals with interest higher than the national statutory deposit and loan rates. In other words, it adopted the operation strategy of "high-interest deposit and loans". In addition, excessive local government interventions, weak supervision mechanism and management, and high risk of capital loans resulted in the reduced profit. This excessive pursuit of high-interest capitals directed the capital flow to the non-agricultural field. Also, in some areas the small-scale bank runs appeared.

After the government realized RCF’s serious impact, it did not shut them down completely but turned to reorganization and rectification as a way out. In the "Decisions of the State Council on Rural Financial System Reform" released in August 1996, RCF’s positive role in increasing investment to agricultural production and alleviating the scarcity of capitals need by farmers in production and livelihood has been affirmed since its establishment. Also, the Decisions proposed measures for the RCF reorganization and rectification to address these problems. This was because many RCFs collected resident deposit in the name of inviting shareholders, whereas in real practice, the shareholders were not involved in the management or sharing any risks. In a sense, some RCFs were operating financial business illegally with great risks hidden. This has brought the state control and rectification with many measures introduced, but all failed to reverse RCF’s operation and management crisis.

Following these measures, the central government decided to fully rectify RCFs in November 1997 as a way to collect funds for the state-owned enterprise reform, and also to guard against financial risks as well as safeguard national financial monopoly. This sudden tightening of policy has triggered the outburst of conflicts hidden in RCFs. As the announcement of any types of financial organization shutdown was always associated with the bank run and crisis situation, thus the bank runs became very common in China in 1998. Large scale bank runs occurred in Sichuan, Hebei and other provinces, resulting in crisis endangering rural social and political stability.

Confronted with the ensuing big crisis, the state government completely lost its confidence in RCFs and decided to ban it. In January 1999 the State Council issued No. 3 Document to officially declare the complete ban of RCF in China. It stressed that "to effectively guard against and reduce financial risks, and maintain economic and social stability in rural areas, the State Council decided to undertake a thorough rectification of RCFs. The goal is to stop the establishment of new RCFs. And all the existing RCFs are forbidden to take any deposits or provide any loans. The capital and asset clearance will be launched to offset the real bad debt. Those meeting specific criteria will be incorporated into RCCs. Those insolvent or unable to pay for debt need to be liquidated and shut down.” This has put an end to RCFs from the rural financial arena.

2. 3 Rural fund cooperation society

The final exit of RCFs fully developed in the 1980s has resulted in the government’s vigilance and mistrust on rural non-governmental financing. Although RCF failed its mission, the rural need for capitals was still strong and a new approach was to be found, which gave birth to the rural fund cooperation society (RFCS). In July 2004, a grassroots CBRC inspector systematically summarized the real situation of non-governmental finance loans after substantial investigations on rural financing forms, and developed a RFCS model. Based on the RCC principle, he first helped Yanjiacun village, Lishu County, Jilin Province to establish their RFCS. Later, in some places, farmers also organized a number of RFCS with financial elements for the purpose of "self-help" financing. RFCS has developed to a certain degree. ⑤

⑤ Li Shangyong, 2013. Distinguishing the Genuine from the Fake “Rural Cooperative Finance”. Li Shangyong’s blog—Caixin.com.

Case study: Baixin RFCS in Yanjiacun village, Lishu County, Jilin Province

Yanjiacun village is located 12 kilometers northeast of the Yushutai town, Lishu County, Jilin Province. The village has 680 households, and the major livelihood sources are corn production and pig husbandry. As early as November 10, 2003, the "able person" villager Jiang Zhiguo has organized five households and established Yushutai Baixin RCC in the form of joint purchase and distribution. As a positive endeavor of exploring RCC operation mechanism, it greatly reduced farmer’s production costs and alleviated the needs for capitals. Since then, this practice has won great publicity and support from media and societies from all circles. Many university experts and agriculture study groups paid visits for investigations. The local government also actively organized various visits. After three years of practice, along with the academic support, this RCC established a sound operation scheme and regulation procedures. Later on March 9, 2007, it was approved by CBRC to become the nation’s first RCFS with the name of Baixin RFCS in Yanjiacun village, Lishu County, Jilin Province. Upon its establishment, there were only 32 members, with a registered capital of 101,800 RMB. It was the first rural cooperative financial unit to run business with finance business license, a fact to show the formal government recognition of this rural cooperative financial endeavor led by the villager Jiang Zhiguo. As of April 7, 2009, 116 members joined this RFCS with the shared capitals reaching 144,400 RMB. It has attracted 47,000 RMB deposits, borrowed funds of 190,000 RMB, and delivered loans totaling 1,248,500 RMB. The loans were delivered to 297 persons with the profit reaching 6,500 RMB, without any non-performing loans.

