Qinghai Community Development Project Evaluation Report

Quality Assurance Series
No 21. June 2000

The Australian Government's
Overseas Aid Program

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Ms Christina Wong, AusAID Beijing accompanied the Evaluation Team providing excellent translation and logistic support.

AusAID Beijing provided support and comprehensive advice through Ms Kim Pendreigh, Second Secretary, and guidance through Ms Donnelle Wheeler, Counsellor, Mr David Gowty, First Secretary , and Mr Frank Ding, Senior Projects Officer.

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Acronyms

ABC	Agricultural Bank of China
ATL	Australian Team Leader
AusAID	Australian Agency for International Development
BOABC	Business Office of the Agricultural Bank of China
BOM	Board of Management
CASS	Chinese Academy of Social Sciences
CEI	Credit Extension Intermediary
CFW	Cash for Work
CGAP	Consultative Group to Assist the Poorest
CTL	Chinese Team Leader
DOFTEC	Department of Foreign Trade and Economic Cooperation (Qinghai Province)
FSES	Farming Systems and Extension Specialist
GOPRC	Government of the People's Republic of China
IGA	Income Generating Activity
MCO	Micro Credit Office
MCS	Micro Credit Specialist
MIS	Management Information Systems
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
PADO	Poor Area Development Office
PCR	Project Completion Report
PID	Project Implementation Document
PMO	Project Management Office
PMU	Project Monitoring Unit
QCDP	Qinghai Community Development Project
RCC	Rural Credit Cooperative
Team	Evaluation Team
UNDP	United Nations Development Program
WF	Women's Federation
WID	Women in Development
Y	Yuan (Chinese Currency, Ren Min Bi, RMB)

Units of Measurement

1 kg = 2 jin
1 ha = 15 mu

Currency

A$ = 6.3 RMB (October 31 1994)
A$ = 5.3 RMB (April 30 1998)
A$ = 5.16 RMB (November 24 1999)

EXECUTIVE SUMMARY

Project Design

The Government of the People's Republic of China (GOPRC) is committed to poverty alleviation as one of the top priorities of national development. In 1978, when China launched its economic reform and opening up to the outside world, there were some 250 million rural people living in poverty. Since then, China has made substantial progress and the number of rural poor population had reduced to less than 100 million by the early 1990's. In 1994, the "8–7 National Poverty Reduction Plan" was launched by the State Council with the objective of eliminating absolute rural poverty of the remaining 80 million over 7 years (1994–2001). The Australian Government also has a firm commitment to poverty alleviation in developing countries[1]. Accordingly, the project was formulated to complement national and local efforts to eliminate absolute poverty in rural communities of Qinghai Province.

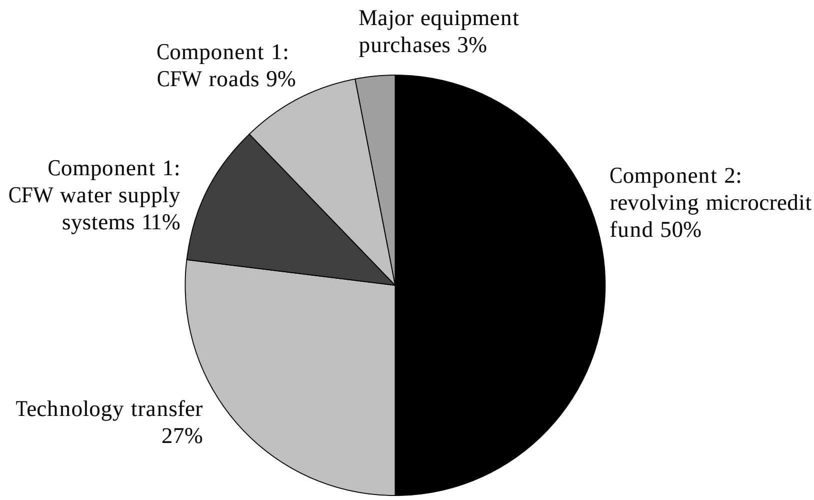
The GOPRC 1992 request identified three counties, Huangzhong, Pingan and Ledu, in Haidong Prefecture as the designated poverty areas. The prefectural government presented 22 proposals for assistance, mainly for township enterprise development and infrastructure. The Australian Government carefully analysed the requests against observed conditions, accepting the basic road and water supply proposals in each of the three counties. However, the Australian Government suggested new ideas to facilitate increased incomes for poor individuals, and to increase sustainable household incomes. The final project design reflected those suggestions along with the infrastructure requested by the counties.

The design process was undertaken with the assumption that very poor people could be identified easily, and targeted for improvements in their standard of living. Potential project beneficiaries were identified based on information on all sources of income, both cash and non-cash. The partner government defined poverty as households having 1992 imputed annual per capita income below Y300 (300 Yuan). The design team identified 187 potential target villages for the project, by locating areas where 50% or more of the population was under this designated poverty line. These became the target areas for project intervention as deemed appropriate by the project team, with the poor in each area as the intended beneficiaries.

1 The policy was most recently encapsulated in the Country Program Strategy Issues Paper, China, of 22 January 1999.

From 1995 to June 1998 the Australian Government and the GOPRC contributed A$4,496,438 and A$2,238,513 respectively to the implementation of the project. The Australian budget can be segmented into three cash contributions, two as cash-for-work (CFW) on village roads and water supply, and half of the total budget as a revolving microcredit fund, as shown in Figure 1.

Figure 1: Australian Budget Segment



Operationally the community development project had four components, with the following objectives:

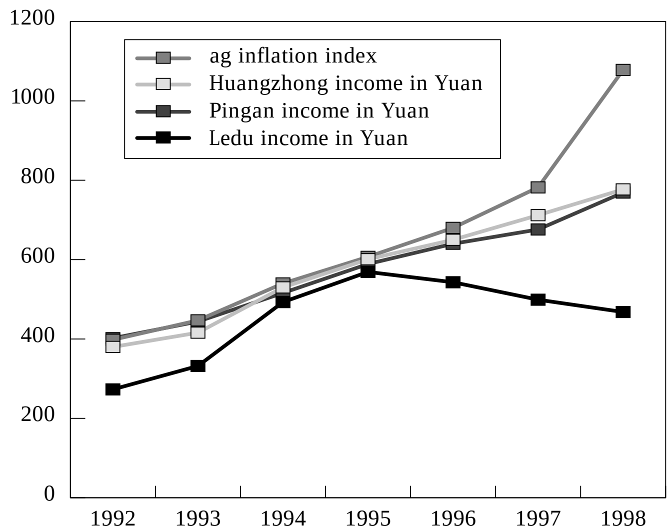
Component 1	To establish income generating activities among local poor households through cash-for-work (CFW) programs to improve access and water supply for households;
Component 2	To assist poor households to participate in farming and non-farming income generation activities by improving their savings and access to credit;
Component 3	To improve community development through training service institutions associated with improvement of living standards in poor villages, and to enable technical personnel to deliver appropriate agriculture and livestock extension, credit services, health and educational services; and
Component 4	To efficiently and effectively manage the implementation of the Qinghai Community Development Project.

Both governments worked hard and actively to develop an improved design structure. The long design and inception period, agreed on by both parties, enabled common approaches to be developed in the field before implementation began in earnest. Grant aid is unusual in China, and was unknown in Qinghai before this project. Strict accountability and reporting structures are an integral part of grant assistance, and need to be understood if projects are to be successful. The long design and inception period was very valuable in establishing a mutual understanding of the project processes and strategies, helping to ensure rapid progress.

Project Impact

In 1992 when the very poor conditions in the project area were considered appropriate for project intervention, the per capita income of poor households, almost entirely in the form of subsistence produce, was imputed to be Y300. The Evaluation Team found that from 1992 to 1995 the average per capita income for each of the three target counties was not much higher than the poverty line, and increases were due to inflation. In the period of project implementation and impact, from 1995 to 1998, while the agricultural inflation index fell, real income increased (Figure 2). As set out in detail in the following chapters, analysis of the data reveals that although other factors may have affected incomes, there are sound reasons to believe the project contributed to overall poverty alleviation in the project area, specifically in target households.

Figure 2: Agricultural Inflation and Incomes



Poor householders in remote mountain villages of the target area now have ready access to markets. They now have additional labour time of between 30 minutes and 6 hours per day formerly used for hauling water due to water supply systems built under Component 1 of the project. Poor households have access to improved agricultural seed and information on technologies based on provision of extensive field-based agricultural training. To put the labour and new technology to use, they have access to microcredit. Ultimately, villagers could and did use these changes to increase household incomes. While other factors may have had an effect, there is a demonstrable difference between the growth of household incomes in the three counties where project activities were undertaken, and those adjoining counties which had the same conditions but did not engage in project activities.

A non-quantifiable impact revealed through the Team's survey work in 19 villages is the significant change in perspectives between 1992 and 1999. There was a fundamental shift in prevailing attitudes of the villagers from isolation and suspicion to an enthusiasm for new ideas. The remotest villages now have private business people running minibuses to the provincial capital on a daily basis, and some townships have also invested in local transport. The effectiveness with which micro-entrepreneurs use this access is one manifestation of the change, as is an increased willingness to trade and work outside the area.

The most striking success in terms of beneficiary involvement has been the microcredit scheme. From August 1996 to September 1999, 15,188 borrower-clients have taken out 38,000 loans at a cumulative total of Y23 million. On-time repayment without significant follow-up is 94%. Average loan size is Y745 (A$149). Client numbers are substantially in excess of both the end-of-project target of 6,550 households and the life-of-investment target of 10,212 households. The program expansion rate is among the most rapid in China. The low levels of cash savings is due to low interest rates, difficulties in co-timing microfinance work with CFW, and lack of a village-based savings service to meet time-sensitive cash needs.

Management of the revolving microcredit fund was handed over to the Agricultural Bank of China for full operation in April 1988.[2] The ABC Haidong Prefecture operates it through a Microcredit Office in Pingan City, 12 branches (Business Office of the ABC, or BOABC) and 148 village-level Credit Extension Intermediaries (CEIs). Since project completion the orientation has been centred rather less on poverty alleviation and gender balance, and a bit more on the fullest levels of village participation and efficiency of operations. While this has still benefited the poor, the approach if not adjusted or provided with additional loanable funds may lead to gender bias and lower options for poverty alleviation over time.

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2 Previously they had been administering funds but not responsible for the entire operation or the CEIs. A tripartite agreement was signed between the ABC, the GOPRC, and the Australian government to hand over operations and govern the period through 2003.

The Team investigated rates of participation in decision-making and receipt of benefits. The project was inclusive of all levels of government administration and generally at all levels of the community. Of the 187 target villages, 112 villages have received some form of project intervention to date. The decision-making mechanisms for the setting of priorities embraced all levels down to village leadership, with villagers consulted by their local leaders as a part of project processes.

Participation rates in the microcredit component are extraordinarily high, with some villages having 100% participation rates. The roads and water supply cash-for-works schemes involved 4,400 households and 12,380 workers respectively, and the field review indicated that the poorest households were able to and did participate. The training program delivered 14,900 person days of technical training to agricultural crops and husbandry agents, an estimated 2,000 farmers and Women's Federation (WF) officers in all three counties (the latter seemed to be dropped as implementation proceeded). The Evaluation Team was unable to determine the degree of overlap between components due to lack of data.

Analysis of *ethnic minority composition* among the 15,188 registered borrowers, whom the Evaluation Team sees as representative of the actual beneficiaries of all components, reveals a pattern reflecting provincial demographics. (See Figures 3a and 3b in Chapter 3). There was an intentional focus on this in the project implementation, balancing the needs of ethnic groups with actual conditions of poverty.

The design emphasised aspects of *gender*, and a Women in Development (WID) specialist analysed local conditions and suggested intermittent short-term assistance for ongoing monitoring. However, the Evaluation Team found that the recommendation was not followed, and that women were less well served in the project area than men. Men dominated the Cash-for-work (CFW) teams for road and water supply construction. Training services were reported as having been delivered largely to males for cultural reasons. The WF involvement during the early stages of the project appears to have faded out, and overall impact was not evident to the Team. CEI composition has been below targets, with only 39% being female (57 of a total 148). Although the gender of borrowers registered is evenly split, some women borrowers were listed only by name, while husbands used and managed the funds and profit. The ABC team is entirely male, while the PMU is entirely female professionals.

Environmental impact was given consideration. The roads and water supply projects were not harmful to the environment, and the agricultural extension was based on sustainable farming practices. Although microcredit facilities may encourage the possible over-use of fertilisers, there was no sign that this has led to degradation. It was also noted that the availability of credit did not lead to untenable goat/sheep herd build-up and overstocking of the grassy slopes.

Management

Overall, this project was well managed. The continuity of personnel is impressive—from the AusAID desk officer, and the current Ministry of Foreign Trade and Economic Cooperation (MOFTEC) Deputy Division Chief who was on the 1992 Identification Mission, to the interpreters and even the driver of the Project Management Office (PMO)/Project Monitoring Unit (PMU). Through the Managing Contractor, good specialists were put in place. The Australian Team Leader and the Farm System and Extension Specialist were repeatedly praised by Chinese leaders for working diligently and patiently with the Chinese side to solve problems and develop innovative procedures.

The four components of this project were well balanced, and were largely complementary to each other. Analysing the components and their budgets, the weighting of respective inputs was judged to be effective. Though a sensitivity analysis to gauge whether the project may have been better if one or other component had been weighted slightly differently was beyond the scope of this evaluation, the question was given serious consideration. It is concluded that in a community originally lacking in development and poor in infrastructure, where the Chinese government was able to leverage large infrastructure investment at a 5:1 ratio, the additional investment in microcredit funds was well-chosen.

The project worked with the existing vertical Government structures for the implementation of each component, which was efficient in terms of time and costs involved. Due to lack of a single Chinese partner agency and insufficiently careful timing of work into the agricultural calendar, some opportunities for cross-component synergy may have been lost. The problem was further aggravated by the fact that China and Australia have different financial years, and so some infrastructural activities started even before the project implementation team arrived in Qinghai. The problems associated with the synchronisation of multi-sectoral interventions, including budget disbursement, could have been better identified in the project design.

Sustainability

The Australian management team departed 18 months prior to the evaluation visit, allowing a first fair test of sustainability. The roads and the water supply system are well maintained by the community. Householders visited involved in the water supply program could demonstrate that water was available on demand. It was also observed that in general the roads are in good condition, are regularly used, and maintained by villagers with support of township administration.

The revolving credit facility, now run under the auspices of the ABC, is not yet fully financially sustainable. Adjustments would need to be made in either fees/interest or expense control, and preferably both, to ensure this. There is a great deal of enthusiasm to expand the program further, both in area and in loan size. The Evaluation Team observed that the microcredit program could be slightly improved to better target the poor, but that current levels of involvement by the less-poor are not a significant problem for operations. Future projects could benefit from start-up with the implementing institution rather than later integration, better joint timing on the cash-for-work and microfinance components, as well as better consideration of savings product requirements in order to meet the needs of villagers. Savings were not firmly established by the project, despite best efforts during implementation.

Some elements of training and agricultural extension are sustainable, as are some of the management methods introduced. The project team worked with local staff who had to create a new frame of reference to process the information provided. They had few or no resources available from the local government budgets to follow up once the training rationale was understood. Many of them were promoted, so impetus was lost. In simple terms the Australian specialists had more resources, and a concentration of effort which is hard to re-create on a local budget.

Conclusions

This was a good project with a well balanced set of inputs and remarkable results. Previously very poor villages have “opened up”, with access to markets and microcredit. Official statistics and also investigation conducted by the Evaluation Team indicate per capita income has risen from Y300 in 1992 to over Y700 in 1998, and that inflation is not significant in this rise. All four components of the project were effective, with the microcredit component exceeding expectations by a factor of four—a revolving fund of Y13 million has been lent out in 38,000 micro-loans to a total of over 15,000 villagers, with a cumulative volume of Y23 million.

The project benefited from good management and flexibility to deal with new problems. In hindsight, there was room for improvement and this has been documented, and set out as lessons learned in summary, below, and in greater detail in the relevant chapters.

Key Lessons Learned

The key lessons learned are summarised below:

1. In any innovative project in a new region, field staff should be allowed some flexibility to achieve the defined goals during design, inception and implementation. Some of the most useful features of this project were not even foreseen in the Project Inception Document, and evolved out of painstaking trials conducted by the Chinese and Australian Team Leaders and their staff during implementation. Provision of both time and resources to enable such experimentation is valuable in terms of project successes later.

