



*Full Length Research*

# Local credit cooperatives financial system and its role in economic development of China

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**This paper reviews and study of RCCs financial system and its role in economic development of China. RCCs are important reforms of china. It improves the performance consistently every year and constituted about 12.3 % all financial loans in China. Rural Credit Cooperatives Development in China constituted an integral and important part of rural reforms in China.**

**Key words:** Credit Cooperatives, Financial system, Economic development, Reforms

## INTRODUCTION

Rural Credit Cooperatives was created in 1950s. In the beginning they were not commercial enterprises like the banks. Like in different countries, farmers and small enterprises has not direct access to capital. It is not easy for them to get credit from banks. There are above 800 million rural inhabitants in china that are engaged in farming, fishery, husbandry and forestry. There are above 20 million township and village enterprises (TVEs), which playing an important role in the economic growth of the country. In 1998 four banks of china, Bank of China

(BOC), Agricultural Bank of China (ABC), Construction Bank of China (CBC) and Industrial & Commercial Bank (ICB) merged 10, 728 branches in five provinces of country (Mu 2003). The most of the branches are in the rural areas. Agricultural Bank of china (ABC) is supposed to serve the rural sector of the country and also making policy of thousands rural credit cooperatives (RCCs). In 1990s agricultural banks has been decreasing the support in the agricultural sector due to allocation of resources which expanded to cities and industries. Now

rural credit cooperatives are the only one or main force for serving and peasants the TVEs. RCCs had 2.2 trillion RMB of deposits and 1.6 trillion RMB for loans at the end of June 2003 and accounted about 12 % of total deposits and near 11% of total loans by the all financial organizations. Rural Credit Cooperatives (RCCs) has 696.6 billion RMB loan for agricultural development and about 84 % total loans for agriculture from all other financial organizations (Mu 2003).

According to the management rules of rural credit cooperatives (RCCs), RCCs is an organization in which all members could buy shares, benefits and implement democratic management. RCCs had been the core of the financial system and played an important role in rural household savings. It has different agricultural projects in rural areas for development. Members, who join mostly under the administrative forces, never managed the business organizations and they have no freedom to withdraw the membership (Xie 2001). RCCs were managed by the Agricultural Bank of China (ABC) at the end of 1996 and afterwards they were restructured as a separate set of independent institutions. RCCs are still partially under the control of the local governments, which intend to increase the supply of agricultural production to capital. However, RCCs has some problems related to control, poor services, low quality of employees and high financial risks.

### **RCCs System and Reforms**

In previous performance, RCCs enjoyed a net profit of 23.3 billion RMB and non-performing loan rate just 5.6 percent in 2010. The improvement in their assets quality can be largely attributed and bailouts from the central government. In 1990s RCC system was simply unsustainable. The capital adequacy ratio and net equity of RCCs were in negative territory, it means their liabilities were so enormous that they were eating equity of shareholders. RCCs are both the primary holders of rural household's savings and the primary providers of household credit.

In 2007, the PBOC provided two forms of financial assistance 168 billion RMB debt-for-bonds swaps and 830 million RMB in earmarked loans to assist RCCs in depositing bad assets and writing off historical losses. RCCs are the best as a myriad of locality based credit institutions with varying financial performance and asset quality. Reforms have also transformed some credit cooperatives into rural commercial banks and rural cooperative banks. Though rural credit cooperatives are largely profit-oriented institutions, they are strongly encouraged to lend to rural households and agricultural borrowers.

### **Loans and Interest Rate**

#### **Legal Interest Rate**

The state council approval and authorized by the state council formulated by the people's bank of China rate for all kinds of legal interest rate.

#### **Benchmark Interest rate**

The people bank of china, commercial banks and other financial institutions of deposit and loan interest rate as the benchmark interest rate.

#### **The Contract Rate**

Lender according to legal loan interest rate stipulated by the people's bank of China and the floating scope of complicity, agreed with the borrowers and the same would be specified in the loan contract with specific loan interest rates.

#### **Loan Conditions**

For applying loans it has following conditions for borrowers;

1. Borrowers have the ability to debt-services payments on schedule.
2. In addition to the natural person and not approved by the department of industry and commerce registration of enterprise legal person.
3. Rural loan has basic account or a general deposit account and keep it within the certain margin.
4. For guarantee and mortgage it must be conform to the provisions of the loan guarantor, the loan pledge.
5. Rural assets and liabilities of the borrowers shall not be higher than 70%.
6. Rural borrowers must according to the regulations of the people's bank of China credit card.