Baixin RFCS was established and operated by strictly following CBRC’s "Provisional Regulations on the Management of Rural Fund Cooperation Societies" (hereinafter referred to as the Provisional Regulations) and the "Pilot Guidelines for Rural Fund Cooperation Societies ". Also, it set up a general meeting of members, and elected Board and the Supervisory Board. Jiang Zhiguo was elected the president and director.

It had four staff. The study has summarized the following characteristics of Baixin RFCS: first, it had an operating system similar to RCC, which included standard accounting system, reserve system, provision system for bad debts, fixed operating premises and security measures; second, it accepted member deposits only, and was not open for non-member deposit and loan business. Its deposit interest rate was no higher than the bank rate over the same period, and the loan interest rate changed only slightly within the specified range; third, the total sum of loans to members shall exceed 10 times of the sharing capital; fourth, the adoption of "one person, one vote" principle; fifth, it had very limited capitals and was very difficult to meet the financial needs of its members. In a way, Baxin RFCS was running strictly in line with the standard business operations required for commercial banks, while it enjoyed no corresponding right as typical financial institutions should. The Provisional Regulations limited RFCS' financing sources to membership deposit, social donations and inter-bank borrowing capitals. Yet, after three years since its establishment, it received only 600 RMB as donations and 200,000 RMB as inter-bank borrowing capitals. Its capital inflow made it hard to meet the growing demand. Many households joined it to get loans, yet in real practice the growth of deposit balance was very slow. Despite the fact it enjoyed low interest by borrowing capitals from the same industry, not many financial institutions were willing to provide loans to them as the government "implicit guarantee" was not available. In addition, though not strong in making profit, its operation cost was high. According to the surveys of Zhang Zhi et al (2009), Baxin had a profit surplus of 7,650 RMB in 2007-2008, yet its operating cost (rent, wages, communications, etc.) in 2008 reached 30,000 RMB, even when its senior management worked for free as volunteers.

In December 2006, CBRC released the "Suggestions on Adjusting the Entrance Policy for the Banking Institutions in Rural Areas to Better Support the Construction of a New Socialist Countryside". It allowed the introduction of social capitals to establish three types of new rural financial institutions: village/township banks, micro-loan companies, and RFCSs, so as to fill the gap of rural financial services and address the insufficient competitions.

In 2007, CBRC formally assumed its responsibility of RFCS supervision. And it issued a series of regulatory documents to prevent bad conducts, including "Interim Provisions for the Management of Rural Fund Cooperation Societies", "Approval Guidelines for the Establishment of Rural Fund Cooperation Societies" and "Guidelines for Rural Fund Cooperation Societies Operation", etc. CBRC defined RFCS as following: approved by the banking regulatory authority, RFCS is the community banking financial organization voluntarily established by towns, villagers and rural small businesses for mutual assistance by providing members with deposits, loans, settlement and other services.⑥ Some scholars believe RFCS is the cooperative organization for financing cooperation among farmers, ⑦ which has a community property⑧, and featured by voluntary participation, mutual aid, democratic management, and nonprofit operation, etc. ⑨

Then CBRC released the "2009-2011 Work Arrangement for New Rural Financial Institutions" and developed specific three-year work plans: from 2009 to 2011, 35 provinces (autonomous regions and municipalities, except Tibet) and special planned cities will establish 1,294 new rural financial institutions, including 1,027 village/town banks, 106 loan companies and 161 RFCSs.

According to CBRC data, as of September 30, 2013, the government has established 979 new rural financial institutions, including 916 village/town banks, 14 loan companies, and 49 RFCSs approved by CBRC. In addition, there were a number of RFCSs established by the financial sector, local government, supply and marketing

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⑥ CRBC. Interim Provisions for the Management of Rural Fund Cooperation Societies http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/200701297EC45ED7B6693ACCFFBE6C825759A000.html

⑦ Wang Shuguang. Operational Performance and Mechanism Innovation of New Rural Financial Institutions. CPC Central Committee Journal. Vol.4, 2008.