2. It is important to interact at the institutional level in addition to having a strong focus on the poor at the community level. Training services in this project had less impact because the institutional structures mitigated against success. By bringing changes in knowledge, attitude and behaviour towards community development and poverty alleviation at the institutional level, the project will be able to enhance its sustainability and replicability.

3. Engagement and commitment to project objectives can be better served if the organisation that will implement microfinance services over time is engaged fully as the intended owner of microfinance processes from the outset. The ABC proved to be an institution capable of efficiently administering the revolving credit fund. During the project considerable efforts were dedicated to convincing the ABC to take on this role, and in providing training to their officers, but the actual setup in the villages occurred under project direction, with the ABC as a passive observer. Eighteen months after project completion, the ABC is fully managing the microcredit scheme in 112 villages, but has weakened its emphasis on targeting only poor households in favour of full village participation to manage costs and risk. If they had been engaged sooner, this issue might have been dealt with much earlier.

4. Key factors which contributed to the successes of the microfinance component that are worthy of replication in future programs are:

    - borrowers decide the purpose of loans (while recognising that some form of income generation is the most efficient use of any loan);

    - borrowers self-form groups of 4 to 7, and display a sense of responsibility to generating income, repaying the loan, and being responsible for the progress of other group members;

- CEIs are village-based, committed and well trained, are familiar with their clients, and are compensated based on the effective delivery of sustainable loan and savings services;
- program management is based on sound and sustainable financial arrangements, reporting, and pro-active client service; and
- other project components support villagers to explore further opportunities for new income generating activities.

5. Villagers borrowing under the microcredit scheme should be well informed of their rights and responsibilities under rules that are the same throughout the program area. There is a need for transparency and access to information on procedures to ensure that in the future, the system is not abused.

6. The participation of women as CEIs and clients needs to be encouraged not only because they are poorer and more disadvantaged than men, but also because they can contribute to higher recovery performance and more effective targeting. Women CEIs had better loan recovery performance and were more effective in targeting women and poorer households. Some women borrowers were listed only by name, while husbands used and managed the funds. However, this happened far less often when the active CEIs were women.

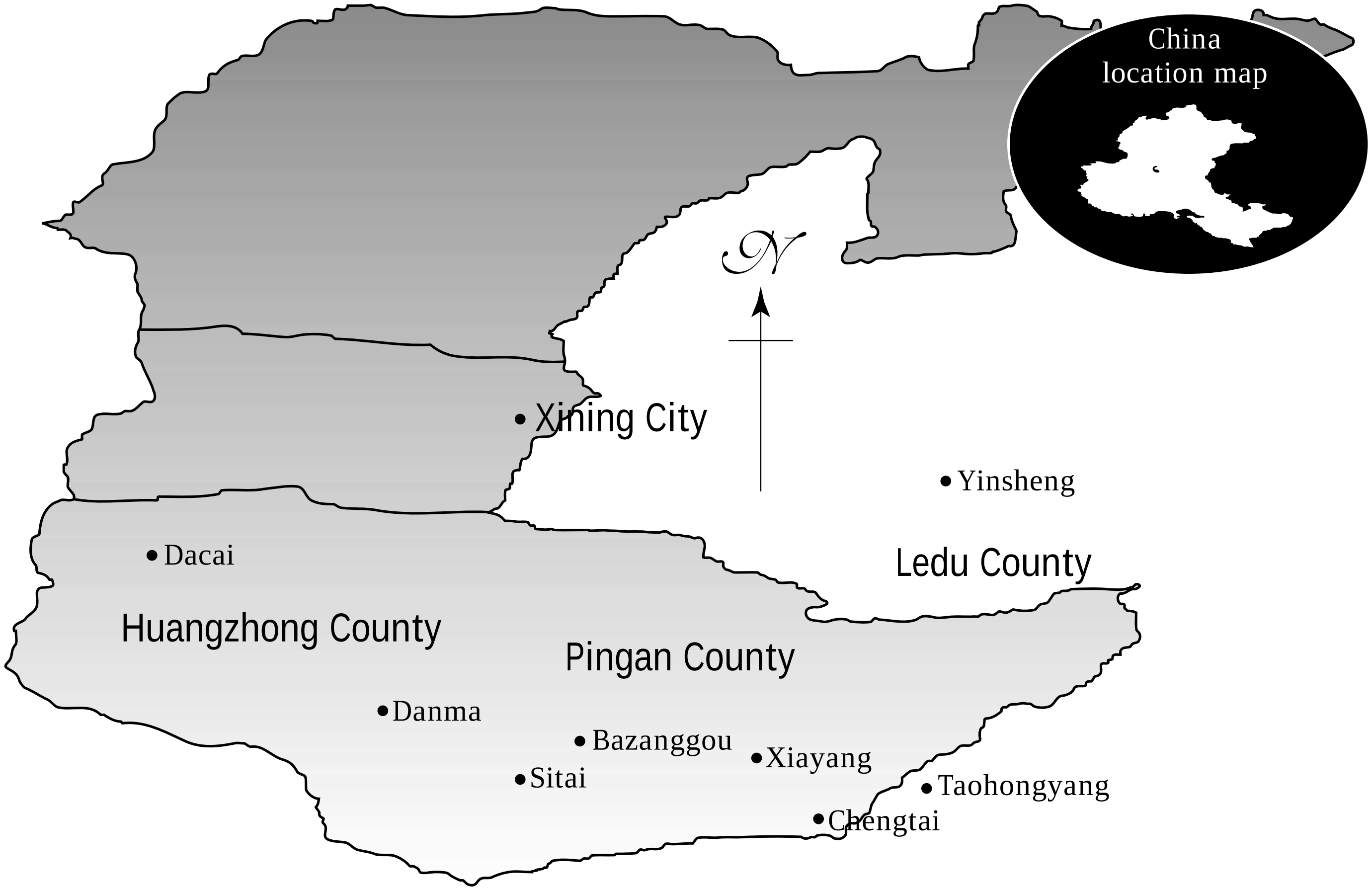
7. The importance of having an appropriate legal and regulatory framework for microfinance institutions cannot be understated. In China, key issues which limit microfinance growth include interest rate controls and limits of existing banks and Rural Credit Cooperatives' lending powers. Advocacy to support changes in these areas must come from Chinese, supported as appropriate by AusAID and other donors.

8. If CFW programs have a savings objective, they must not be implemented until the microfinance component is ready to take advantage of savings generated from the CFW. CFW programs are typically straightforward, easy to administer, and eagerly promoted by the local authorities. In comparison, microfinance projects are not well understood locally, and require research, analysis and then training. For these reasons, if the CFW program starts too early in the project, there is a real danger that payouts will be dissipated before appropriate savings mechanisms can be made available.

9. Before project completion, any new electronic information system (in this case the Management Information System) needs to be fully embraced by the host institution responsible, with data competently inputted as a matter of course, and with managers confidently utilising the available information to check results achieved and to make plans and project future needs.

Three counties in Haidong Prefecture, Qinghai Province

• Main townships mentioned



1 INTRODUCTION

1.1 Project Background

An AusAID Poverty Project Identification Mission was conducted during May 1992 in four provinces of China. The Mission was presented with 22 requests from the Government of the People's Republic of China (GOPRC) for bilateral assistance in Qinghai Province. The proposed activities were located in the three poor counties of Ledu, Pingan and Huangzhong in Haidong Prefecture, eastern Qinghai.

A Prefeasibility Study Team visited in March/April 1993, resulting in the formation of a conceptual framework for the project, including the Terms of Reference for a nine to twelve month Inception Phase. The three county project area was agreed as proposed by the GOPRC.

In 1994, Hassall & Associates Pty Ltd (in association with CARE Australia) was appointed the Australian Managing Contractor for the Inception Phase. Two long term and several short term specialists developed the Project Implementation Document (PID). The Inception Phase was completed in March 1995.

In June 1995 Hassall & Associates were appointed the Australian Managing Contractor for the Implementation Phase. The Australian Government and the GOPRC contributed A$4,496,438 and A$2,238,513 respectively to implement the project. Budget details by component are listed at Attachment 9. The project components were:

Component 1	To establish income generating activities among local poor households through cash-for-work programs to improve access and water supply for households;
Component 2	To assist poor households to participate in farming and non-farming income generation activities by improving their savings and access to credit;
Component 3	To improve community development through training service institutions associated with improvement of living standards in poor villages, and to enable technical personnel to deliver appropriate agriculture and livestock extension, credit services, health and educational services; and
Component 4	To efficiently and effectively manage the implementation of the Qinghai Community Development Project.

Project implementation was completed in June 1998. Through special arrangements made at the completion of project implementation, the microcredit revolving fund will be monitored until 2003 with the involvement of the Australian Government.

1.2 Project Setting

Qinghai Province is in western China, and is remote, high, barren and has cold winters. The three contiguous counties of Huangzhong, Pingan and Ledu in Haidong Prefecture abut the Tibetan Plateau, and though they have a river and main road running through their lowlands, the ridges rising up from the valley are steep and inhospitable. On these ridges, and in the gullies between them, are the villages identified as very poor. The 1992 Project Identification Mission observed many of the villages had no water supply, and access only by walking track. Others had water only during part of the year. In some villages access by tractor could be gained, but only when conditions were favourable.

The roads program was targeted to provide year round access to villages so that a) farmers had the confidence to grow crops that could be marketed in a timely manner, b) villagers had better general access for trade, information dissemination, health services and social well-being. The water supply issue was addressed by laying pipe 1.8 metres deep (to avoid freezing) from snow-fed springs high in the mountains several kilometres down a gully and servicing several villages along that line.

A statistical summary of the counties and project targets is at Attachment 9.

1.3 Aim of the Evaluation

The purpose of the evaluation was to assess the following:

- the appropriateness of the project goal in the context of GOPRC needs and priorities, AusAID's relevant Country Strategy, and AusAID objectives;
- the extent to which the activity has achieved its stated goal and objectives;
- the outcomes and impact (both intended and unintended) of the project;
- the efficiency of project implementation; and
- the sustainability of benefits, including the extent to which the Agricultural Bank of China's (ABC) provision of microfinance services has covered its costs.

The Terms of Reference (TOR) in Attachment 5 lists evaluation questions under the headings of design, policy, impact, sustainability, participation and management.

1.4 Methods Used in Evaluation

The ex-post evaluation team (the Team) used three mechanisms for the review process:

1. Desk review of selected documentation, particularly reports prepared during the project term;
2. Interviews of officials and experts who had worked on and visited the project, including members of the project administration and monitoring centres; and
3. Field surveys.

Prior to arrival, the Team identified and discussed the importance of balancing local official discussions with random sampling, to ensure that project impact findings were justifiable on both institutional and individual grounds. Therefore, the Team welcomed initial official introductions to field level situations and issues, to ensure that the role, resources and aspirations of local institutions were well understood. Following this, the team independently conducted field visits to sites selected by the Team. Direct observation methods, individual householder interviews, informal focus group discussions and transects were used.

The Team obtained detailed contour maps of the three counties and gained a good appreciation of the location and setting of individual villages. From available project records, lists were made of villages that received roads, water supplies, agricultural or other training, and microfinance. The team then selected villages to visit in a stratified sample, with the highest concentration of villages being those which had received more than one input, and lowest number of villages being those which received one or no inputs. Villages from all three counties were chosen, with at least three township areas visited in each county in order to have a broad base of physical and ethnic diversity in the sample.

The Team developed sets of questions, phenomenon to be observed, and key indicators to be checked which enabled understanding of the household conditions, changes, and circumstances particular to the project that affected the interviewees. These questions were used in the interview process. Typically, there were three sets of interviews/observations conducted concurrently in each village. Information and responses within a village were cross-checked by triangulation, that is rechecks by different interviewers, and discussions with various types of persons within villages, as well as by physical observation of conditions and tallying.

Female team members conducted interviews with women of the household using a female interpreter, in an effort to gain more open responses. Interviews of male and female household members were often done separately, then together. With the exception of focus group work, efforts were made to minimise those present at interviews (ideally one interviewee, the interviewer, and the interpreter).

A distinctive feature of demographics in eastern Qinghai is that villages can be categorised by prevalent ethnicity, and recognition of the implications makes for a better understanding of community conditions. Accordingly, the Team took this into account in both the sample village selection and in the interview/observation process. Hui nationality villages practice Islam, the Tu village visited was matriarchal, and Tibetan villages also have different characteristics from villages occupied by the majority Han. The four ethnic groups perceive gender roles in different ways. The Team worked with expert local advice to ensure sensitivity and awareness to these issues, in order to evoke the most factual responses in data collection.

The computerised Management Information System (MIS) operated by the ABC provided a list of 15,188 names of participants in the microfinance component, together with their village name, ethnicity, gender and age. For 5,693 participants, significantly more information was included in the computer records at the time the first loan application.[3] While the incompleteness of the MIS was a handicap, it did allow the identification and interviewing of approximately 40 borrowers with the complete set of information, located within the selected villages. The extensive range of data available on these borrowers enabled a comprehensive picture of income and economic conditions at the time of loan application to be drawn, and then discussion could proceed to current conditions for qualitative comparison purposes.

Having conducted field interviews and visits, evaluation then turned to the organisation and review of poverty and income data collected and published by government sources. This was done only after a realistic sense of conditions in the field had been gained. Information sought from government sources included poverty data, household production data by crop, information on changes in area growth, comparators on microfinance program success, gender and ethnicity data, and changes in area incomes and productivity. The Team visited data collection centres at the county and province level, as well as Chinese Academy of Social Sciences (CASS) in Beijing, and was able to

3 Information on all clients has been collected, but the remaining records were found to be incomplete in the computer system.

assimilate what had been observed in the field with overviews from the statistical offices.

The process of collecting and using data from official sources in China requires careful consideration of both the polling methods and the interpretation of the results. The Team spent considerable time understanding the problems and issues of data collection, built up relationships with those officers involved, and gradually was able to gather some recent (calendar year 1998) statistical data at the levels of village, township, county, and province. The information gathered was understood in terms of how and why it was collected, and in some cases, who had done the work.

1.5 Validity of Data

The Team brought to the evaluation process considerable experience in dealing with primary and secondary Chinese information and data, and an understanding of microfinance and related management information systems, so that some potential errors were identified and avoided. Cases of results falsified for purposes of proving success or attracting more funds, as frequently reported[4], usually come about when it is presumed there will be no rigorous cross-checking or auditing.

Through the data collection methods described in the preceding section, there was a high level of confidence that the data collected on demographics, income, and physical economic indicators was reliable. In a detailed interview with the province-level Poor Area Development Office (PADO) Deputy Division Chief, the degree of sampling, the calibre of data collectors, and the amount of visual cross checking of submitted data convinced the Team that there was professionalism and experience in the data collection system.

Team members had a number of opportunities to talk informally to farmers without supervision, even without local interpreters, and no impression was gained that there was deliberate artificiality about official data presented.

With respect to the 5,693 householders whose economic conditions had been comprehensively recorded, confidence was reinforced and understanding deepened by on-site discussion with a representative sample. The householder could point out physically what was meant by data entries. Typically, credible reasons were provided (without any perceived searching for correct answers) when there appeared to be a discrepancy between recorded data and what was physically checked. For example, through this form of questioning, the

4 "China: The Numbers Game", Newsweek, January 24, 2000, pp 34–5.

difference between chickens listed, loans taken for chicken-raising, and the number of chickens observed revealed the problem that some loans for chicken-raising had failed because the farmers had not inoculated, and the chicks had died. The farmers did not initially volunteer this information, but cross-checking between data and observation identified this fact.

The Team physically checked that the tangible components of the project were delivered. Through independent cross-checking of records and through interviews, it was satisfactorily verified that CFW payments and other financial transactions for training and extension were accurate.

1.6 Data Analysis

The Chinese Government defines poor households according to levels of annual per capita income from all sources, both cash and non-cash. In 1992 the poverty line was set at Y300 per person. The Haidong Prefecture PADO informed the team that the 1998 poverty line was Y640 per person, or about Y2,560 per household. It is worth examining what this data means. In poor households there is little cash income; what is being measured is average per capita consumption. The figure of Y300 represents the imputed value of all on-farm products and on and off-farm income. This includes the daily intake of staple grains that the household grows and consumes.

