

PRO-POOR POLICY OPTIONS: VILLAGE POVERTY REDUCTION FUNDS COOPERATIVES & RURAL POVERTY ALLEVIATION IN CHINA

INTRODUCTION

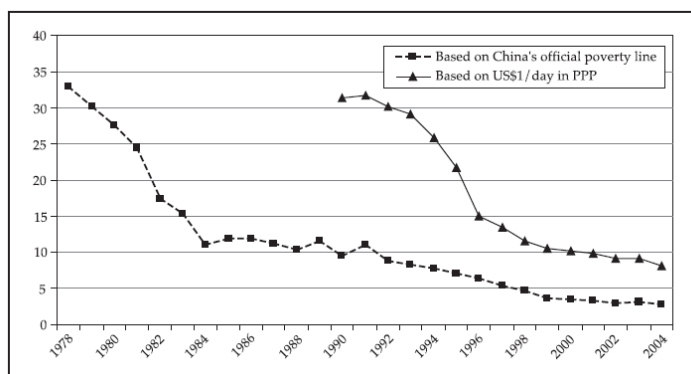
This policy brief suggests that innovative mutual aid models known as Village Poverty Reduction Funds Cooperatives (VPRC) constitute an effective strategy for reducing persistent rural poverty in China. VPRCs, complemented by public service improvements and integration with other poverty alleviation approaches, create opportunities for improving poor farmers' livelihoods by facilitating grassroots decision-making regarding the use of government poverty reduction funds.

Policy analysis findings and recommendations from a study conducted under the auspices of a "Pro-poor Policy Formulation, Dialogue and Implementation at the Country Level" project inform this brief¹. Between 2007 and 2010, the Food and Agriculture Organization–Regional Office for Asia and the Pacific (FAO-RAP), with support from the International Fund for Agricultural Development (IFAD), implemented this project in partnership with governmental and non-governmental organizations in eight Asian countries. The project goal was to enhance institutional capacity to conduct policy analysis, formulate and implement pro-poor agricultural and rural development policies. In total, twenty-three policy studies examined issues identified at national level dialogues in all project countries².

CONTEXT

Approximately 60 percent of China's population lives in rural areas and 20 percent of citizens depend on farming for their livelihoods (World Bank, 2009). China's rapid economic growth in the past thirty years has been associated with impressive poverty reduction (Figure 1). Based on the Chinese national poverty line, more than 230 million rural residents have escaped poverty in the past twenty-five years (Huang et al, 2006).

Figure 1. Poverty incidence in China (1978-2004)



Source: Huang et al, 2006

Yet China still has a high number of poor people by international standards. In addition, the prosperity of rural Chinese remains tenuous; for every poor rural inhabitant, another one risks falling into poverty in any given year (World Bank, 2009b).

¹ Lin Wanlong (College of Economics & Management, China Agricultural University) and Xu Xuchu (China Academy for Rural Development, Zhejiang University) were team leaders and primary authors of the study on which this brief was based. Study methods included both desk review and field study of two representative models ("Yilong model" in Sichuan and "Huotai Model" in Anhui). The original study was written in late 2008 and can be accessed by contacting: INFORMATION.

² The other selected policy issues for China include Integrated Regional Poverty Reduction in Special Regions and East-West Pairing-Off Cooperation Policy for Poverty Reduction.

PROBLEM STATEMENT

In spite of China's remarkable achievements, challenges to combating rural poverty remain:

- **Serious functional and structural defects in existing poverty reduction institutions:** Top-down approaches are favoured, at the expense of effective cooperative measures which engage poor populations. The lack of supervision structures for government poverty reduction funds also handicaps fund effectiveness.
- **Lack of sustainable financial service models which effectively target the poor.** Micro-credit's effectiveness in improving the lives of China's poorest has been questioned³. In 2003-2004, only 15% of poverty reduction loans reached the poor (Liu Jian, 2006).

VILLAGE POVERTY REDUCTION FUNDS COOPERATIVES

Innovative mutual aid models known as Village Poverty Reduction Funds Cooperatives (VPRCs) have been piloted since 2004 as a means to respond to these challenges and involve poor farmers in China's rural economic and social development. VPRCs differ from previous top-down approaches, by relocating government poverty reduction fund management and decision-making at the grass-roots level.