⑧ Wang Wei, He Guangwen, 2008. Mechanism Research on Regulated Community Management and Rural Cooperative Fund Society. Issues in Agriculture Economy. Vol. 9. 2008.

⑨ Kang Rongying, 2011. Study on the Operation of Rural Cooperative Fund Society. Journal of Socialist Theory Guide. Vol. 12. 2008.

system, poverty alleviation departments, and the capital cooperative departments within the internal RCC framework, which were not included in the statistics. The rural finance reform innovations led by RFCS has significantly improved the rural financial services, and activated the rural loan market. On the other hand, there were facts to show that due to lack of supervision, disorderly expansion, RFCS had also encountered new obstacles.

RFCS had essential differences from those not fully developed cooperative financial organizations. It was the cooperative financial organization created by farmers in strict accordance with cooperative principles. It truly reflected the cooperative nature of owners as same as users, with capitals from farmers used on farmers, and fully operated for the interests of its members. Additionally, as the most grass-roots organization born from the rural context, its biggest advantage was its deep root in the rural society and its thorough understanding of farmers. It effectively reduced transaction costs, and its operating system fully met farmer's needs and habits. With strong vitality, it has won recognition from farmers.

RFCS responded to the rural capital needs and ensured the proper profit through appropriate cooperation mechanism. So once the system was introduced, it has won support from farmers. Up to now, although only 49 RFCSs were officially recognized by CBRC, the actual RFCSs far exceeded this number. In some counties, the number of RFCSs exceeded a hundred.

The reason why RFCS was developed can be traced to three reasons. First was the real market need. Second was the legal and policy support it had won. The Third Plenary Session of the Seventeenth Central Committee has allowed appropriate cooperatives to run RCCs. Third, the self founded and developed RFCS has accumulated experiences for reference, which reduced cost of new participants.

Despite the support from the central government and farmers, relevant government departments were very cautious, fearing for any bad consequences and relevant responsibilities. The reasons behind this were partly related to the failure of RCFs, and partly to the worries about the operation and management capacity of farmers. In addition to the prudential attitude from the regulatory authorities, local governments held a negative attitude on RFCS as well by not encouraging their registration, and banning many RFCS if not following formal procedures to avoid future troubles.

The huge rural capital needs led to the birth and continuous growth of RCFSs, while the strict financial entrance has made the supervision on unrecognized RCFSs ineffective. As any deposit and loan business has a risk, RCFS as a form of internal deposit and loans, had risks as well, which would be guaranteed by scientific scheme design and external supervision. Otherwise, ethical risks might occur, harming the interests of members. Among those not formally recognized RCFSs which later showed problems, some did not follow regulations and had very short-term goals, and lacked proper approval for loan projects. And most of them accepted deposits and provided loans to non-members. The worst cases were those fake RCFS, which deceived farmers incapable of identifying real ones in the first place by taking their deposit and then fled away with all capitals. This has been a common problem in whole China, which deserved serious attention. In 2012, some RCFSs in Guannan County, Jiangsu Province, embezzled the deposit of 2,500 farmers with the value of reaching approximately 110 million RMB. This has rung the alarm for the RCFS supervision. The unregulated RCFS development has not only brought risks, but also transferred rural capitals for other uses, thus violating its purpose.