In 1992 the targeted households consumed approximately 200 kg of grain per person per year, with almost zero surplus for sale. Paradoxically, because the crop yields on the dry semi-barren mountainsides are so low, poor farmers consume only about half their daily requirement of kilocalories from grains, and actually have to rely more on own production of oil seed and animal meats than the better-off lowlanders.[5]

In 1993, the Huangzhong County agricultural population of 86,327 had a per capita average annual income of Y416. With the poverty line that year at Y350, there were 79,000 persons estimated to be below the poverty line. In 1998, the agricultural population had grown to 90,543, their average per capita income was Y777, and only 12,903 were below the poverty line. This is a significant shift, because it occurred in an area where the Qinghai Community Development Project (QCDP) was the only donor project in operation during the period. Government poverty alleviation investments in this county were lower than in most other counties in the province, according to data supplied by PADO. While the Evaluation Team cannot discount the possibility of other extraneous factors

5 Introduction to Qinghai Tibetan peasant consumption patterns, briefing by Rinchen Coudren, 1992.

affecting the income levels, such as larger incomes from men's external earnings in this county than in others, the evidence suggests that the project may well have had a reasonable income impact.

Shifts in poverty require inflation indexing in order to determine their real impact and potential permanence. Accordingly, inflationary prices of agricultural products were analysed and their index was graphed against the rises in per capita income in Huangzhong County. It was concluded that despite the two years of high inflation in 1994 and 1995, the increased average per capita incomes from 1992 to 1998 include a significant real improvement in incomes. Thus in both real and absolute terms, poverty declined in the area. Refer to Attachment 7 for detailed information on all 3 counties.

The Team then turned to the MIS data for analysis of target households in the project. At the time when clients first borrow, they must complete a lengthy questionnaire that records all significant assets, including amount of land farmed and numbers of livestock and condition of the home. Interviews revealed a surprising uniformity in methods of calculation of incomes. It is assumed that the 5,693 borrowers for which full data was entered in the MIS were not selected in any biased way, and therefore may be reasonably representative of the entire group of borrowers. These borrowers are largely from the period 1996 and thereafter, reflecting the growth pattern of the microcredit program, and have surprisingly high incomes. The average annual income of the borrower is Y2,274. There are four possible explanations as defined below:

1. The income is defined as that for the householder applying for the loan. Thus this is different from average per capita income (which is nearly always lower because it includes children and the very elderly). The Team considers that this is the most likely explanation.

2. Borrowers overstate their income to prove creditworthiness. There may be a tendency to do this, but the Credit Extension Intermediary (CEIs) are village-based and know their clients. Therefore, the accuracy of this information is higher than might otherwise be the case.

3. The CEIs are seeking out those with high incomes to ensure repayment. The recommendation of the Team to encourage CEIs through regulation and incentive to seek out poorer borrowers would cut out a top bracket. Checking the top quartile of the 5,693 in the survey, a cut-off point of total income from all sources of Y5000 would have disqualified 200 applicants.

4. The fourth possibility is that since 1992 these householders, including those who were poor before, have actually increased their incomes.

2 COMPONENT 1 Cash-for-Work Programs

2.1 Purpose

Component 1 was designed with the primary purpose of generating savings for poor households by providing cash-for-work (CFW) activities in their areas. The injection of cash into the local economy was linked in the design to Component 2—Income Generating Activities, leading to savings and then access to credit/investments, stimulating new rounds of income generating activities. The secondary purpose of Component 1 was the provision of household benefits from new roads and water supply facilities. Both these activities would enhance opportunities for income generation. The roads would save time to and from market as well as increasing access, and water supply would free several hours of labour per day, which would then be available to earn money. The benefits were expected to also lead to a healthier, more productive community, with lower burdens on human transport, and clean abundant water resulting in improved household hygiene.

The activities aimed to achieve a balanced gender and ethnic participation.

2.2 Verification

The Project Completion Report (PCR) stated that 71 km of access roads were built and water supply facilities delivered to 38 villages. The CFW programs for road and water disbursed Y2,038,000 and Y2,616,295 respectively (that is, 9% and 11% of the total Australian budget).

The Team travelled over all 71 km of road, and physically inspected 19 of the 38 of the villages receiving water supply. The Team met with prefectural, county and township authorities responsible for design, construction and maintenance, and visited and personally interviewed over 100 villagers who were beneficiaries of one or more of the components. The MIS from the microcredit work was used to identify some villagers and discuss the impact of the water supply on their circumstances.

The roads were generally well built and well maintained, and the water supply systems were in place and being used to good effect, with the exception of one village, Xia Tai. This is further discussed in Section 2.3.

The Team verified that the CFW program was implemented properly, sighting records that individuals were paid cash-for-work on a piece rate for roads and per day for water works. Village community work obligations of up to ten days per year per adult was mixed with the CFW program, so that some workers were not paid for some days on trench digging for water pipes. Independent cross-checking showed this to be complicated and confusing to villagers, but consistent with local agreements and, as far as could be determined, honestly implemented.

2.3 Impact

Most roads are well used, with regular minibus service (owned privately within the villages) all the way to the provincial capital and with a high level of local farm traffic. Users have emphasised that the roads are important in the timing of product delivery to market. Prior to the road being constructed, the tracks could be used for delivering products, but were impassable during wet weather. Thus farmers did not invest further in crop or animal production under previous conditions, because they risked not being able to sell during the times when prices were highest, or might suffer transport-related losses. Timely access to markets is now possible. Additionally, more goods are available to farmers at more competitive prices.

The Chengtai–Xiaying road was in relatively good condition, and the project had improved some adjoining donkey paths of 6 km apparently not recorded in the PCR. The road joins two townships high in the hills following contours around steep ridges. Ironically, the two roads connecting the main highway to Chengtai and to Xiaying have suffered washouts after excessive rains, so that the project road is only used for inter-township travel. Previously there was some confusion over responsibilities for various parts of roads, which led to lack of maintenance. However, the provincial-level Roads Bureau is beginning to rebuild both roads leading to Chengtai and Xiaying, after which it will take on the responsibility of maintaining the project road section.

The Team conducted random spot checks of water availability in over 80 homes in 19 villages, and concluded that the water supply system has been very successful. In 12 villages all households had been connected so that tap water was available in the courtyard. In 2 villages the water was available outside each home near the front gate and in 4 villages the water was running at public taps 10 to 40 metres from homes. The water was drawn far upstream from controlled sources, and so, as explained by township and village leaders, was cleaner than water previously used. The saving in time for one household, in one day, because of this project element varied from 40 minutes to over 6 hours[6].

6 Instances were found where there was no time saved using the new facility, because previously water near the house had been drawn from a stream, rather than the spring fed water pipe. In such cases the advantage was in having water that was cleaner than that which had run several kilometres through grazing land.

It is noted that the project delivered water in pipes (typically from several kilometres up in the foothills, buried 1.8 metres deep to avoid freezing) to public outlets in the village street. Yet in 12 villages observed, and some others not visited, the village organisation had managed reticulation into the courtyards of each home (at cost price). This initiative is a positive sign of how welcome the project input was. Informal discussion with householders on demonstrating how their tap worked invariably resulted in warm comment on the changes this had made to their lives.

There was unanimous agreement amongst villagers and their leadership that the new water supply was very beneficial. They mentioned time saved, cleaner water, and improved hygiene. The Team was unable to locate data showing trends in health which could be attributed to the new water systems.

The Team made every effort to analyse gender issues in water carrying as they existed under previous conditions and now. No quantitative data was available, only qualitative information. In general, from observation and interview, water collection is not a responsibility based on gender, and interviewees commonly insisted that water was collected by both males and females. It was noted that men often travel to other regions for work, so women are more likely to have benefited from this component to the extent that their time was saved.

Villagers mentioned that they needed to take animals to other watering places at times, since water taps provided very cold water (so cold as to be harmful), probably because it is sourced directly from high in the hills. The Team also observed that the areas around community water taps often had spillover, causing dangerous icy conditions and undercuts on adjoining paths. It is unknown why villagers have not taken on the responsibility of rectifying these problems.

At Xia Tai village their water system did not work. According to the County Water and Electricity Bureau Chief this is due to silting and the fact that the villagers are being resettled, and therefore maintenance is not being conducted. Xia Tai is a dry and barren mountain hamlet, where a water supply system is difficult to install, and difficult to maintain. Half the population has already moved out under a government resettlement scheme planned in 1995. The Team had no time to pursue this problem, but accepts the explanation given by the County Government. No village other than Xia Tai was observed or reported to have a failed water supply system.

Issues of environment were surveyed and checks made for any positive or negative impact. During construction of the roads and the digging for water pipes, it is believed that any environmental damage was negligible. Threats to the environment that arise after new vehicular access is made were checklisted and found to be not significant. There is no forest, and certainly no logging in this region. In general, roads and water supply projects were not observed to be harmful to the environment.

2.4 Sustainability

The CFW scheme was not expected to continue past the project completion date. The GOPRC, especially at the local levels, regarded the cash made available as very useful leverage for commanding domestic funds and channelling them into road and water works which otherwise may have not been carried out "for 5–10 years" (in the words of one county road finance officer). In this project, the domestic funds for road building were reported to be 80% of total cost.

The Team evaluated the results of the scheme—the roads and water supply system—with respect to sustainability. Functionally, these projects are generally working well 18 months after project completion. The Team found that the communities welcomed the roads and water supplies, a prerequisite for the achievement of sustainability. The community wanted activities to work, they appreciated the benefits, and would do what was required to maintain them.

The Team reviewed the sustainability of the infrastructure created under the project. It was found that although the roads and water supply were being maintained, it was not in the manner the project originally proposed.

The roads were built and maintained in each of the 3 counties by the Road Engineering Group of the county-level Transport Department. Interviews in their offices and on the roads revealed a strong element of pride in ownership, and both willingness and the resources to maintain the roads. The exception to this was the Chengtai–Xiaying Road referred to above, which will be maintained properly after the transfer of responsibility to the provincial-level Roads Bureau.

The Team noted the presence of well-designed training manuals in Road Bureau offices illustrating road erosion prevention, road surface inspection and repair, and other practical basic skills. It was difficult to determine whether road maintenance training, which was provided to villages as an aspect of project work, added to or reinforced road maintenance. The maintenance manuals were not found in the villages.

The ongoing, community-led water supply system maintenance program provides a valuable lesson for future programs. The project designed and implemented a program involving a village-level ("barefoot") water maintenance person. This person was selected from the village, with no prior experience necessary. The village water maintenance person was trained and equipped to check the water supply system, pre-empt problems, and to ensure the continuous availability of water. The Team did not find one such individual. It is not clear whether individuals had been appointed or had never been appointed. The PMU showed well-illustrated training manuals of the kind that had been issued, and in the Team's presence urged officers of the township and county-level water bureaus to recall receiving and distributing the manuals. But it seems the officials had genuinely forgotten receiving the manuals.

The substitute solution was for the village committee to informally decide how to maintain, extend and further reticulate the water supply over time. In the short period available to the Team, it was not possible to elicit the details of this decision-making process. The villagers themselves had not thought about this, only mentioning that they cared about having the water supply, and would do whatever it took to ensure water flow. In one village, tapping into the water main for a new public outlet was observed. There was no supervisor or technical authority, but quite a large group working cooperatively. It seems it was done on a "needs basis". It is unknown if this had a negative impact on water sharing or availability.

2.5 Conclusion

In hindsight there is a significant failing of Component 1—that the cash paid out preceded the commencement of savings group formation by over 18 months. Thus cash earned was nearly all spent on various forms of consumption, both necessary and non-essential items, before it could be used as a basis for savings and for contributions to income-generating activities or credit collateral.

The reason for this is clearly documented in the project completion report (PCR). The GOPRC supplied the majority of funds for the construction of roads and the water supply system, and had their program for implementation ready, subject only to agreement from the Australian government. The Chinese financial year follows the calendar year, which is different from the Australian financial year. The Chinese administrators feared losing their funds for these activities if they were not spent in time. At the time when the Chinese were gearing up for construction, the Australian team were still working on the best design options for Component 2—Income Generating Activities. This involved negotiating an acceptable interest rate and identifying the institutional structure that would manage lending and collection. For these reasons the Australian team of the Project Management Office (PMO) were unable to set the savings and credit program up in time to catch the flow-on from the cash-for-work program.

2.6 Key Lessons Learned

1. Any new CFW program must be preceded by the gaining of a thorough understanding of existing community programs that employ labour for infrastructural work. This is especially the case if communities are expected to deliver some work for infrastructural projects without pay. This will ensure there is no confusion when individuals are called on to do some work as community volunteers, and others work for wages.

2. Care must be taken to ensure that timing of co-dependent components will occur as planned. This often means delaying expenditure while planning and training occurs, so budgeting for both the Australian and the recipient government should be established accordingly.

3. Ensure that the design of the road works is approved and supported by all key agencies, so it will be maintained according to agreed-upon arrangements.

4. Ensure that areas designated for works activities are not being considered for relocation programs, and ensure very good donor/government coordination in this regard.

5. Public water outlets need to be designed to ensure water spilt or flowing out is channelled away without impeding access to the point of collection. This is particularly important where runoff water freezes, and results in a dangerously slippery surface.

6. Consideration in water supply design should be given to the potential use of water for livestock, and water users should be carefully consulted in this regard.

7. Maintenance must be planned through institutions that have the will and resources to continue after project completion. In this project maintenance occurred, but not in the “new ways” planned, but by default through existing institutions.

8. Prior to implementation, what is possible in targeting gender issues needs to be pragmatically delineated, and then this needs to be progressed during implementation with conviction, rather than as reactive process.

3 COMPONENT 2
Income Generating Activities

3.1 Purpose

The purpose of Component 2 was to assist poor households to participate in farming and non-farming income generation activities by improving their savings and access to credit[7]. The objectives to support this purpose included[8]:

1. To ensure that "revolving credit" funds are managed efficiently and are directed towards the needs of poor households following guidelines developed by the Project.
2. To improve the financial standing of poor households through group formation, and provide them with collateral for seeking credit, initially through the revolving fund and later from commercial sources.
3. To support the income generating activities (IGA), which will lead to increased incomes among poor households. The IGAs will be poor household targeted and will therefore be appropriate small-scale enterprises.

The initial design called for creation of savings groups, whose members would save Yuan earned during the CFW activity. Savings groups would then be linked to a micro-lending system through the local village councils, with the Agriculture Bank of China (ABC) as an agent handling mechanical funds disbursement and collections. The beneficiaries' savings plus the loan funds were to finance selected income generation activities as determined by the project team. The precise details for microcredit provision were left to the implementation phase.

The PCR documents the substantial changes in the component design during the implementation period. The implementation team recognised that the introduction of microfinance into China at this level would require a great deal of both analysis and training. In addition, they saw the wisdom of considering clients capable of selecting profitable activities for their loans without project

7 In this report, reference is made to "microfinance" as the concept that includes savings and loans, while "microcredit" is used when dealing with small loans. This project was designed to include promotion of savings, but for reasons explained, resulted in implementation of a microcredit component.

8 As per the Project Implementation Document, or PID.

designation. Accordingly, an additional four months' work for a Micro Credit Specialist (MCS) was added to the project to complement the microcredit study tour, local training, and loan fund contribution of A$2,255,653. The MCS participated in the overseas study tour and provided three rounds of training and review inputs to the project.

The most important input to this implementation period refining process was the positive impact that the overseas study tour had on the attitudes and beliefs of the ABC managers. In many ways, the concepts now accepted as international best practice were new to the Chinese professionals, and they were dubious of the potential effectiveness of such best practices in China. By seeing solid microfinance programs in operation, the ABC managers could agree on the final operational structure. This was critical at the time, even though those who were on the study tour have subsequently left the professional positions that linked them to the project.

After a good deal of field review, debate, and engagement of the Chinese who had participated in the overseas tour of microfinance programs, the project team came to agreement on August 21, 1996 on an experimental model to be implemented for microfinance[9]. The key factors guiding this model were:

- Group lending mechanism: this mechanism involved the self-formation of groups of 4 to 7 villagers, who were to meet monthly. At meetings, members would jointly ensure individual member's loans, make repayments, and develop social cohesion. No compulsory savings, guarantors, or collateral requirements were required;

- Use of Credit Extension Intermediaries (CEIs): one person was elected within each village and trained to be the conduit for lending, repayment, and savings. CEIs received commissions of Y4 for each loan disbursement, and 1.5% of the principal repayments;

- Client Choices: a range of three repayment options (term, installment, and blended) was offered. Monthly interest repayments were calculated on the actual outstanding loan balance. Clients could use their loans for any purpose, without further checking[10]. In this way clients could fit loan use and repayment to household earning circumstances; and

9 For those interested in further detail, a basic primer on microfinance and its mechanisms is included as an Attachment.