Farmers voluntarily establish VPRCs, with county government and poverty reduction office support, to cover one village or approximately 30-40 households. VPRCs also work in conjunction with existing village committees (Annex 1 illustrates the cooperation between the different structures). Although VPRC models differ by location, their central objectives include:

- Promoting farmer cooperation
- Enhancing poor groups' capacity for self-organization
- Providing micro financing services to poor farmer households
- Utilizing government poverty reduction funds efficiently and sustainably.

By some accounts, VPRCs have improved China's poverty reduction targeting and have been particularly effective in responding to community-identified needs and circulating loan funds. Examining VPRC impact on rural poverty provides an opportunity to take stock of the models' strengths and suggest changes to improve their effectiveness, as addressed in the policy options described below⁴.

POLICY OPTIONS

1. Promote VPRC pilots as an important poverty reduction strategy

Rooted in a holistic vision of poverty that considers not only material scarcity, but also deprivation of opportunity and choice, VPRCs address both current living standards as well as larger questions of access and decision-making (Sen, 2002). By helping farmers to independently manage funds and engage with public affairs decision-making through bi-

³ Several recent studies indicate that some micro credit projects in China have shifted their focus from poor farmer households to better-off households, indicating the need for model innovation in order to reach the poorest (Liu Xichuan, Huang Zhuhui, Chen Enjiang, 2007; Huang Zhuhui, Liu Xichuan, Chen Enjiang, 2007).

⁴ The "Huotai model" grew out of a 1998-2003 Sino-Dutch Poverty Reduction Project while the "Yilong model" began in 2005. By the conclusion of the Huoshan and Taihu County (contracted as "Huotai") project in 2003, 43 community fund groups existed. The Yilong country project counted 17 VPRCs by late 2007.

weekly meetings, VPRCs build capacity and confidence alongside material opportunities to increase production and income.

The key VPRC benefits include:

- Loan opportunities meet villagers' financing demand;
- Creation of open space for public discussion and information sharing as well as encouraging villager communication and participation
- Opportunities for further cooperative production and marketing
- Improved farmer organization
- Mechanism for villager self-education and development, as people are "learning by doing"
- Creation of new frameworks for open and democratic self governance (Lu Hanwen, 2007).

... but gradually expand VPRC based on continual review, readjustment and documentation of lessons learned.

A gradual scale-up of VPRCs is recommended, however, since several issues remain to be resolved. The government is therefore urged to:

- **Finalize the legal, institutional status of VPRCs.** Uncertainty remains regarding their official classification. On the basis of their different activities, VPRCs could be considered either "financial", "specialized", or "comprehensive" cooperative organizations.
- **Develop policies allowing use of poverty reduction funds to subsidize VPRC pilot operational costs.** Otherwise, VPRCs will continue to operate with an undue financial burden.
- **Create systems for internal and external financial supervision.** Internally, VPRC loan approval and disbursement procedures need to be tightened to ensure effective operations and sustainability. In addition, VPRC establishment and operations demand significant support from external organizations, although local Poverty Reduction Offices do not have the capacity for financial oversight. External actors capable of legal and administration supervision should therefore be identified in order to control risk.

2. Integrate VPRCs with other institutional approaches to poverty alleviation

VPRCs provide micro credit which supplements rural finance and improves farmers' access to credit in impoverished areas. Other forms of financing, such as Rural Credit Cooperatives (RCC) which began in 2001, have high hidden costs that make them prohibitive for many extremely poor households.

VPRCs organize and define poverty fund ownership differently; however two broad models include collective ownership (with subsequent dividend distribution) or individual share systems. In the share system, poor households are granted shares while wealthier ones purchase their shares. Government funds provide a 1:1 match on shares as well. Farmers can borrow loans based on the number of shares they own and a guarantee by at least three other VPRC members is required in the event that a member wishes to borrow beyond their allotted number of shares.

A case study of two villages in Yilong found that overall borrowing activities increased following the founding of the mutual aid cooperative. Although poor households gained more

loan opportunity than before VPRCs existed, their wealthier neighbors accessed more loan services (Lin Wanlong, 2007). Even when controlling for other factors, VPRC loans did not specifically target poor farmer households. Furthermore, the poorer the farmer household, the more difficult it was for them to get a loan in Yilong, Huoshan and Taihu counties (Figure 2). As such, VPRC microcredit alone can not be said to increase loan opportunity for poor households.