RCFS was in its nature a good tool to gather rural idle funds to solve its members' financing problems and to develop livelihood projects for rural economic development. However, some people took advantage of the government policy, insufficient supervision, and also the concept of internal credit cooperatives on behalf of RCFS. This has posed great risks to RCFS and other forms of rural financing cooperatives, which all required tightening of supervision. Currently, those non-standard RCFSs need strict supervision. No. 1 Document had designated supervision responsibility to local department. However, in most cases, the industry and commerce department only takes RCFS registration as their responsibility, whereas when such illegal conducts as illegal collection of capitals from non-members happens, it becomes the task of the public security and finance department. In addition, the finance department believes "who approves takes corresponding responsibilities”. The agriculture department as the authority department claims they are not empowered for management, while the public security department has no capacity and experience in handling cases related to cooperative fraud. Thus, the supervision on RFCS should first follow the No. 1 Document and provide financial service only to members in the designated area, and the profit distribution should strictly follow CBRC regulations. The main objective of supervision was to control the RFCS development in the scope of cooperative financing and community finance, and strengthen its property of cooperation and mutual assistance. Development needs to be secured thorough regular operation to end the chaos situation. Supervision is part of the government functions, which shall not collect any mandatory charges. Also, supervision shall cover the whole cycle and be strengthened in terms of market access and exit, scope of business, information disclosure, democratic management, complaints and reports, etc. In addition, the self regulation and supervision capacity of RCFS shall be enhanced.

The national authorities had a very clear observation on the potential RFCS operation risks. CBRC Chairman Shang Fulin said in a report: Fourth, the large emergence of uncontrolled and unregulated RFCSs, their potential risks cannot be ignored.

2. 4 Poor Village Cooperative Fund

Led by the National Poverty Alleviation Office, the Poor Village Cooperative Fund (PVCF) refers to the capitals to be paid for use for non-profit purpose, and managed democratically and rolled within the village. Managed democratically by its members, PVCF is operated by the elected board members and supervised by all its members. It operates only in the village, relying very much on acquaintance relationships to identify loanees, and using social pressure to reduce the non-payment risks. In addition, it can only be run in the poverty-stricken villages identified by government. Its capitals come from government poverty-alleviation funds. It is owned by all villagers, who have the use right after enrollment.

PVCF shares similarities with RFCS in its organization form, management approach, and operational principles. However, there are two differences. First is the scope of members. PVCF only covers the village level, especially the poverty stricken villages, while RFCS can cover towns. Second is the source of capitals. PVCF is mainly from governmental financial support and supplemented by capital shares from its members, while RFCS is mainly in the form of sharing capitals from its members.

Since the early 1990s, China began to learn from the international experience. Government departments, international organizations, financial institutions, non-governmental organizations and research organizations were all exploring ways to provide credit services to the poor farmers and low-income households. UN aid agencies were the first organizations to introduce techniques or organizational approaches used in foreign financial microcredit and village financing practices in the China aid programs. It mainly covered two aspects: from the direct donation to the revolving use of capitals, and from the government directed programs to the introduction of women group in the program management. In the early 1990s, in the context of international microcredit development, a Caohai Community Fund mode came into being. It was led by the international NGO by learning from "Grameen Bank" and "Yixian poverty agency" model and the Latin village bank experiences. This has initiated the exploration process of China’s micro-credit and poverty alleviation projects thorough community fund. From 1995-2000, supported by the international aid agencies and non-governmental organizations, the community fund model has been piloted in many places.

Case study: community fund in Caohai, Weining County, Guizhou Province

Community fund in Caohai, Weining County, Guizhou Province, was established with the support of foreign NGOs (International Crane Foundation and Trickle Up Program) and Guizhou Environmental Protection Agency. By providing credit capitals, its goal was to promote the diversified livelihood, improve the life of poor families and to reduce the conflicts between environment protection and economic development caused by the over-reliance on natural resources in Caohai. The seed money was provided by the international organizations. Then villagers established fund groups on voluntary basis to manage and revolve these capitals. The loan targets, conditions and rate were decided by the group members. The community fund program was supervised by Caohai Protection Division. Such technological support as trainings and monitoring was provided by many external organizations. The operation of Caohai community fund was not smooth. Later, due to loosened and inappropriate supervision, out of 74 fund groups, only 11 is running now.

Restricted by Chinese macro-financial policies, China's community fund started in the form of government poverty alleviation projects by highlighting the poverty alleviation purpose rather than the financial service function, when compared to foreign community fund. In most cases, the internationally successful community funds have converted to micro-credit or established effective links with formal financial institutions. However, community funds in China were mostly to provide extra credit support to farmers in the form of projects, which were confronted with many institutional and management problems. This was the background for government to promote PVCF development.