10 In the original project design, the project team would identify and develop accepted income generation activities for lending. Allowing clients to borrow and use funds for any purpose is more consistent with international best practice on microfinance, which recognises that clients can best identify income options in their own working environments.

- Very Low Initial Loan Size of Y400 (A$80): depending on the loan type, the initial loan ceiling was small. There were incremental increases in the maximum loan size, if and when clients successfully repaid on time, and worked out the new loan with the CEIs.

This model was implemented in the field based on guidelines drafted by the MCS. The guidelines were redrafted into an Operations Agreement and signed by ABC, the government, and the project team. Initially the Project Management Office (PMO) introduced the program to villages, and hired and trained the CEIs, commencing microcredit activity in the project area. However, in 1997 a mechanism for handing over the activity to the ABC was designed, allowing for a Micro Credit Office (MCO) to be set up within the Prefectural ABC to handle lending operations. An agreement was signed through 2003 between AusAID and the Chinese government to continue this activity. Selected PMO staff (three professionals, an accountant, and two drivers) were retained through the Prefecture Planning Commission to continue as a Project Monitoring Unit, with the responsibility of overseeing the ABC activities and ensuring they were continuing to meet project objectives.

A Board of Management (BOM) made up of key individuals from the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), the provincial Department of Foreign Trade and Economic Cooperation (DOFTEC), ABC, AusAID, and the Prefectural Government was set up, meeting every six months to review and advise on policy and key operations issues. Signing and handover occurred in April 1998. Since that time, the MCO has been the key office for operations, with the Project Monitoring Unit (PMU) providing review, training, and logistics support for the BOM.

Targeting to the poor villages, community participation, and engagement of local organisations was well planned and structured. The design included explicit targeting to ethnic groups, and rather less overt targeting for women, although 60% of clients were supposed to be women.

The aspects of the design involving microcredit included the use of subsidised interest rates. Interest rate restrictions are imposed centrally by the GOPRC, and for the project to charge financially sustainable rates would have been illegal at that time. Thus the interest rate was restricted to 12%, which was below the estimated 15% required to pay the full costs of program operations.

The design team recognised that additional information, experience and changing attitudes might result in alternate implementation options. Accordingly, they built in technical assistance to develop the model as experience was gained on the ground. This flexibility for change during implementation is unusual in donor projects, and it proved highly successful in the case of the QCDP.

When the design set up the cash-for-work system as the mechanism for ensuring initial savings, the importance of co-timing both CFW and savings group formation was not evident. With budgetary pressures forcing the Chinese to spend government infrastructure funds quickly and efficiently, the roads and water supply activities were started even before official project inception.

While sustainability and client services were carefully discussed, the ABC was operating as a traditional state bank without experience lending to the target group. Accordingly, there were significant institutional constraints to fully adopting the microfinance program at the end of the project. These included lower attention to selective targeting of the poor within villages, and resistance to using women as CEIs[11]. Fuller integration of the operations into the ABC from the beginning would have led to a higher commitment to program objectives.

At the time of project design, AusAID's objective was the promotion of sustainable economic and social development of people in developing countries, with poverty alleviation intrinsic to this objective[12]. The official documentation goes on to list micro-credit and micro-enterprise development as appropriate direct programs to target the poor. The official policy of the GOPRC in the area was to focus on poverty alleviation, and included both infrastructure investment/cash-for-work and small business lending[13]. The project conformed to the policy stances of both the donor and the recipient government. While clients could have been more readily consulted in the initial stages, the design of the loan process to enable them to choose loan-based activities, and the structure of lending enabled them to openly choose whether to participate, and how.

3.2 Verification

The Team conducted interviews with numerous clients, non-clients, CEIs, officers of the Micro Credit Office of the ABC, other senior ABC officials, officers of the PMU, and the previous Chinese team leader regarding the operations of the microcredit component. Structured interviews and physical observation of clients and their household conditions were completed in a stratified sample of villages in all three counties. The villages visited are listed in Attachment 1. Time and access limited the Team largely to qualitative information acquisition. The Team

11 Chinese researchers and other donors uniformly expressed surprise that the ABC was so effective in this program, and they and others assigned this to the persuasiveness and commitment of both the ABC prefectural officers and the technical team in the field.

12 AusAID Programs Operations Guide, Volume 1 March 1993, cross sector policies, 5:19.

13 Personal communication, DOFTEC, 30 November 1999.

interviewed a total of 47 clients and all CEIs in 15 of the 112 villages covered by the project to date. The interviews were supplemented by reviews of accounting records at the CEI, Business Office of the Agricultural Bank of China (BOABC), and MCO level. The MIS was thoroughly reviewed.

3.3 Impact

3.3.1 Level of Participation

The QCDP lending program as it emerged was established to target households below the poverty line (Y300 per capita per year at project start), focusing on a balance of ethnicities and biased toward the participation of women. In order to provide loans to women in greater numbers than men, the project established firm guidelines on the involvement of women clients, and encouraged the appointment of women CEIs. Villages were carefully identified for participation, to ensure ethnic balances similar to those in the prefecture as a whole. Low loan sizes were established to ensure that poor families felt comfortable participating, and that richer families would find the loan amounts too small and go elsewhere to borrow.

Poverty targeting was not as effective as was hoped, although 112 of the 187 project villages have received microcredit services, and the remainder await access once sufficient loan funds are available. Target villages were estimated in the PID to have about 50% of their populations under the poverty line. However, in every village visited by the Team more than 50% of the population had received a loan. In fact, in 13 villages loans were held by over 80% of total village households; in at least two of these villages it was 100%[14]. This did not necessarily reflect the active loans in the village, since the Team was present after harvest, during a net repayment period. However, it does reflect structural characteristics of the program, showing that where villages are involved in the program, both the poor and the better-off are participating. This is not necessarily a bad thing, except that funds going to the relatively wealthy do not go to the poor in an as-yet unserviced village, and credit-rationing[15] is already taking place. While credit rationing seems sensible in such circumstances, most

14 Poverty levels on a per-village basis were not available from government sources, thus preventing a village-wise comparison.

15 Credit rationing is the arbitrary establishment of rules, such as those currently limiting new loans to Y1000 and, in some BOABCs, requiring clients to wait for some months until "funds are available", so that the existing funds are sufficient to serve the clients currently in the program. When this occurs, CEIs will provide funds first to those which have the strongest likelihood of quick repayment, leaving those who are poorer—and thus higher risk—to wait until more money is available. The incentive of receiving larger loans may also be lost, resulting in higher delinquency over time.

mechanisms used for credit rationing do not enable borrowing by the most needy clients.

In the limited time available for the review, it was not possible to conduct an empirical study into the absolute levels of poverty of program participants. However in most Qinghai villages, agriculture is the principal income generating activity and therefore there is limited wealth disparity between households. This relatively even income distribution is due to the government policy of regular land redistribution according to family size. Only in the villages closer to townships do significant levels of off-farm business cause larger wealth disparities to occur.

Why is everybody in the village borrowing from this program? The first reason is that CEIs were well motivated by the compensation structure to lend widely and frequently. A compensation structure of Y4 per loan disbursed and 1.5% of repayments, or about Y2,000 to Y3,000 per year on average, is a significant income for any villager, providing ample annual cash income. Since many of the CEIs are members of the village council and virtually all are well off, they have influence as well as the power to lend. Larger numbers of loans, for larger amounts, lead to higher incomes for them.

There are also social pressures for universal participation in programs within villages. There is some indication that borrowing by all villagers is due to the representation of the microcredit project as one for the entire village, with accompanying subtle pressures to "join". The Team was unable to determine whether this is a one-off phenomenon, or whether all villagers try to borrow regularly.

The relatively wealthier households in the village take small loans for two purposes. The first, and by far the most common, is for fertiliser and incidental expenses at planting time. BOABC directors confirmed that in some areas where they have MCO loans, demand for fertiliser loans has declined[16]. Often these micro-loans are taken and repaid as early as cash flow allows. The second loan type for the wealthy is that which fills out the remainder of a major investment. The Team encountered borrowers taking small loans that made up 10% or less of their total equity investment in restaurants, walking tractors, and similar items. The loan was viewed as a social conformation to what is viewed as a village program. It was repaid, and renewed if the investment needed regular cash flow injections.

16 This is a little odd as traditional fertiliser loans are provided at lower interest rates than the QCDP loans. It may be that the Bank was restricting this limited resource in villages participating in the QCDP microfinance program; however, villagers told us that the convenience of borrowing locally without providing collateral was worth the additional interest paid, 5% per year.

Ideally richer households should be excluded from the program, since their participation cuts the level of funds available to poorer target households in those villages which have not yet received access to the program. However, attempts to identify and selectively target poor households in other microfinance programs around the world has been largely unsuccessful—even when dramatic disparities in wealth occur. The costs of delivering such services to isolated village areas argues for the inclusion of some who are less poor, particularly in locations such as rural China where the differentials in incomes between the poor and the less-poor are very small. It may be more practical to accept the fact that most village households will wish to take advantage of the program and, providing the program is proving effective, concentrate on ensuring adequate credit funds are available.

Figure 3a: Qinghai Population by Ethnicity

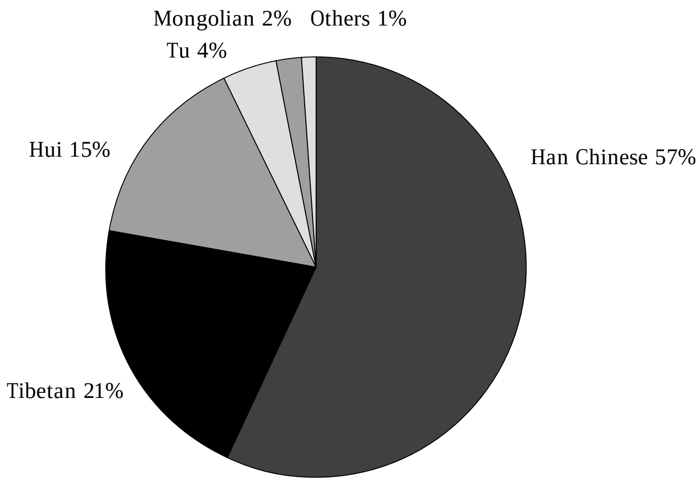
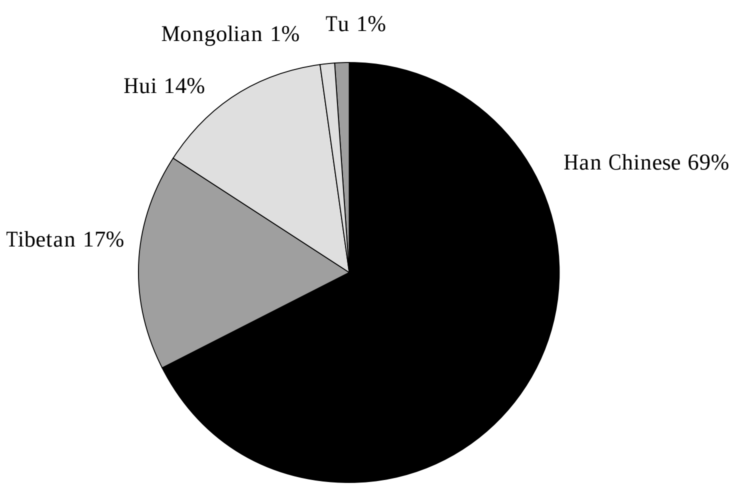


Figure 3b: Microcredit Borrowers by Ethnicity



The project has provided microcredit services to an ethnically representative sample of the local population. Figures 3a and 3b show the ethnicity of clients per the MIS information, and the ethnicity of the Qinghai province population. The ethnic balances reflected in the MIS are remarkably similar to those of the overall population in the prefecture, with less than 2% variation in any given ethnic group. This is a significant success, tied to the design selection of target villages and the implementation scheduling of access to the lending program. The breakdown of CEIs reflects the same ethnic breakdown as the province (Figure 4a). The latter result means that villages do find an ethnically representative person to operate as their CEI.

Figure 4a: CEIs by Ethnicity

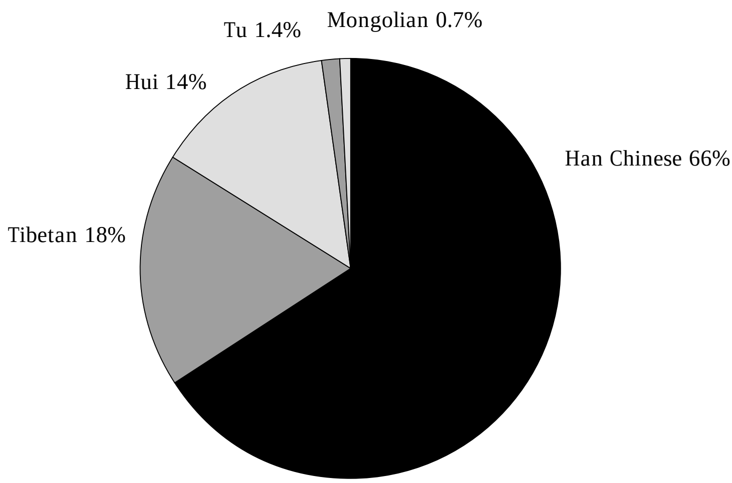
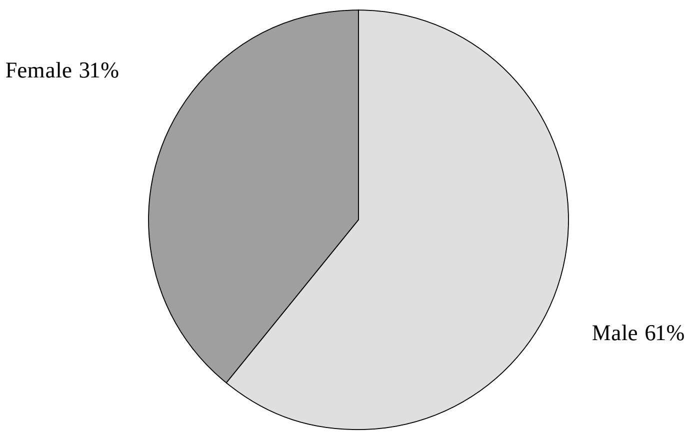


Figure 4b: CEIs by Gender



The program has been less successful in *gender balancing*. Loan records in the MIS show that as of October 1999, 48.4% of borrowers were women and 51.6% were men. This compares favourably with 37.5% women[17] at project closure, but is still lower than the project target of 60% women. Furthermore, actual control of loans by women is lower than the borrower ratios would suggest. Although consultations between husband and wife regarding income and expenses is common in the project area, most women do not control the levels or types of cash which husbands manage. Two thirds of the women clients interviewed told us openly that they only listed their names on the loan papers because the program required it, but that their husbands took the money from the CEIs and spent/managed it without informing them. Interestingly, this happened far less often when the active CEIs were women. While the Team was unable to determine the cause of this with certainty due to the brevity of the investigation period, it is believed that women CEIs feel that the borrower should be the person handling the activity, and lend accordingly.

The gender of CEIs is also relatively unbalanced. The CEIs are predominantly male, 91 compared to 57 women,[18] or 39% female (See Figure 4b). Of the three women CEIs interviewed, the duties of one woman CEI had been taken over by her husband with the tacit approval of the ABC. The education levels of women in villages, and traditionally negative attitudes towards women as leaders, may result in less representation of women in this important area. Active female CEIs mentioned the increase in their status and importance in the village and its activities. They also stressed the importance of female membership, even in cases where the males take a strong role in the loan activity. This indicates that female CEIs might improve the effective borrowing power of women in the villages.

Under the influence of the MCS, the CEI composition was initially strongly biased in favour of women (Figure 4b). However, this situation changed later in the project as the ABC and the PMO favoured male CEIs. This was despite the fact that the MCS' final evaluation report (1997) demonstrated that women CEIs had better loan recovery performance and better targeted women and poorer households.

The Team found no women BOABC credit officers or MCO staff, which is daunting in terms of finding a champion for women within the ABC structure.

17 PCD Page 16 Table 9.

18 Although 112 villages are active, a number of villages have two CEIs since the villages are too large to manage alone.