#### **RCCs Incentives**

The main reason of RCCs includes all efforts to improve the regional financial infrastructure to encourage and take an active interest in the microfinance. It's not an easy task and RCCs may not use any sources of refinancing for the microcredits operations. Strong incentives are required to convince RCCs to change the way of operating, but getting them interested is particularly difficult given their current situation. Crises in the financial sector have induced PBC to tighten controls under which RCCs and other financial institutions operate. RCCs need to be provided with funds at attractive costs and terms compared with those of other sources of refinancing but will not reduce the incentive to mobilize deposits. A dependency or 'lock in' to donor funding must be avoided.

Rural Credit Cooperatives Assets from 2005 to 2012 at the end of December are shown in the following table (Table 1):

Years at the end of December	Foreign Assets	Reserve Assets	Deposits with Central Bank	Cash in Value	Claims on Government	Claims on Central Bank	Claims on other Depository corporation	Claims on other Financial Corporation	Non-Financial Claims	Claims On Other Resident Sectors	Other Assets	Total Assets	Unit 100 million RMB
2005	14.7	4779.7	4314.1	465.6	1019.9	31.5	3373.2	115.9	18551.9	456.8	3410.6	31754.3	-
2006	13.3	5293.7	4776.5	517.2	1020.5	245.8	3134.1	165.6	20458.3	565.9	4090.7	34987.8	-
2007	9.4	7853.8	7226.3	627.5	898.6	201.1	3792.6	186.9	13375.9	11240.5	3537.0	41095.7	-
2008	9.7	8948.3	8340.4	607.9	1197.1	379.6	6755.1	211.5	16015.9	12471.1	3879.3	49867.7	-
2009	15.0	9366.1	8675.3	690.9	1061.2	267.5	7021.1	282.2	20003.6	14497.7	3527.8	56042.1	-
2010	1.9	10191.3	9474.5	716.8	743.0	128.5	8353.1	1164.3	17511.8	18504.5	3607.9	60206.3	-
2011	5.8	12399.6	11568.7	830.9	731.8	140.8	10755.3	1146.7	18528.0	20204.4	3687.5	67599.9	-
2012	5.4	10549.0	9609.1	939.9	537.8	94.5	14604.8	1940.1	20120.4	21751.7	3253.7	72893.3	-

Graphically it can be shown in the following fig (Figure 1):

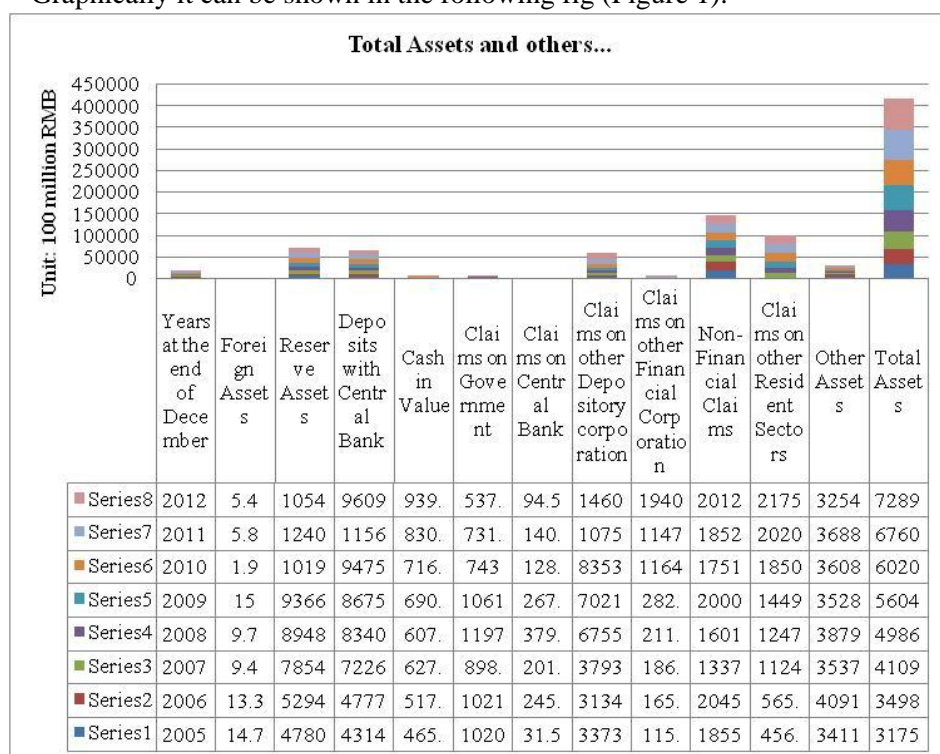


Figure 1.