Since the new century, Chinese government has launched a village-based poverty reduction strategy. This has pushed the government poverty alleviation departments to find ways to provide government funds to specific households and help poor household for new livelihoods. When the Sino-Dutch project was completed in

Huoshan County, Anhui Province, local government began to allocate poverty alleviation fund to continue the magnification of cooperative community fund in the whole county in 2004. By August 2007, more than 3.13 million RMB financial funds were provided, and 154 PVCF groups were established, covering 71 villages in 16 towns, benefiting 3683 households. From 2004, Gansu Province has explored the combination of governmental funds and the World Bank credit funds in some pilot villages for paid use. RCC and township government jointly managed its use and designate RCCs to deliver poverty alleviation fund. Starting from 2006, village-based poverty alleviation development fund was piloted in some villages. From 2004 to 2005, Yilong County in Sichuan Province, with its institutional microcredit experience, has again led the exploration of combining entire-village development and the community fund. In this process, the county microcredit association established has assumed the responsibilities of mobilizing and supervising community fund. From the poverty alleviation fund, 20% were used as the management fee, and the remaining 80% as the loan principal; government funds were taken as rationed shares and donating shares, which guaranteed the ownership of community villagers; also, the total sum of principal was increased by selling shares. All these pilots have gained support from the central and local governments. The central poverty alleviation and financial department decided to magnify this practice in 100 villages from 14 provinces by using poverty alleviation funds in 2006. In 2007, another 270 villages participated in the pilot program. By the end of 2010, 1,013 counties in 28 provinces have participated in the program with pilot villages hitting 12,800 in number. The total sum of village-level PVCFs has reached 2.5 billion RMB, with each village averaging about 200,000 RMB, of which 78% were from the government financial fund. The rest 22% were from 1,120,000 farmers. PVCF has become a new form of credit to help the poor, and an important supplement to the credit markets in poor rural areas.

III. Cooperative property of rural cooperative finance and its three poverty reduction mechanisms

After reviewing policies and practices of China's rural cooperative finance development, the mechanism of cooperative finance to reduce poverty can be summarized, which can be further improved in policy design and actual practice so as to best play its role in contributing to social justices.

3. 1 The cooperative property of rural cooperative finance

Cooperative finance is defined as the financial accommodation created by the economically disadvantaged individuals or groups on the principle of membership, closed management, and voluntary participation to obtain easy access to financial service or economic profit. Membership here means the cooperative finance is to serve its members, specifically including the freedom of member entry and exit, the one person one vote democratic management, and the distribution of profit among its members. Close management means members can participate by holding shares, without receiving fixed return. Also, the capitals are to be used by its members, meaning the owners are the users. No deposit or loans service is provided to non-members.

Rural cooperative finance is the financial business operated in the rural areas based on the above principles, by providing deposit and loan services to its members. Rural households are the joint owners of the collective capitals and the recipients of financial services. The root cause for its development is the internal social network of rural communities by fully using the rural credit and overcoming the issues of asymmetric information, lack of mortgage, etc to generate profit. Also, as the capitals belong to the rural households, and each loan affects the dividends of members, thus all members are quite concerned about the real operation. In this way, the internal supervision mechanism can fully play its role.

The criteria of identifying a rural cooperative financial organization are as follows: (1) the basic criterion is whether the organization principle keeps in line with the internationally accepted cooperative principles. Cooperative financial organizations should be established based on the international protocol. (2) Is the capital structure formed by capital shares from the participants? For a financial organization, capitals are the foundation for business activities. In the capital structure of the cooperative financial organizations, capital stock should occupy the absolute advantage. (3) Are the shareholders also the major service targets? Cooperative financial organization is not for profit but to provide services for those share-holding members. (4) Is its operation focused on the basic financial business?

3. 2 Poverty reduction mechanism of rural cooperative finance

The reasons why rural cooperative finance contributed to poverty reduction can be analyzed through three internal mechanisms.

1. The rural cooperative finance can fully mobilize the rural internal capitals to meet the financial needs of poor farmers and to increase their income. When rural cooperative finance was not in place, people merely relied on improving production skills to reduce poverty, ignoring the fact that to a great extent, poverty was caused by the lack of sufficient fund to execute the above skills. The capitals under the cooperative finance structure enabled farmers to access to capitals many times more than what they could provide alone. In this way their production skills can be converted to profit. The supply of capitals helped poor households to use new production technologies progressively to increase revenue.