3.3.2 Management and Implementation Arrangements

The CEI system was established during the implementation phase. The CEIs were to be selected based on education, honesty, and ability to do the job, by village election. They were then trained for two weeks intensively, and took an examination. Those who passed were able to start the programs in their villages. After the initial course for each CEI, there have been no additional training services provided to deepen CEI skills or refresh them. A few weaker CEIs were re-trained with subsequent new CEI groups. The lack of ongoing training and strengthening of CEIs was a problem both during implementation and after handover to the ABC. It emerged due to lack of microfinance technical skills of the implementation team, lack of a human resource orientation towards the CEIs, and lack of acceptance of CEIs by the ABC as staff needing ongoing training and support.

The Team found that generally the CEIs were committed, able to undertake their tasks effectively, and interested in this work. Most were willing to continue this activity, because of the income of Y2,000 or more per year. A cash income at this level can enable significant amounts of time to be spent on micro-lending activities without loss of household security. For some, an increase in status in the village was also important, particularly for women CEIs.

There are some problems with CEIs which, although they do not invalidate the approach, need to be addressed soon. Selection of CEIs in new villages seems to be veering away from levels of trust and village elections, toward arbitrary selection by village councils and the ABC itself. ABC officers justified this by saying that others in a village were insufficiently well educated. The result is likely to be more male CEIs who are already well off and in positions of authority. Concentration of such power is dangerous in any village situation, because it creates more opportunities for exploitation of the poorer villagers. The lack of full village consent to a CEI may lead to distrust and delinquency.

CEI training and follow-up has been relatively poor. The reasons for this are understandable: new program, few experienced in the process, a belief that as long as the clients were provided with the loans and repaid on time, no further work was needed. However, this has had some negative program results, which might have been prevented or swiftly adjusted if regular training occurred. First, CEIs were found to have made arbitrary decisions about program implementation which adversely affected clients. For example, one CEI implemented a penalty fine for late payments, which income presumably he kept, since the ABC was unaware of it, making more money for himself but alienating clients[19]. Another CEI, when told

19 Penalty interest generally is an ineffective mechanism to ensure on-tine repayment in situations where borrowers are delinquent due to lack of ability. In situations where families cannot repay, penalty interest damages their circumstances further.

that loan fund would be restricted in availability, lent to wealthier clients for that loan cycle, defeating the objective of poverty-based lending.

About one-third of CEIs have had trouble keeping accurate records, and there are a wide variety of ways that CEIs keep their individual records for clients, some of which are unacceptable in terms of accounting principles. For example, one CEI has kept disbursement information by group, so he will be unable to tell who has not repaid within a group if some default and they cannot agree. If accounts are not accurate, there is room for abuse—CEIs taking loans from ghost clients and not repaying, for example. If accounts are not correct there may well be disputes, and the potential for loans to be repaid by clients may be lost.

Many CEIs have required prepayment of all interest from the loan disbursement, and then utilised the funds for their own benefit until loan interest was due to the bank. This cheats the client of money they may need up-front, charges them more interest than is due to be paid, allows CEIs to create arbitrary rules (a dangerous practice which they may continue and expand on to their benefit), and slows down necessary cash-flow to the ABC. Such an option can be built into the microcredit program, but should be explicit, result in the same interest rate being paid, be paid directly to the ABC rather than the CEI, and be the choice of the client rather than the CEI.

Finally, while the incentive payment structure worked well in many ways and was financially appropriate, the CEIs had no incentive to generate savings for clients, and thus did not do so. In one area observed by the Team, the repayment incentive was insufficient to prevent delinquency from being addressed by the CEI. Additionally, there was no part of the incentive system which supported better targeting to the poor; this was something which might have been included.

The Team found that the CEIs facilitate the *application process*, and help fill out forms, even going to the borrowers' homes. The loan forms are simple and easy for clients to use, if they are literate. However, the CEIs do not necessarily take care to be accurate in loan documentation, nor do they screen out wealthier clients or run any checks to ensure the client has the capacity to repay the loan. Further, since many applicants cannot read, and there is no physical crosscheck of clients by any other party, there is scope for fraud. A CEI could, theoretically, create loans for fictitious clients (or real persons who did not apply), then use the funds for his/her own purposes and not repay.

Finally, a few clients have applied for new loans before the old loan was fully repaid, according to information provided by the AusAID auditor.[20] This is a violation of the rules, and a problem because clients will then repay old loans with new loan funds,

20 The Ex-post Evaluation Team did not find any cases of this occurring.

and have too little to use for their income generating activity. The MCO is not keeping track of this data accurately on its database. This highlights the importance of effective monitoring of the program and of the CEIs by both the ABC and PMO. At present this monitoring and supervision is highly inadequate.

The Team found that the CEIs facilitate the process of *loan approval and disbursement*, and most will support clients to submit applications once loans are repaid. The forms then go in to the BOABC during monthly payment/review meetings between CEIs and the BOABC. Loan applications are reviewed and approved in time to receive new loans one month later. In some cases where loans are needed rapidly, CEIs will go to the bank repeatedly to try to find the credit officer and receive approvals and loan disbursement funds. In the case of one accommodating BOABC, CEIs can get their loan applications reviewed and approved while they are meeting with the branch; this was an intention of the initial program structure.

While the program design intends that all clients with 100% repayment record should be allowed loans up to the next credit limit, the Team was unable to discover what rules the BOABC officers actually apply when approving loans. We did not find any loans that had been denied.[21] Thus, we do not know whether there is any screening to determine if the application rules have been followed, and whether the loan funds are being appropriately lent. The Team did find some first loans and subsequent loans that were in excess of stated ceilings. This makes less funding available to other clients, and makes lending more arbitrary.

CEIs complained about having to travel frequently to the BOABC to pick up loan approvals or funds, often finding no one available to help them when the credit officer was out (as frequently he was, in the field). Since CEIs are only reimbursed for one trip a month, they are incurring additional personal costs in order to better serve their village clients by trying to get their loan disbursements in a timely manner. Counter to the initial rules requiring BOABC officers to disburse all loans in the villages, BOABC officers provide all loan disbursement funds to the CEI at the bank branch. The CEIs then disburse at the village. In the current lack of field monitoring, this provides scope for abuse, as CEIs may create fake loans for their own use, or withhold funds, again using them for their own purposes until providing them to borrowers at a later date. Even passbooks cannot prevent this situation. Only continuous random monitoring can identify such abuse.

21 It is likely that loans are not submitted by the CEIs if they do not expect them to be approved. However, the CEI system for filtering loans was not clear, even in interviews; CEIs advised that "anyone" could get a loan if the CEI judged the borrower could repay it during the scope of the loan period.

The Team found that funds transferred from the MCO to BOABCs for their loan disbursement did not match the actual loan demands for those areas. Thus, some BOABCs are holding funds that are not being lent, while other BOABCs are short of funds and are undertaking loan rationing. Accordingly, there are fewer funds available to poor clients since they are sitting in a BOABC account.

The Team found that in many cases the CEIs are deducting the full loan interest amount from borrowers at the point of disbursement. The CEIs are holding the funds in their personal savings accounts or using them for their own businesses until the monthly interest is due. In some situations, the clients have asked for this service because they fear that they will not have sufficient cash available at the time required for interest payments. In other cases, the CEI expresses this concern and accordingly forces the prepayment. The MCO is aware of this situation but has not acted to change it by ensuring that any interest paid by a client, whether by payment or deduction from a loan disbursement, came promptly to the BOABC office. Their rationale is clear: clients and CEIs fear that on-time repayment of interest is risky, and so they arrange prepayment, and the ABC looks the other way since it gets interest payments on time. This in itself is understandable. The problem is that both the clients and the ABC are losing out to the CEIs, without realising it. Clients are getting a net smaller loan but paying interest on a full loan. The ABC is not receiving the full value of funds, because the interest has been prepaid, but the ABC gets it only when it is due. Meanwhile, the CEI has the potential for investment and income from the clients' money. Interest prepayment should be allowed but this should be deposited into the clients loan account, not held by CEIs.

In the absence of reliable data on a loan-by-loan basis, the Team was unable to evaluate the full patterns of loan uptake for the *second and subsequent loans*. Qualitative assessment indicated that there were three distinct patterns. The wealthy took fertiliser or investment loans once or twice, but generally for convenience, and to demonstrate participation and solidarity with what is perceived as an all-village program. For the poorest, and for those who have highly variable cash income sources, about half of those interviewed did not take a repeat loan, finding either that they could not repay without substantial stresses, or that their household had sufficient funds that year to manage without borrowing. It is too early to determine whether such poor households simply take a break from loans, or permanently excuse themselves from program activity. The majority of village households lay in the middle, and did take repeat loans. These were based on seasonal demands much more than perceptions of market opportunities. This is acceptable and consistent with microfinance programs in other places.

The use of term loans has replaced that of the installment and combination loan types[22]. CEIs and the ABC advised that this was a much simpler mechanism for lending, as they did not have to worry about collecting periodic principal repayments. In two villages visited, other loan types had been converted into term loans when the clients could not pay the principal repayments on time. While term loans fit the majority of purposes, repayment in installments forces more loan discipline and tends to enable clients to keep business finances separate from home consumption. It is also easier for poor households to generate small repayments than large ones. Installment lending should be used for loan purposes where there is regular cash income, such as restaurant operation, cash-based trade, and butchering.

Clients in the field were found to make *loan repayments* most often (31 of the 47 interviewed) by having a member of the family go outside and work to earn cash income. This is a new and relatively lucrative mechanism for additional income, but it does not necessarily strengthen the local economic circumstances of the household, and it places significant additional labour burdens on those left behind in the village, who are mainly women. The next most common source of repayment funds was the loan activity itself, where it generated cash income. Finally, a very small number of households under stress (two in our interview sample) did sell grain or animals to repay, but only under severe duress, preferring to ask for a grace period.

Some borrowers claimed to have paid funds to CEIs without getting a receipt. Clients in all but one of the villages we visited did not have any passbooks; ABC informed us that they are starting to distribute passbooks now. Without passbooks, CEIs are the only ones with records on the loans, records they can lose, change, or make errors in without checking or correction. Clients also cannot keep close track of their loan activity and timing.

Early repayment has been a significant positive characteristic of this program. Villagers take the debts very seriously, and are quite conscious of the interest being paid, especially when compared to other debts to friends, local shops, or the Poverty Alleviation Scheme, on which interest is rarely paid. Accordingly, when cash is earned, the microcredit loans are paid early. The presence of the CEI in the village helps ensure this, as households are frequently reminded when interest or principal is due. Finally, the CEI and the borrower agree on a loan period longer than they actually think it will take the household to repay—just in case there is a problem which delays payment, or an investment that can pay

22 Term loans have no principle repayment (only monthly interest) until the end of the loan term, installment loans have set minimum monthly principle repayment requirements (and monthly interest), combination loans start as term loans and finish as installment loans.

a quick return before funds are due. All of these reflect a serious commitment to repayment and a clear understanding by borrowers of the relationship between loan interest and repayment timing, which is unusual and highly encouraging in such a new program.

An MCO officer informed the Team that there are about Y500,000 in delinquent loans, or about 6% of the outstanding portfolio[23]. Delinquencies in the field stemmed from two sources–the 1999 area crop failure, and sheer inability of the household to cope with the loan repayment due to lack of sufficient cash income generation. The latter case shows that CEIs still have difficulty determining who can and cannot repay without household financial stress, or figuring out what the rules are for dealing with delinquency. In one case, the Team found that a CEI had arbitrarily decided to charge late fees to clients who paid late, without reference to the ABC. The impact of this situation is that MCO resources are heavily engaged in dealing with delinquency without clarity on policy and practice, and that some households may face economic stress and loss of quality of life if not handled carefully.

In villages with defaulting borrowers,[24] we found that defaulters could not name their other group members, or had not met with them since loan disbursement. Intentional defaulters demonstrated a lack of concern or commitment to their groups or the program. In one area, Xia Tai and surrounding villages, delinquency[25] is understandably due to the fact that borrowers are 800 kilometres away, having been resettled in another area of the province. What is interesting is that they find ways of getting the money back to Xia Tai to repay, including coming back to the villages themselves, so they do not ultimately lose this valuable loan window.

Since handover in April 1998, all BOM reports have advised that there is no loan delinquency within the program. However, it has been recognised for some time by BOM members that the early repayments of some loans and the nature of the data aggregation process have disguised the delinquency level. The ABC has commenced a more thorough process of joint monthly reviews of CEI individual loan records with the BOABCs and the PMU to resolve this problem, and to determine real levels of delinquency and deal with such loans appropriately.

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23 Since arrears data is not available for earlier periods, and specific loan information was not provided to the Team, we cannot comment on trends or portfolio quality.

24 Delinquencies are defined as loans less than one year in arrears, where defaulters have not repaid for at least one year. The ABC, and Chinese generally, use the latter term, "defaulter" for anyone whose loan is more than one month overdue.

25 The delinquency rate is unknown; the CEI was unavailable in the village, and per-village data on delinquency was not made available to the team.

Given that the ABC supported all requests to visit areas with delinquencies, and our Team selected area interviews found high rates of on-time repayment, the delinquency estimate provided by the MCO officer can be assumed to be reasonably accurate. The list of delinquent loans has been generated manually during monthly reviews of CEI books at the BOABCs, but the Team did not see it. Unfortunately, the lack of updating of the MIS means that the projections from it understate principal due, and overstate interest due, so manual work has to be done to supplement the computer projections.

Field investigations of delinquencies found loans that were provided in late 1997 for repayment at the end of the 1998 season, which have not yet been repaid. They comprise a combination of circumstances where there was true hardship in households, particularly due to a drought/flood combination during the 1999 agricultural season, and situations where clients were unable to absorb a loan of this nature responsibly, due to extreme household poverty and relative restrictions from earning cash income[26]. Interestingly, in no case did the Team find a circumstance of intentional non-repayment paired with real capacity to repay. Cultural norms, which encourage repayment as a social responsibility, coupled with the importance of protecting this relatively simple lending source and the proximity of oversight, seem to make it highly ranked in the pantheon of rural household financial obligations.

The MCO and its partner BOABCs are discussing repayment options with clients whose loans are delinquent, most of which mean a de-facto loan extension and interest repayment through the harvest in 2000. In one area (certain villages in Chengtai township), the MCO has halted all new lending due to the defaults, but did not reveal the level of defaults to the Team. It appears that no pressure is being brought for group members to repay the loans of their groups' defaulters. CEIs appear to be relatively unconcerned about defaulters, feeling that "they are poor, let them wait until next year when they can pay" The impact of this attitude will be program collapse over time, if the repayments are not collected and other borrowers perceive that repayment is not that important—as with the government's Poverty Alleviation loans. Collecting defaulter loans requires better preparation and lending processes by CEIs so those who cannot repay do not take loans. It is important at the point of default that the ABC act much more quickly, and pressure CEIs and group members of defaulters to help pay.

In the *record-keeping* process, CEIs keep both individual loan records and a separate book of payments and loan disbursements, both designed by the ABC/MCO. This book is checked every month at the BOABC, when all the CEIs

26 Examples and descriptions of at-risk households are included in the section on borrower access.

assigned to that area meet. BOABCs consolidate the information, with some keeping individual borrower records and some BOABCs simply writing down the net disbursements and payments for the entire village. Copies of individual assets information, loan documentation, and a BOABC payments sheet are sent to the MCO each month from the BOABC. The Team was unable to see any individual records, but did see the summary payments sheet. The BOABC records of loan disbursements and payments can be said to be reasonably accurate, since they balance them to actual cash paid and received and cross-check them with the CEI individual/group records.

While it is a good first start, this system has a significant weakness. The original passbook system has been dropped in many cases. This used to serve both as a transaction and balance record and receipt. Thus, borrowers do not have regular records in their own control. The BOABC also does not keep individual loan records, but relies on the CEI records and completes only summaries of payments in and out of the villages (which are accurate since they are based on cash payments receipted by BOABC cash handlers). The CEI is thus the only person who has any records of the loan disbursements and receipts, violating basic accounting principles for cross-checks and separation of record-keeping from cash processing. Because the MCO and BOABC do not keep accurate individual records, they cannot accurately project repayment and interest payment amounts, nor can they assess the probable loan demand in any given area.