It would be appropriate that the RCCs receive funding at a rate not exceeding the rate at which PBC lends to RCCs.

Financial intermediation at the local level improves once complementarity among the interlinked elements of the local financial infrastructure is strengthened. This calls for the various civil-society organizations and other actors to collaborate with RCCs in providing credit in rural areas. However, the present financial situation of the

RCCs does not allow them to invest in enhancing outreach capability and capacity building, so RCCs require grant funding for these purposes.

## Rural Credit Cooperatives RCCs Assets and liabilities

### Problems in RCCS

Rural Credit Cooperatives have some problems in

Rural Credit Cooperatives RCCs liabilities from 2005 to 2012 at the end of December are shown in the following table (Table 2):

Years at the end of every year	Liabilities to Non-financial Institutions	Deposits Included in Broad Money	Demand Deposits of Enterprises	Time Deposits of Enterprises	Household savings Deposits	Deposits Excluded from Broad Money	Transferable Deposits	Other Deposits	Other liabilities	Liabilities to Central Bank	Liabilities to other Depository crop	Liabilities to other Financial corp.	Deposits Included in Bond Money	Foreign Liabilities	Bonds Issued	Paid in Capital	Other Liabilities	Total Liabilities	Unit : 100 Million RMB
2005	27698.1	27645.0	4436.1	1462.4	21746.6	29.3	2.0	27.3	23.8	639.6	845.7	65.8	0.0	0.0	0.0	1717.8	787.3	31754.3	-
2006	30426.8	30372.6	4921.6	1473.1	23978.0	29.0	2.7	26.3	25.2	401.8	1081.5	12.8	0.0	0.0	0.0	1720.4	1344.6	34987.8	-
2007	35289.5	25329.2	6422.6	1612.9	27203.8	20.1	2.9	17.2	30.2	408.1	1298.7	23.9	0.5	0.0	0.0	1887.6	2188.1	41095.7	-
2008	41766.8	41715.9	6804.9	1875.6	33035.3	19.8	4.1	15.7	31.2	413.5	2386.2	42.7	0.0	0.0	0.0	2014.0	3244.4	49867.7	-
2009	47466.9	47398.2	9205.2	2017.6	36175.5	23.1	7.8	15.3	45.6	512.5	2295.3	101.3	0.0	0.0	0.1	2102.0	3564.1	56042.1	-
2010	50563.7	50500.5	10083.2	2029.8	38387.5	6.1	1.3	4.8	57.1	780.8	2403.1	204.9	0.0	0.3	0.1	2152.1	4101.3	60206.3	-
2011	55846.8	55702.7	10876.7	1914.7	42911.3	7.2	1.0	6.2	136.9	1107.6	2652.9	412.6	44.4	0.0	6.0	2353.6	5220.4	67599.9	-
2012	60029.1	59914.7	10708.8	2135.2	47070.7	9.7	0.8	8.9	104.7	1314.7	3103.6	602.5	255.1	0.2	0.0	2357.8	5485.5	72893.3	-