2. The democratic management of rural cooperative finance allowed poor farmers to participate in the financial cooperation management, and enhance their awareness

of rights and their finance management capacity. Also, it improved understanding between the rich and poor within the community, and promoted the community mutual support, thereby helping the poor households to step out of poverty. The most prominent feature of rural cooperative finance was its community property, raising funds within the community and making best use of the internal community social capitals. The internal credit scheme reduced the cost of poor households in using capitals and increased diversified their channels to get community support.

3. The full development of rural cooperative finance has promoted the supply standard of community infrastructures, and helped the spread of new livelihoods and new technologies, which improved the external environment for the poor households to develop. Rural cooperative finance has enhanced the capital efficiency, and provided necessary investment to the community infrastructure construction. This further led to the improvement of external environment for overall development. In particular, the upgrading of roads, water supply and other living conditions can improve the community health and the basic production conditions.

IV. Major paths of China's rural cooperative finance development and the evaluation on its future poverty-reduction tendency

At present, China's definition of rural cooperative financial institutions becomes clearer in the relevant policies. The Third Plenary Session of the Eighteenth Central Committee proposed to "develop inclusive finance". And its No. 1 Decision Document in 2014 has specially stated, "Develop new rural cooperative financial institutions. On the basis of democratic management, regulated operation and strong mobilizing influence of RCCs and supply and marketing cooperatives, rural cooperative finance shall be developed by exploring more types of rural financial institutions. The development of rural fund cooperative organizations shall be promoted under the principle of membership, closed operation, no fixed return and no deposit and loan to be provided to non-members. Also, relevant task includes: improve the local rural financial management system, clarify the supervision role of local governments on the new rural cooperative finance development, encourage local governments to establish the risk compensation fund to effectively guard against financial risks, and develop timely management approaches for rural cooperative financial development."

4. 1 Two major paths for China's rural cooperative finance development

The No. 1 Document has included the definition of cooperative finance as described in the above analysis, and also pointed out directly the future paths of China's rural cooperative finance development. The future development is expected to have the following paths.

One major path is to develop rural cooperative financial organizations with the RCCs and supply and marketing cooperatives as the foundation.

The 2007 Third Plenary Session of the Seventeenth Central Committee of the ruling party has requested to "allow farmer cooperatives with appropriate conditions to carry out credit cooperation." This has provided policy support for those qualified cooperatives. Some capable farmers' cooperatives with sound management system have engaged in the mutual finance assistance business. However, in real practice, some fake cooperatives disobeying management procedures, took advantage of government financial funds and large capitals from some rich individuals and tried to make a fortune by carrying out credit business. These cooperatives collect deposit from its members with the interest rate higher than the bank and provide loans to non-members. In this sense, members are merely depositors, without any supervision and participation right to oversee their operations. Such cooperatives have great risks and in some regions they have become potential risks for the healthy development of cooperatives and credit cooperative business.

NO. 1 Document specially required developing cooperative finance organizations “on the basis of democratic management, regulated operation and strong mobilizing influence of RCCs and supply and marketing cooperatives". The specific description of “democratic management, regulated operation, strong mobilizing influence”, has clarified the conditions for the “the farmers’ cooperatives with appropriate conditions” in the Third Plenary Session of Seventeenth Central Committee. This has been a precaution response to the existence of non-standard cooperatives. Only by introducing such approaches could the development of the cooperative financial organizations be maintained on the right track without detours. Since the release of Farmers’ Cooperatives Act" in 2007, by the end of February 2014, the registered farmers in the cooperatives amounted to 1,038,800 nationwide with the sum of capitals reaching 2.04 trillion RMB and the development has shown an acceleration tendency. [⑩]By the end of June 2013, the legally registered cooperatives have reached 828,000, 32 times that of the end of 2007. The registered members amounted to 6.54 million, accounting for 25.2% of the total rural populations. Within the short period of 8 months from the end of June 2013 to February 2014, the members have risen by 210,000 households. And the actual members have accounted more than a quarter of the total rural population. However, at the same time, farmers’ cooperatives have also shown up a tendency of small scale and non-standardized operation. Thus, the tasks shall highlight the role of principles in the famers cooperative development, especially the guidelines of “democratic management, regulated operation, strong mobilizing influence” in order to ensure the quality of financial cooperation.