The MIS for use in the microcredit component was designed and introduced by the Australian Project Manager in 1996. It was designed in Microsoft Access, with both Chinese and English screens, and with pre-set mechanisms for reports generation. Information sets on CEIs, on clients (as a baseline), and on client loans and repayments were included as three sets of data with which to work. The CEIs filled out an assets and information profile when they start working on the project. The clients filled out a detailed form showing their household composition, assets and debts, and all sources of cash and non-cash income when they take their first loan. In addition, borrowers filled out a loan application form with loan amount, purpose, and repayment schedule for each loan. These were kept with the CEI, with copies sent to the MCO for entry into the database.

Considerable training was delivered to assist the ABC in managing the records of loan disbursement and repayment. Reports which can be generated from the MIS, when it has accurate information, include CEI gender and ethnicity; number of loans given in any month, with locations; loan types breakdowns; repayment schedules and projections of principal and interest due, by area and month; delinquencies by borrower; borrower ethnicity and gender; relative assets levels of borrowers, by area; and growth patterns. The MIS can be maintained at reasonable cost, and if properly updated can be an excellent management tool.

In March 1998, the MIS Final Report showed that as of the end of December 1997, almost 8,700 loans had been disbursed, for a cumulative amount of Y4,079,000. These numbers are close to the MIS database information for that date. This shows that entries of client loan information were being made during the period when the Australian technical team was responsible for the database. The reports do not reveal if client baseline data was being entered, and the Team was unable to check to see if the entries were accurate against submissions made by the CEIs to the MCO.

Since the handover of the MIS to the ABC/MCO in April 1998, it appears that data entry has been very spasmodic. The ABC and PMU have not ensured that the data was entered, or checked the data entry operators' work against the BOABC data and the original forms for accuracy. Reports generated by the MIS have not been checked against other data being supplied manually. ABC/MCO staff do not perceive that the MIS can be an effective management tool, even if it is kept updated, since they do not know how to use the information which the MIS can provide. Instead, the MCO staff have been developing a series of manual mechanisms to provide information on numbers of loans, delinquency, and other matters. While these manual systems are useful and important, the sheer volume of activity has overwhelmed the process and made it much more difficult for the small but competent ABC staff to access necessary information. The ABC data, while accurate at the BOABC level, is not kept at the individual client basis requisite for proper repayment and income projections. Proper input and checking could make the existing MIS very useful, and enable a conversion to a more effective system much simpler.

The MIS database as copied by the AusAID Audit Team in September 1999, with data entered up to August 1999, reflected the following data.

Borrowers registered:	15,188
No of loans disbursed:	26,194
Cumulative total disbursed (Yuan):	17,929,805

In reviewing the database, the Team found 400 loans of Y2,000 and above (up to Y30,000) assigned to individuals. The Team conducted random field checks and found that these individuals took no loans at the time stated. The problem seems to have been a temporary data input person working on data from September to December 1998, who entered data irresponsibly and was not supervised or checked. Subtracting the 400 wrongly entered loans of Y2,000 and above:

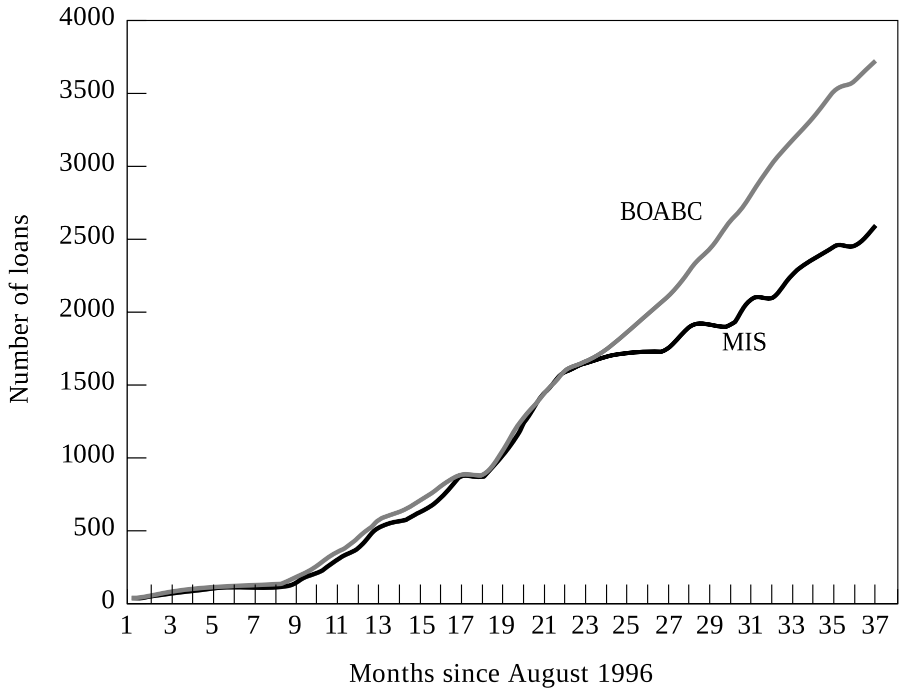
No of loans disbursed:	25,794
Cumulative total disbursed (Yuan):	14,138,655

The ABC relies on a manual system of managing paper records via activities in each of the BOABCs, and insists its system is accurate. According to their system, as of 30 June 1999, as quoted in the PMU Quarterly Reports of 15 July 1999:

No of loans disbursed:	35,436
Cumulative total disbursed (Yuan):	20,585,750

An analysis of the above shows that as of July 1999, 9,642 individual loans totalling Y6,447,095 have not been entered in the MIS database. This is shown in Figure 5.

Figure 5: BOABC and MIS Database Comparison



The error of 400 mis-listed loans has persisted for over nine months, unnoticed by the regular data entry operator, his superiors, or the PMU. When the issue was first brought to the attention of the data entry operator as he scrolled down the monitor, his explanation was that the replacement operator had lumped group or village totals together. MCO staff were then taken to the field to Ying Po Village, Dan Ma, where members were listed as taking Y10,000 loans. On physical checking, the individuals said they had not taken a loan anywhere near the time recorded (they had only taken one loan in 1996). Evidence from other field checks showed that there were no loans issued in this entry period for over Y1,400 recorded in the MIS.

It seems clear that insufficient care is taken of the database loan records or members list. The subject of the incompleteness of the MIS was raised with ABC staff, as evidence appeared that records did not match interview information. MCO professionals were dismissive of the MIS as a management tool, despite its clear and effective use before turnover to the ABC. The problem of neglect of the MIS data entry is threefold. First, by not entering data, the loan portfolio projections become very inaccurate, and the MCO can neither report effectively on the portfolio nor on aspects of its performance such as delinquency and cash flow projections. Without this information, program growth and financial planning become difficult or impossible. Secondly, by neglecting to see that the BOABC data doesn't match, the concerned officers demonstrate their lack of understanding of the figures, and of the value of the MIS as a predictive and management tool. Given the requirement that programs above a certain size be computerised in order to provide timely information, if ABC ignores their current MIS, they may do the same to a new MIS, to their ultimate detriment. Thirdly, if the data on clients is unavailable or inaccurate, it is impossible to determine if the program is reaching the poorest in a given village, and to measure impact of the program on the poverty level of borrowers.

Ironically, while the MCO is working on developing a manual system, the overall ABC is in the middle of a computerisation exercise. The BOABC staff were found to be conversant with the PCs in their offices, and able and willing to keep records on individual loans and repayments. BOABC accountants mentioned their keen interest in supporting the MCO program to have accurate records. Branch managers are starting to use the computerised data to better understand portfolio performance.

The ABC has entered into serious discussions with donors regarding the financing of a new computerised MIS. It is quite likely that this is needed, since other programs may make the process of data entry and analysis easier. However, without a clear understanding of why a computerised MIS is important, and how it can be effectively used for management purposes, a new program is just as likely to be neglected as the current one. In light of this, it seems crucial that the ABC/MCO work on two areas. First, it seems important for all staff to understand why a computerised MIS will be more of a help than a burden, and how it can be used effectively. Second, it is critical to accurately input and check the data in the current system, and bring it up to date, so use and conversion are simple. Without these steps, any new MIS computerisation program will ultimately fail.

The ABC structured its Micro Credit Office in 1998 to take over the loan process, which was in operation within the project. Actively overseen by a senior manager from the prefectural ABC, the office consists of a Manager, an

Accountant, two field officers, a computer operator, and two drivers. The office manages the program, including all relationships with the CEIs and twelve participating BOABCs. They are also supposed to manage the database updating and input, as well as accounts for their activities. At the time the Team visited, they were focused on collection of delinquencies. The Team only met the Accountant and computer data input person, who also worked in the field with us. The MCO Manager was ill, and the two other officers were reported to be in the field working to collect delinquent loans. The size of the unit was small for a lending program of this size, but CEIs and the BOABC officers are doing much of the work. The supervision in the field has improved with the recent introduction of MCO and PMU attendance at monthly meetings of CEIs at their BOABC with records and loan applications.

The BOM has been meeting every six months to review project performance. It consists of representatives from AusAID, the ABC, DOFTEC, MOFTEC, and the Haidong Prefecture, with the PMU acting as Secretariat and translators. Regrettably, though the Board has been careful and conscientious, the lack of sufficient microfinance skills has meant that a number of issues, such as the delinquency level, MIS discrepancies, and cost factors have not been identified and rectified to date. Thus the ABC has had insufficient guidance to correct program difficulties, and funds were disbursed which might have been held back for leverage to fix these issues.

3.3.3 Impact On Intended Beneficiaries

The project outputs listed above imply five important areas where participants were expected to benefit and these were reviewed by the team:

1. Increased group participation;
2. Better microfinance services access;
3. Broadened income generating activities;
4. More collateral for the program; and
5. Then more collateral for formal financial sector borrowing, whether in cash savings or other assets.

The Team found very interesting results in the area of group participation, some of which have been confirmed in the Grameen replications implemented by CASS.[27] First, although in general groups were self-formed according to the rules, in a few areas the group assignments had been arbitrarily made by the CEI. Members in

27 Confirmed in discussions with Dr. Du of CASS on December 3, 1999.

these areas did not know their groups or group members, nor why being in a group might have been important. Higher loan delinquency was found in areas where groups were not client-formed. Since responsibility to one's group is a key factor to on-time repayment internationally, repayment may well be affected by the mechanisms by which QCDP groups have been formed.

Second, clients and CEIs of many groups interviewed stated that they neither meet nor reinforce payment processes as a group. Accordingly, the CEI travels door-to-door for repayments. Members complain that they do not have time to spend in meetings, since such meetings do not generate significant and immediate economic benefits. Interestingly, the lack of meetings does not seem to have the same impact on repayment as group selection mechanisms. This may be due to the fact that villagers mentioned that they see their credit group members in the village on a regular basis while doing their regular work. Accordingly, they may discuss microcredit issues in a non-meeting setting. It may mean that formal meetings are less important for repayment than ensuring some form of regular group communication is occurring.

Third, in five of the villages visited, particularly minority nationality villages, there is a strong willingness to support other group members, helping them repay interest or even principal if they cannot. In three areas, clients did business with members of their groups, and commonly helped each other out for interest payments and (occasionally) principal repayments. These cases occurred in the oldest program areas, and where a substantial number of women were members who managed their own loans. The reasons for better support between members in these villages may be to ethnic values or work systems, to family relationships, or to the specific operation of the program in that location. It may also be due to the relatively more difficult living circumstances found in these villages compared to those in lower elevations or closer to main cities and towns. Some combination of these factors may also be at work. The implications are that work with women, and in minority nationality areas, may provide more cohesiveness and mutual support to the poor.

Fourth, except for those villages listed in the paragraph above, there is widespread ignorance of the group obligation to cover for defaulters. Most members know only that if someone defaults, the rest of the group cannot receive a new loan until that person repays, as stated in the handover agreement in 1998. Clients were unaware of their option to repay on behalf of a defaulting group member in order to regain their loan access. The ABC has not enforced group obligations to repay either, focusing on cutting off new lending as motivation. The implication of this is that clients may not select other group members with similar income levels, so they can exercise this option. Additionally, some needy and viable clients may be cut off from borrowing because they are unaware that they can regain access to the program. This can be done by paying off the group defaulter's loan, collecting from her/him later.

Finally, there is total confusion about the relationships between a group's full repayment of existing loans and eligibility and timing of a subsequent loan. According to the initial intention of the program as discussed in the MCS documents, clients would borrow according to their own needs. They would repay on the basis of their income streams, and then re-borrow after full repayment, if no group members were delinquent in their ongoing loans. Groups were expected to borrow in successive rounds, but it was anticipated that the different needs might result in different loan levels within groups.

The circumstances that emerged in the lending program were different from the intentions of the MCS (which were to maximise individual client flexibility while maintaining group security). The rules stated in the handover agreement require clients to wait six months after repayment before borrowing again, and not to take more than two loans in any twelve-month period. In addition, the Team found three CEIs who lend to a group only when the last member has repaid the initial round of loans. This disregards loan timing and requirements for different members, making some clients wait for a new loan for many months and creating hardships for those who repay early or take short period loans. Furthermore, the handover agreement is disruptive, since a loan structure based on seasonal activities may require nine months of loan operations and repayment followed by a three-month gap. The agreement will not support this loan pattern, which the Team found was common in the villages interviewed. Fortunately, 12 of the CEIs interviewed are not abiding by the 6-month rule.

Group cohesion seems to be a problem area not only for this project, but also for other microfinance projects in China. In discussions with Professor Du of CASS, he advised that his work with Grameen replications has revealed a marked resistance to regular meeting attendance and group activity. Clients feel that it is a waste of valuable and limited time, with little to be gained from spending more time together.[28] With the dual pressures of limited additional help from children (few in number, and in school) and husbands (out to work in other areas to earn vital cash income), women in particular have exceptional demands on their labour time. While there are limited numbers of groups that are cohesive and work well together, and there is a problem with the establishment and recognition of joint responsibility, this does not seem to be having a serious negative impact upon loan repayment.

28 This finding is supported by evidence gained in the field investigations of the Team.

The number of loans being taken and the amount of cash savings being mobilised best measures increased financial service access for poor people. It is significant that clients were able to self-determine appropriate use of loans (generally for traditional activities) and to successfully repay these loans from a variety of income sources. The decision to allow clients to decide loan usage, when oriented towards cash income generation or supported within a household with sufficient and varied sources of regular cash income, has been shown in microfinance programs elsewhere to result in improved loan repayment rates. Both repayment rates and client demand for services from QCDP are high, consistent with experiences elsewhere. Borrowers did take significant risks, and a few did lose money rather than making profits. This was most often due to unanticipated price changes that affected farmer gross profits. Other clients' incomes did not meet expectations, due to increases in overall production of loan-funded goods in the area. However, microfinance best practice shows that restricting clients to externally-determined "financially viable activities", or assuming that business training will prevent losses, costs more and produces poorer results than those experienced in this project.

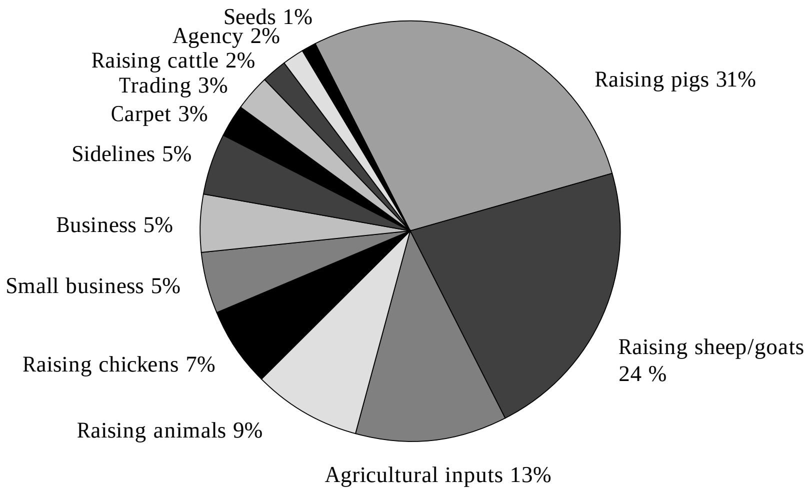
Every loan application must state a purpose for the loan. In the PCR the 14,460 loans disbursed to that date were categorised logically into just 5 groups: animal husbandry, cropping, trading, enterprise and other. By September 1999, without further training or supervision, CEIs were entering over 100 different purposes. An aggregation of these loan purposes is shown in Figure 6. Because there are many instances of groups of applicants listing a purpose—eg "business", the Team believes that the stated purposes on the loan applications may actually have understated the variety of activities actually financed by loans.