Figure 2. Loan flow of poverty reduction mutual aid cooperatives of Huoshan and Guanashan counties. Anhui Province

Household economic status	Accumulative loan (Yuan) A	Accumulative number of loans B	Number of farmer households C	Number of farmer households borrowed D	Loan occurrence rate D/C	Mean loan amount per household A/C	Mean number of loans per household B/C
Upper	50000	13	16	7	44%	3125	0.81
Middle upper	92200	21	48	22	46%	1920	0.44
Middle	148200	24	74	37	50%	2002	0.32
Middle lower	43700	3	41	16	39%	1065	0.07
Low	8000	1	18	2	11%	444	0.06
Total	342100	62	197	84	43%	1736	0.31

Data source: Lin Wanlong & Yang Congcong (2007). Data is from mutual aid fund of 6 villagers groups.

Nonetheless, further analysis showed that poverty itself is not the most important or crucial obstacle to loan access in rural China. In particular, a large sum invested in production, household economic activities, migrant employment duration, labor ability, and health status are significantly related to borrowing behavior.

These findings suggest opportunities to combine cooperative micro credit with other approaches to optimize poverty reduction results. Some strategies can include:

- **Strengthen public service provision:** Public services in rural China have been consistently underfunded, which negatively impacts farmers' income and well-being. Therefore, the Government should:
 1. *Establish and improve rural minimum living standard guarantee system* to ensure the welfare of rural residents.
 2. *Invest in rural education, technical training and basic medical care* to improve the quality of rural human capital as well as reduce rural groups' dependence on financial institutions to cover educational and/or medical expenses.
 3. *Invest in market information and transportation infrastructure* to increase market effectiveness, reduce farmers' costs and stimulate product sales and rural market development. These improvements will also increase farmer household demand for VPRC production and financial services.
- **Integrate with Community Driven Development:** Since the 1990s, the World Bank and others have promoted Community Driven Development (CDD) as a means to provide communities with ownership, resource control, decision-making and management of development initiatives. As grass-roots actors, VPRCs & CDD present advantages in terms of balancing public service supply and demand and delivering services which are adapted to local needs.

3. Consolidate poverty reduction fund organizations and government poverty reduction resources

The Poverty Reduction Office lacks a concrete vehicle to accomplish its planning and coordination functions. VPRCs create a platform for consolidating poverty reduction resources into one source, indirectly enabling the Poverty Reduction Office to implement its mandate.

The Yilong County pilot can serve as a model for scale-up due to its rich experience in rural community development and micro credit operation. On the one hand, the establishment and operations of VPRCs benefited from close collaboration with the County Poverty Reduction Office, especially in standardizing charters, establishing financial management and record-keeping systems, as well as systemizing operational flow charts. Uniquely, the County Poverty Reduction Office entrusted the Yilong County Township and Village Development Association (TVDA), a third-party professional organization established with the support of a UNDP microcredit project, with cooperative mobilization, promotion, support and guidance.

CONCLUSION

Although China has made notable progress in reducing poverty over the past thirty years, rural Chinese (who represent more than half of the population) still remain on the brink of poverty: for every one poor person, another risks falling into poverty in any given year.

Village Poverty Reduction Funds Cooperatives have been piloted over the past six years as an innovative means to respond to the functional and structural defects in existing poverty reduction strategies, as well as the lack of effective microfinance targeting for the poor. Although their activities differ slightly, all VPRC models employ demand-driven, mutual aid approaches and utilize government poverty reduction funds on a rotating basis.

Key recommendations on poverty reduction utilizing VPRCs include:

- Promote gradual expansion of VPRC pilots as an important poverty reduction strategy. To do so, the Chinese government must: 1) finalize the legal and institutional status of VPRCs, 2) develop policies allowing use of poverty reduction funds to subsidize VPRC pilot operational costs, and 3) create systems for internal and external financial supervision of VPRC activities.
- Integrate VPRCs with other institutional approaches to poverty alleviation by 1) strengthening public service provision through rural minimum living standard guarantee system, investing in rural education, technical training, basic medical care, as well as market information and transportation infrastructure and 2) optimize integration with Community Driven Development (CDD) programs.
- Consolidate poverty reduction fund organizations and government poverty reduction resources.

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ANNEX 1: Organization and Management Model Framework of VPRC in Yilong County