Supply and marketing cooperatives at different levels have done a lot of work in developing the cooperative finance. Thanks to its vertical system, the supply and marketing cooperatives have supported the development of RCFS and introduced

[⑩] China Industry and Commerce News. March 11, 2014. China’s Market Entity Development Report: a Progressive Growth in Number. Author: General Administration for Industry and Commerce.

credit cooperation within the well-running cooperatives. Also, it contributed to the establishment of RCFS cooperative unions, and provided business guidance and necessary capital management for the internal cooperative finance, all leading to the better business operation.

The second path of rural cooperative finance is to develop RCFS. No. 1 Document has defined RCFS standard as membership, closed operation and community property with the main goal to highlight RCFS' roles of maximizing risk prevention by not providing any external deposit and loan business, and not providing fixed return. In addition, by providing financial service solely to its members, RCFS shall gradually build its capacities by providing needed loans to its members on regular basis. In the coming future, community RCFS shall be further developed based on the membership and closed operation standard.

4. 2 The poverty reduction role of rural cooperative finance will gradually take effect

However, the above two paths of development will not take effect very soon. There is a long way to go before the poverty reduction takes effect.

First, RCCs as the main form of rural cooperative finances will deviate from the cooperative development direction, and cannot directly play its poverty reduction roles. RCC alienation refers to the deviation from the "cooperative feature", which is shown specifically in the following three aspects. First, regarding the business objectives, RCC will be converted from pursuit of mutual benefit to maximal profit, and then approach commercialization. Secondly, the democratic management will be weakened and replaced by professional and centralized management. The ownership will be separated from operation, and one person one vote will be replaced by the one share one vote decision structure. Lastly, regarding service targets, RCC deviates from its goal of providing finance service to farmers. And its operation activities are not related to farmers' production and operation, having no direct link with its members. RCC capitals will continue to flow out of rural areas to cities, failing to meet farmers' demand for agricultural funds.

Second, the development of finance cooperation on the RCC basis will be confronted with challenges of weak RCC foundation and low levels of regulated management. In the short term, its role in poverty reduction cannot fully take effect. In addition, the financial risks caused by unregulated management should be paid special attention. With its standardization, its poverty reduction role will gradually take form. In its rapid development, farmers' cooperatives have shown many problems, including the unregulated management, irrational allocation mechanism, and ill-functioning of democratic decision-making procedures, etc. The pilot cooperatives did not fully play its positive roles. Under the context that most cooperatives share such issues, to find the suitable cooperatives to conduct finance cooperation is not an easy work. And those unregulated RCCs carrying out finance cooperation by taking advantage of government policies have significant financial risks as well. These risks, away from decent supervisions, will have substantial negative impact and require higher level investigation and strict supervision.

Third, RCFS is not fully developed and its expansion will be affected a series of factors, including restrictions from supervision authorities, insufficiency of rural finance staff, and also acceptance of farmers. As a formal cooperative financial institution, RCFS is subject to CBRC's approval and supervision, and has gained governmental support. Its immature development and consequent problems have constrained its positive role in poverty reduction. In rural areas, insufficient supervision and farmer's limited knowledge have made it difficult for farmers to distinguish the real RCFSs from the fake ones. So when the fake ones have debt issues and fled away as a result, the interest of farmers will be greatly damaged. Secondly, RCFS has limited financing channels to fully meet the rural capital needs. According to the "Interim Provisions", sources of funding for RCFS mainly include three parts, namely membership deposit, social donations and funding from other banking and financial institutions. The scarcity of idle funds from farmers made it difficult for RCFSs to obtain large sums of capitals from farmers. And without the government policy support on RCFS' loan business, it was difficult for them to obtain loans from banks. The supervision was a problem as well. Though RCFS is supervised by CBRC, it is actually approved by the Ministry of Civil Affairs, and managed by the Ministry of Agriculture and Industry, while the latter is not a finance supervision department, and has no real supervision capacities and approaches. What's more, as RCFS is established in the rural area, it has no contact with township government and is out of the scope of township supervision. Consequently, many RCFSs have deliberately lowered its membership benchmark to fraud members or even engage in illegal operation.

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