The Team conducted spot checks in interviews against stated purposes and found they may have been vague, but not actually wrong. In doing business in China, there is a strong tendency to secrecy, usually for reasons of market advantage.[29] In most situations, people will respond to inquiries about what they are doing in terms that are as vague as possible, to protect any informational benefits they have. This is especially true in environments where the perceived or actual options for cash income are limited, such as in the mountainous areas of Qinghai.

The Team found some significant differences between the loan utilisation information provided at project completion, the MIS database, and the field

29 In most other countries, profit levels and sales prices or markets may be concealed, but members of a microfinance group and microfinance staff will know what specific activities borrowers were funding with the loan proceeds. This seems not to be the case with the Team's interviewees, many of whom were hesitant even to disclose what they were doing in terms of any entrepreneurial activity.

Figure 6: Stated Purpose of Loan



situation in November 1999. The lack of CEI and borrower attention to identifying the specific use of the loan was the first discrepancy noted. Many put “business” or “crops” in the purpose segment of their loan application, while the real use of the loan was for other purposes such as travel costs to work in city areas, medicine, or for purchase of animal feed. Additionally, many borrowers used the funds for two or more purposes. Thus the database and written information on loan purposes is much less reliable as a reflection of the real loan utilisation. Accurate data on loan use enables the PMU and other evaluators to determine what types of loans are most — and least — beneficial to borrowers in terms of additional income and risk. However, it is only an operational problem if it indicates that the CEIs are paying less attention to the potential of the loan-funded activity or other household activities to generate cash income than to the continued provision of loans themselves. This can easily lead to higher defaults, as loans are taken for consumption purposes and other cash income cannot cover loan repayments.

The second finding in the field, and the most important in terms of the poverty alleviation objective, was that some households on the bottom end of the income scale are taking loans and then are having difficulties repaying them. Based on interview results, the Team estimates that about 14% of households are borrowing for activities, which do not generate extra cash income to pay for the loan, such as medical expenses, wedding costs, or fertiliser for consumption crops. In the absence of other reliable sources of cash income, the Team observed that these households then find themselves under stress to find cash to pay back loans, and are forced to borrow from others in the village or sell an asset to repay the loan.[30] This group often includes households with a chronic labour shortage: widowers/widows and elderly persons without grown children, young married couples without children old enough to help out, or those who are ill. The impact on poor households is highly negative, creating burdens in terms of additional debt or lost assets, which adds strain to already difficult circumstances. Therefore, consumption loan provision to these disadvantaged households without relatively certain alternative cash income sources is irresponsible on the CEI's part.

The other issue the Team found which embodies a set of problems is the increasing use of loans for fertiliser, both for consumption crops (estimated now to be about 50% of the total microcredit program) and for cash crops (canola and garlic). To the degree to which borrowers use fertiliser to increase production of cash crops for sale, the loan can generate returns worth its value and provide an important input. However, the use of loans for fertiliser for food crops, which will be consumed and not sold, can in fact disadvantage households with limited income generation options. The intention of the loan program is to increase cash incomes to poor households, and unless other resources are freed for income generation or the fertiliser produces extra crops for sale, a fertiliser loan does not fulfil that purpose.

There are two unacceptable risk levels for the microcredit program in having a high degree of consumption fertiliser loans. The first is the level of variation of crop production, graphically demonstrated by cuts of up to two-thirds during this last drought/flood year. Such natural variation puts households with limited income sources at a dual disadvantage of owing a loan and needing to make up grain shortfalls to survive. Secondly, the high level of such lending is an exposure problem for the ABC. The portfolio risk of having fertiliser loans as such a large part of the lending profile is unacceptably high. If half the portfolio becomes delinquent, the program may collapse through lack of ability to deliver follow-on loans, causing existing borrowers not to repay since new loans are not assured.

The Team found that fertiliser borrowing was distinctly focused in two groups: the poorest borrowers, and the wealthiest ones. The former found the MCO to be the lender of last resort. Better-off villagers told us that since the loan was very convenient to procure, and did not require trips to the bank or guarantors/

30 We found that families would far prefer to borrow from others than sell an asset; the Team found only two cases of asset sale, with the rest borrowing from family and friends. This is a problem, since if an emergency then strikes the same family, they will find it very difficult to borrow money to deal with the situation.

collateral, it was far preferable to the Rural Credit Cooperative (RCC) or standard ABC fertiliser loans. To the degree to which such lending at the poorer end exposes vulnerable households to more risk, it must be avoided. CEIs can be cautioned on this, and the risks to households discussed in training of villagers as well as CEIs.

The blending of road access and microcredit services is a mixed blessing for those who take loans for purposes other than fertiliser for food crops. The Team found that borrowers raising animals (a very common activity) had a more ready market for those goods due to increased access by more persons via the road. However, prices over the last five years have dropped, particularly for animal products, due to increasing local production and better information on prices coming over the road link. Those borrowers involved in trading, if careful, could also make significant incomes, but mentioned the need for great care in considering costs when calculating sales prices, and considering the greater competition from incoming traders over the road link. Borrowers doing trade talked about the importance of barter trade, with over 60% of their payments received in grain and potatoes, necessary so they can compete with those coming in by road. Accordingly, such borrowers keep close track of sales prices of local grains and vegetables of different qualities, which vary more due to information flows and changes in demand outside the immediate area. The trader-borrowers must also cost products to take account of the required extension of up to eight months' credit without interest to their own buyers.

Those borrowers who had the most significant changes of fortune were those who either had or developed a semi-technical skill, and put it to use. The Team found butchers, tailors, small repairpersons, and cooks that had moved from risky subsistence to comfortable security within three to four years. These individuals developed their markets carefully, guarded trade secrets assiduously, and largely reinvested their income in their businesses and in income-generating assets. They checked prices constantly, kept as much as possible of their business outside the household expenditure loop, and marketed both within and outside of their own villages. Two example case studies of such persons are included as Attachment 2. It is conceivable that identification and development of key skills, once clients themselves identify these as commercially valuable, would be an important input to sustainable poverty reduction.

As of June 1999, the BOABC records show a total of 35,434 loans disbursed, while the project database shows 24,740. The Team knows that the latter is far understated due to data entry problems, and the former is derived from direct disbursements and so is likely to be more accurate. (see Record-Keeping subsection below for details). This level of loan disbursement exceeds the project objective by almost three times, and shows no chance of abating. The growth patterns are sustainable if properly managed and financed. At this point, lending is only constrained by the low level of available loan funds against the demand by actual and potential clients in the field. The project has been very successful in disbursing loans and attracting new clients with their consequent loan demand. The disbursement rates are consistent with young, dynamic programs elsewhere in Asia. Since the project was experimental, there was no way of knowing in advance that it would be so successful. What can be learned here is that having sources of additional funding identified may be very useful in facilitating further microfinance program growth.

The initial average projected loan size was Y1,575 in the PID, but by end of the project was Y496 according to the PCR. This is a substantial change, showing that poor clients could make effective use of much smaller loan amounts than were originally envisioned. The impact of the change in loan size is that borrowers are managing small amounts as they enter the program; with consequent lower risk should something go wrong.

The project established maximum loan sizes, which started at Y400 and then increased to Y600 and upward by increments of Y200. Clients became eligible for a larger loan after successful on-time repayment of the previous loan. Loan average sizes between May and October 1999 were between Y678 and Y745 per loan. This latter range is consistent with individual borrowers moving up the loan maximum scale, taking larger loans, as they prove reliable in repaying their earlier loans on time. The movement up the scale will stop shortly, since the ABC has established a loan ceiling of Y1000 per borrower.

Due to problems with funds availability, as the number of clients is much higher than the projected number the loan funds from AusAID can handle, the MCO has placed a ceiling of Y1,000 on borrowing. The Team found one village that had been granting loans of Y1,400 but in general this ceiling is being respected. The Team found that this ceiling is appropriate and consistent with lending to poor households. However, those who have become more successful, and the wealthier, are having problems with business expansion using loans at this limit. Insofar as the program is intending to graduate borrowers once they are stable above the poverty line, if they need larger loans to reach that point, the program will not graduate them. Interestingly, the loan ceiling has not yet impacted loan repayment, whereas in other locations worldwide if the follow-on loan is not larger than the existing loan, repayment rates decline since borrowers feel there is no additional benefit to be found in repayment.

Savings groups were not formed in time to save income from cash-for-work activities, and the Team found no evidence of any savings groups in existence. Accordingly, the Team found that the cash-for-work savings were not accumulated as expected. In field interviews, beneficiaries stated that CFW earnings were used for consumption purposes. Some households also used earnings for school fees. Where income was used for income generation or additional social investment such as in school costs, it was productive. However, comments from CFW staff indicated that the lack of a savings scheme made the CFW much less productive than it might have been. They argued that most of the funds were used for non-productive consumption activities[31]. Alternatively, if funds had been saved, households with crop failures might have been able to make up these shortfalls from savings. Additionally, creating a habit of cash savings would assist poor households to smooth their cash income streams. In this way they can cope as their environment becomes increasingly monetised and they need regular cash to pay for goods and services, which they previously received via allocation.

The MCS suggested, and the project adapted, a mechanism for loans that did not require savings as a condition of lending. Given the difficulty of mobilising regular cash, the lack of funds remaining from the CFW at that time, and the recent introduction of cash transactions in many of the project areas, this was a good idea. Savings interest rates of 2% per annum were provided for voluntary savings. The structure of compensation for CEIs did not include any incentives for savings mobilisation. As a result of this, and the low interest provided for savings (due to central interest rate controls), mobilisation has been minimal, with only Y1 per client by the PCR[32], and no savings since then. This is reflected in the BOM financial reports.

The Team did not have sufficient individual income and assets data to measure changes in poverty that could be assigned to the microcredit component. As the preferred proxy, the best way to determine if households are better off is whether they are accumulating either cash or non-cash savings as a buffer against risk. The Team observed increases in traditional savings mechanisms in over 86% of client households. These included additional animals, hard goods such as new stoves, and fertiliser in storage for next year, additional grain storage, and even tractors in a few wealthier households.

The implications of the savings situation are twofold. First, clients are saving in traditional ways, and their lifestyles are improving as such. Second, because they are not saving in cash due to problems in interest rates and physical access

31 Both CFW program-related staff and villagers advised us that men, who did a great deal of the labour and controlled the cash payments, treated the CFW funds as a windfall. Men spent a great deal of the proceeds on gambling and alcohol consumption. Women spent funds under their control largely on school fees, medicine, and foodstuffs.

32 Page 39 Section 3.2.2 para 4.

to funds, they are becoming more vulnerable to emergency circumstances requiring cash, particularly medical costs and crop failures. While all Chinese are more at-risk due to the monetisation of the economy, clients could have been better assisted to establish savings patterns to smooth cash income and create a buffer against disaster. This could be done by trials of higher interest rates on savings, along with village-based savings funds in smaller amounts, and closer examination of how and when villagers need savings, so their needs can be met in this manner.

3.4 Sustainability

There are three key questions regarding sustainability as summarised below:

1. Can income derived from loans cover the total costs of running the operation, including loan losses, the cost of funds to be lent, and inflationary erosion of the loan portfolio?

2. Can additional loan funds be generated to meet growing demand?

3. Is the organisational structure such that the project objectives will continue to be sustained, given that ongoing service to the poor requires long-term sustainability?

Long-term self-sustainability is critical to microfinance programs, so they can continue to operate and expand after donor involvement is completed. The Team looked at financial data and considered this issue during the review. The MCO accountant provided data for a draft income statement on 1 December 1999. The data is based on work the MCO has been doing to allocate costs and determine its income levels. The six-month period was calculated first, since these are actual expenses incurred. For the six-month period, the losses were approximately three times total income. However, expense levels in some categories exceeded a six-month period. For the one-year projection, income is expected to exceed expenses.

Attachment 4 shows projections of costs and income by the MCO, completed after work with the Auditor and training with World Bank consultants. However, these cost estimates have some flaws. The projections do not include imputed office rental costs. Depreciation and the default reserve are understated. The office running costs and MCO staff salaries and expenses may be understated, similarly the budget allocation for entertainment/board meetings. If training provision is increased to meet the actual program requirements over the long run, then training costs may be double the budgeted amount. In addition, the two vehicles, which are worth a substantial amount of money, were ABC donations and will need to be replaced. The interest income may also be over-estimated, although without much better information on loan structures the Team was unable to assess the full veracity of this number. Finally, assuming the 6% delinquency rate stated by the MCO is approximately correct, write-downs may be in excess of the 1% that has been budgeted. The budget provided to the Team, Attachment 4, shows that additional funding is needed if the program is to be fully financially sustainable over time.

The interest rate charged on loans has been a difficult issue to resolve, because there is a variance between the need for cost coverage, and an entrenched view within the ABC that the poor are only able to borrow cheaply (this view has been widely discredited internationally). The initial interest rate in the PID was 9% per annum. The final interest rate agreed by the ABC and PMO of 12% p.a., was the highest that the program could legally charge. The MCS suggested that larger loans could be structured to attract a higher interest rate. However this mechanism to reinforce self-targeting was never put into place, as the ABC felt that it was too complicated to manage. After extensive training by the MCS on the rationale for interest rates and the mechanisms for determining them, the ABC is now realising that the current interest rate may be too low for full sustainability, if the necessary increases in training and full cost accountability are taken into consideration. ABC management stated to the Team that an annual interest rate of 14–15% per annum would cover all costs[33]. However, increasing interest rates is viewed as politically impossible at this time, although expansion into new areas might be possible at a higher interest rate. The implications of this are that, unless there is an explicit ABC commitment to carefully review and minimise expenses, and/or to increase the interest rate/fees to cover the estimated costs, the program's loan fund will erode.

An interesting aspect of the financial arrangements is that the MCO has negotiated to pay some (but not all) BOABCs 30% of the interest collected on microcredit loans. The BOABCs collect payments of principal and interest from the CEIs. From the interest collected, 10% of the total interest paid is recorded in the ABC accounts as specific BOABC income, and 20% as county BOABC income, with the remaining 70% as MCO income. (With their funds the MCO pays the CEIs their commissions and covers their transport costs, as well as paying for MCO operations.) This arrangement provides positive incentives to the local BOABCs to give support and services to the CEIs, and for the BOABCs to submit program paperwork and records to the MCO on a timely basis. The amount given to the county BOABCs may not be commensurate with the contribution they make to this process, and might be worthy of reconsideration.

33 This was also the rate calculated and provided by Dr. Du in the Team interview with him.

The second question involves limitations to program expansion. Currently, the full amount of the Australian funding has been disbursed to the ABC. The MCO needs to manage the loanable funds shared between BOABCs more effectively, but still has disbursed almost all of the funds (the Team found they had just received the last tranche on our arrival). According to projections, they cannot expand further to new clients or new areas without additional funds. The Team suggested that they consider using some of the allocated Poverty Alleviation Funds from the Chinese government for this purpose. This is under consideration, however, such funds are usually required to be on-lent at very low interest rates. Funding applications have also been submitted to other donors. Consideration must be made to the use of commercial sources to expand the available loan fund. ABC officers informed us that they felt it would be possible to attract commercial funds to use on this program, but until interest rates can be increased, they needed to blend commercial and non-commercial (donor) funds to be sustainable. If additional funds are not available for on-lending, the program will either remain static or shrink as program costs exceed income and cut into the loanable funds.

ABC managers are also looking at other options. The MCO is considering cutting the maximum loan size down to Y900 from Y1000. This will not serve the program objective of reaching the maximum number of poor with a loan service which meets their investment needs, and may not enable organisational financial self-sufficiency under current conditions. Given experiences in other countries showing that loan limits ultimately result in higher delinquency because there is no real benefit to repaying, applying an increasingly stringent loan ceiling may be counter-productive. The result could well be a program that cannot grow, and cannot serve new clients easily, while older clients do not see the reward of a higher loan amount from on-time repayment, and simply stop paying back. Accordingly, additional loan funds are required in this portfolio, or ABC must structure a new program of larger loans that MCO borrowers can “graduate” into.