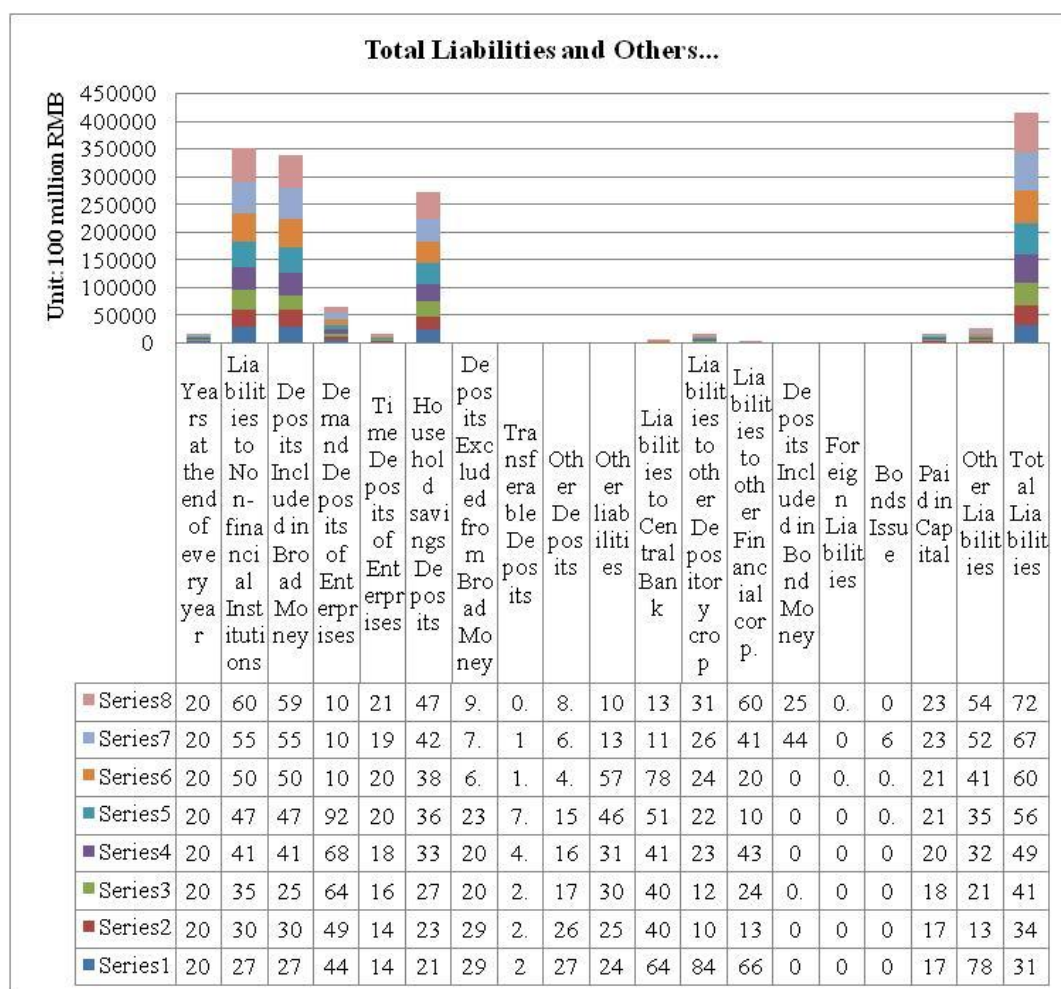


Figure 2.

China's rural finance. Following are some problems with details;

### **1. Loss Due to Operating**

Rural Credit Cooperatives RCCs of China has operating loss of 23% of the total number of credit cooperatives in 1987. When china's market of economy established in 1993, rural credit cooperatives increased his loss and it reached 19% to 52.19%. In 1997 loss reached to 64.23% in RCCs.

### **2. Unhealthy Credit Management**

Unhealthy Credit Management is also problem of RCCs. The faith breaking behaviors and the maintenance of the credit order finally should depend on the deterrent force of laws, which is same to the construction of the Chinese rural credit system.

### **3. Asset Quality is not better**

A third problem in Rural Credit Cooperatives is that the quality of asset is not better. Rural credit Cooperatives (RCCs) has bad loan ratio of all loans in 1999.

### **4. Out dated Services**

Rural Credit Cooperatives (RCCs) has always involve with the loan business and traditional deposit savings, out of table and intermediate business is blank due to lack in modern services and credit instruments. In 1999, RCCs loan interest income of 642% from the revenue of 35.7% and intermediate income is accounted for only 0.1%.

### **5. Imperfect Present Rural Credit Guarantee Mode**

In the credit association and the country credit association, multi farmer guarantee mode should be evaluated and checked by various departments which prevent and eliminate the risk of rural credit to some extents. But with the increase of the management, credit demand, and capitals, this guarantee mode could not satisfy the rural financing demand and prevent the credit risk obviously.

## **CONCLUSION**

RCCs had been the backbone of the financial system and played an important role in rural household savings. It has different agricultural projects in rural areas for development. RCCs are the best as a myriad of locality

based credit institutions with varying financial performance and asset quality. Reforms have also transformed some credit cooperatives into rural commercial banks and rural cooperative banks. Although rural credit cooperatives have some problems and issues to management, but RCCs are largely profit-oriented institutions, they are strongly encouraged to lend to rural households and agricultural borrowers.

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