The third question on ABC organisational structure and sustainability is perhaps the most complex. The ABC is to be highly commended for taking on the risks it has assumed in running the microcredit program. The concerned officers are committed, hard working, and very well known in the villages. The number of staff working in the MCO is appropriate, given that the CEIs are the “field officers” with a ratio of about 125/1, and BOABC services are provided at the ratio of about 1 per 6–10 CEIs.[34] The Haidong prefecture ABC management has kept a close eye on this experiment, and committed its own resources to filling

34 Worldwide for this type of group model field staff ratios run between 100–200 clients per field officer. Supervision ratios run 1 per 8–12 subordinates. Data per Team experience in 15 countries.

financing gaps. There is an interest in program replication in other areas where the ABC works, and management willingness to use their own Poverty Alleviation Funds to source lending. In the MCO, the on-time repayment rates are high at 96%, there is commitment to disbursements to all village members, and there is a real sense of the importance of lending conveniently to the village.

There are two main obstacles to the ability of the ABC to maintain this program indefinitely. They are the lack of an appropriate set of financial plans and records, and the lack of an integrated understanding of the roles and relative payments of the different parts of the ABC. If the MCO is to survive and thrive, it must operate as a net contributor to the ABC as a whole, rather than a net consumer of organisational resources. The MCO should be set up as a cost centre, with very clear income projections and actual income information, cost projections and expenditure tracking, and cost allocations to different offices based on the actual contribution to program operations. Since the MIS is a part of financial records, an accurate MIS can provide the loan disbursement and repayment information vital for any micro-loan program. The CEI individual borrower records must be reinforced with borrower passbooks and individual client records at either the BOABC or the MCO level. If projections and records are properly kept and used in a timely manner to manage the MCO, costs can be managed and realistic interest rates derived and charged based on this management process.

A clear understanding of the roles and payments of different parts of the program begins with the CEIs, runs through the BOABCs and the MCO to the ABC as the larger entity. The CEIs need to be identified more closely by the MCO as their agents. The CEIs need to understand their roles and responsibilities more clearly, and be regularly trained to reinforce their work. The CEI payment system in particular needs review, to ensure that the dual roles of loan disbursement and poverty alleviation are being met in the most efficient way given the limits of loanable funds. Agreements should be made between the MCO and BOABCs on the precise role of BOABC staff. County BOABC payments must be lower, consistent with their lesser contribution if they do not pay out loans or collect them in villages, and do not make officers readily available for CEI services more than once a month. The role of the MCO as a collector of last resort, provider of records and performance assessment, trainer for CEIs and BOABC officers, and policy guide must be explicit, and its work and budget should be set up to fulfil these roles. If roles and compensation within the ABC are not clarified, the vagueness of the existing program will inevitably lead to performance problems and program collapse.

The PMU is viewed as a donor-designated group to keep an eye on the ABC activities. The PMU was formed in April 1998 to monitor the ABC's performance and compliance with the project objectives. It consists of a woman Manager who has been seconded from DOFTEC and was only involved in the end of the implementation period, two women who were interpreters during the project implementation period, a woman accountant whom the Team did not meet, and two drivers.[35] The PMU is partly funded by the ABC under the handover agreement, which provides an annual contribution of 1% of the value of the overall portfolio of Y12 million, or Y120,000. The prefectural offices fund the six staff.

Each month the MCO provides them with an updated version of the MIS database, which they maintain as backup. The Team observed the PMU in action, and they are dedicated and very bright workers, who are learning fast and understand a good deal about the program and field issues. They have successfully brokered improved relationships between the CEIs and the BOABCs. There are good personal relationships between the PMU staff and the ABC, and of late there has been a greater collaboration at field level, particularly in monthly meetings of the BOABCs, a positive development. The PMU staff work hard to understand the MIS better, and to facilitate relations between the MCO, BOABCs, CEIs, and borrowers. The PMU has also operated effectively as the Secretariat for the BOM.

Unfortunately, at project completion in 1998 the full role of the PMU was not sufficiently clearly stated in the handover agreement, and insufficient power was provided to the PMU to act in case it viewed the ABC/MCO as deficient. In order to be able to check the ABC micro-loan portfolio performance and to review MIS accuracy, the PMU staff needs more accounts training. In order to work on poverty alleviation, the PMU needs to work closely with the provincial PADO. In both cases, the skills required to perform these tasks have exceeded those of the transferred staff. Lack of sufficient PMU operating funds is also an issue, along with timing and calculation of payment from the ABC/MCO. The costs of program supervision are substantial, and the PMU operations are dependent on funds flows from the very organisation that they are mandated to supervise. The result is an artificial agency without power or sufficient human or financial resources.

The PMU provides a useful networking role due to the strength of its staffs' professional skills, and arranges Board of Management meetings/paperwork, but cannot effectively supervise the MCO or analyse the effect of the program on

35 Generally it would have been best to either staff the PMU with persons trained in microfinance, or to provide such training to staff who were retained after project completion. It may be that the PMU was a late decision, so extensive training was not possible for the Australian team to provide to those staffing the PMU. The particular circumstances showing when the decision was made to staff and fund the PMU, and how staff decisions were made, was unavailable to the Evaluation Team.

poverty alleviation in the area. To resolve this, it needs a much clearer mandate and mechanisms to enforce MCO performance, better funding from external or government sources, and staff trained in skills needed to handle poverty evaluations and MCO performance.

3.5 Conclusions

The conclusions of the Evaluation Team are as follows:

1. The microfinance program has been very successful in serving the target group, meeting the demand for microfinance services by the poor at levels far exceeding anticipated levels. The number of clients, average loan sizes, and repayment rates are consistent with solid microfinance programs elsewhere in the world. The growth rate of the Qinghai microfinance program is the highest in China.

2. Flexibility in setting up and implementing the program was a critical factor in its success. Of particular importance was the time and effort spent convincing ABC staff of the rationale behind microfinance best practice. This resulted in a significant effort by the ABC to make microfinance work according to such principles.

3. The methodology was sound in design, but over time some flaws have emerged which need correction if the program is to be sustainable in the long term. These include the gender of CEIs, uniformity and public knowledge of program rules and regulations, balance between costs and interest income, mechanisms for pre-payments and repayments, and group operations. With a management commitment from the ABC, all of these issues can be resolved.

4. The client group is similar in ethnic diversity to the population in the area, showing that the project was successful in targeting ethnic groups without focusing on them to the detriment of the Han who were poor. The project was less successful in meeting the target of 60% women clients, due partly to gender bias in the ABC and other relevant agencies, and partly due to social conditions in the villages. Lack of sufficient women CEIs was also a significant factor preventing larger numbers of women from becoming active borrowers. Some better-off villagers also borrowed, in order to join in or use this new mechanism to avoid providing security or going to the township to borrow. They did not prevent the poor in their villages from borrowing, but their use of funds meant that other unserviced villages could not receive funds.

5. The support of poor clients to create cash savings accounts was unsuccessful. The reasons for this included lack of a mechanism to provide ready access to funds in the village, lack of CEI incentives to generate such savings, and low legal interest rates. The relatively high returns to animal husbandry and the immediate saleability of small animals makes them a more viable “store of value” for savings, despite the attendant risks.

6. The microfinance program is not sustainable in the long term. Financial sustainability cannot occur without an increase in client-based fees. The establishment of the interest rate was insufficiently well-linked to cost projections, likely because at microfinance program inception the full handover to the ABC was not envisioned (nor was there any way it could have been.) Increasing the interest rate will be critical to long-term sustainability, but is likely to be problematic for national policy reasons and because the ABC managers feel uncomfortable doing so.

7. Evidence suggests that the clients who took microloans have benefited from this service. However, no ongoing monitoring work has been undertaken in this regard.

3.6 Lessons Learned

Key lessons learned are summarised below:

1. When establishing a microfinance program, carefully consider the probable costs of service delivery and of loan default, inflation, and the cost of loanable funds. These costs should be compiled and then compared to the income likely to be generated from interest payments. If there are any interest rate caps limiting the income to levels below costs and, therefore, the program cannot achieve sustainability within five years, this issue of non-sustainability should be discussed with officials and policy makers by senior AusAID post official in an attempt to achieve a financially sustainable program.

2. Use standard microfinance progress indicators in the log frame of every program containing a microcredit/microfinance component, and monitor them monthly from startup of microfinance activities. The most common indicators include: number of active clients borrowing, number of active clients saving, total outstanding loans, total outstanding savings, average loan size, average loan size as a percentage of per-capita income, interest rate shown as an annual percentage rate at declining balance method, percentage of loans overdue for 30, 60, 90, 120 days as a portion of the total amounts due, percentage of the total portfolio tied up in loans

overdue over 30 days, percentage of operating costs covered by loan interest income and loan-related fees, and percentage of total costs (as point 1 above) covered by interest income and loan-related fees. The Microfinance Network and some donors have developed standardised indicators that can be used as models.

3. Make all attempts to create a project which will, at project completion, leave behind an autonomous microfinance institution which is capable of reaching financial self-sufficiency without further assistance.[36] Where this is not possible, determine the mechanisms for monitoring progress towards this goal. AusAID should fully and separately finance this monitoring. Such mechanisms include supervision of program and financing progress by an external body such as the PMU, backed up by specific agreements on the supervising body's role, power to ensure the desired result or put sanctions in place, and a staff and resources which can fully perform these roles. The supervising body staff should have solid lending and savings experience and records, and understand and support both the "full financial self-sufficiency" goal and the "effective poor client service" goal. Ideally, such an agency should be able to be dissolved within three years maximum after a project is completed.

4. Ensure that the record keeping system and program operations ensure full transparency to the clients, and records for them to keep of their own financial activities. This involves a passbook and or receipt system, open access by clients to CEI or local loan officer records of their transactions, a simple but complete program rules book available to all clients and staff, and mechanisms for clients to confirm any changes in the rules without jeopardising service access, such as having the MCO or BOABC staff come and explain changes and amend their program rules books. Rules can also be recited at village meetings of borrowers, or be placed on blackboards in village CEI offices/homes or Village Council locations. Given the importance of public proclamations, it may be useful to consider the Grameen mechanism whereby the clients recite a list of promises regarding program rules, and the loan officer (CEI) responds with a list of promises regarding his/her client responsiveness and adherence to program rules about loan officers.

5. The question of institutional sustainability and structure is a critical one. AusAID was fortunate in having the ABC be cooperative and innovative

36 In China, this is likely to mean initial selection at project startup of one of the two state banks ABC and RCC, which are the only institutions legally allowed to provide such services in rural areas.

in Qinghai; worldwide, such experiments have far more often been failures than successes. Sometimes a non-government institutional structure is best, while at other times a cooperative or corporate structure is more appropriate. Ownership can be public, clients, or private. In determining whether a local institution should be formed by the project or an existing one should be found and used, the critical factors to be considered include the capacity of existing institutions to implement and sustain microfinance under conditions listed above; the reputation and relations of existing organisations with the target client group; the stability and legal/regulatory status of the existing institution; the financial status and stability of income of the existing institution; and their political autonomy. If a new institution is being considered, factors to consider include the legal and regulatory circumstances for a new institution; its ability to be politically, managerially, and financially autonomous at project completion; the cost of creating a new institution versus partnering with an existing institution; and the poor historic record of government institutions in maintaining such programs. In retrospect the microcredit program should have been operated out of the ABC from the very outset. This would have slowed implementation of the microcredit program as the ABC were initially very wary of the microfinance concept. However, it would have ensured the program grew at the same pace as the capacity of the ABC to implement it.

6. The importance of having an appropriate legal and regulatory structure for microfinance institutions cannot be understated. In China, key issues, which will limit microfinance growth, include the interest rate controls and limits of lending power to existing banks and the RCC. Advocacy to support changes in these areas must come from Chinese, supported as appropriate by AusAID and other donors.

7. Ensure that agreements about joint financing and timing of savings and loan group formation linked to cash-for-work for infrastructure are finalised well before action needs to be taken in the field, so the income earned from the CFW program can be physically saved by the workers.

8. Provide financial and training resources for the establishment and use of an appropriate MIS that can be locally managed and used. Ensure that the individual loan disbursement, condition, repayment, CEI, and client data is easily accessible, fully accurate, and up-to-date, and able to be aggregated by village and BOABC area. Separate clearly the information required for ongoing microfinance operations, and data that the donor agency wishes for poverty alleviation and related analysis, into two sets of data. (They can be jointly managed and linked, but do not need to be

arranged this way.) Ensure everyone who is to work on the MIS or use information from the MIS is engaged in the design process in a consultative manner, and understands all the reports and what they mean, and why they are important for management purposes. Have local managers use the financial data for project management on a monthly basis with the implementation teams. Ensure that the local implementers are using and maintaining the MIS for their own purposes well before project completion.

9. While poverty alleviation is the ultimate goal of donor engagement in microfinance, the purpose of microfinance institutions (MFIs) is to provide savings and loan services to the poor, but not necessarily to monitor the ongoing effects of their program. If they are serving clients in ways the clients like, then the borrowers and savers will continue to use these services. Such organisations rightly view their income as limited, and their applied research equally narrowed to ensuring their client base gets the best possible services at the lowest possible price. AusAID desires a much greater depth of information regarding the precise impact of their microfinance investment on the client group's poverty. Accordingly, AusAID should pay for and contract the management of any database and/or processes meant to measure adherence of a microfinance project/program to target groups, also to measure the impact of microfinance efforts on poverty. AusAID should agree with the GOPRC on joint roles and investment shares in this regard.

10. The importance of having clients use loan access to improve their financial condition requires that they understand and use the funds accordingly. Establish all programs with client-selected lending purposes, after training loan officers to ensure that clients have sufficient numbers of reliable sources of cash income for loan repayment regardless of loan funds use. Train actual and potential borrowers, and loan officers, that the loan program is set up for income generation, with retention of profits for further investment, and they should use the funds for this purpose wherever possible. Monitor the program in the early stages to ensure that clients are not using funds for subsistence production when they do not have sources of cash income to repay the loan without making the households worse off. Train both clients and MC staff (reinforcing periodically) in understanding why and how loans should be taken for activities that generate income, which can pay for the loan, especially in situations where other income sources are lumpy and relatively unreliable.

11. The Qinghai project provided a good number of experiments regarding loan size and loan structure. Evidence suggests that the term loan structure is

simplest, and less risky in China than in other locations due to the strong social reinforcement of loan repayment. The other types should be introduced to a more mature program, not started at the beginning of a program. The stepwise increases of loan size are useful, and CEIs and borrowers are very good at self-monitoring the most appropriate loan size. Where the overall loan fund allows it, stepwise increases of Y300 seem appropriate. Every two years the smallest loan should be re-evaluated and potentially increased to account for inflation. Repeat loans should be able to be accessed within 30 days of on-time repayment of the previous loan.

12. Ensure that the lending purposes will discourage non-target group persons from borrowing. Either cost them out, or set up participation/staff incentive structures to dissuade them, and stick to them. Such disincentives might include much higher interest rates for the non-poor, low loan sizes for them, or limited access to repeat loans, as well as outright barring of those who do not have official village recognition as a poor household.

13. If project areas can cause environmental or significant client/microfinance organisation risk by having one predominant loan type, clients must still select their own loan purposes. However, it is appropriate to carefully watch loan purposes, and do occasional loan utilisation checks to ensure integrity in the purpose reporting process. If loans become too concentrated in terms of one purpose, find out why, and assess the risk to the program carefully. Take remedial action if possible, which might include education programs for borrowers on the risk of continuing that type of business.

14. If possible, establish savings as a viable mechanism by setting up savings accounts, which are readily accessible and pay interest rates above the rate of inflation, and where services meet the needs of clients. Perform an extensive information and training campaign for savings services, with examples of how well households might have fared if they had savings when disaster struck. Ideally it should be handled over a six-month period, with use of winter months as time for group formation and training in communal support structures. If savings is to be mobilised, agree on appropriate incentive structures for workers to collect savings and pay client savings withdrawals. Work continually with clients on the importance of savings structures as an insurance mechanism against bad crops or other household disasters such as illness.

15. The CEI system, despite some minor problems, is a highly efficient mechanism for the delivery of microfinance services in China, and should be used elsewhere. CEIs should be selected by joint village acclamation, should have primary school educations, should be persons who will not

use any existing roles to force villagers to borrow, and should be engaged in training and updating of skills at least quarterly. BOABC officers should work more closely with CEIs, making and keeping monthly schedules of office time, village visits, and exchanges of funds/checking of records.

16. As the program gets larger, security of funds becomes a greater concern. Funds should be collected from CEIs in their villages, rather than forcing CEIs to travel by public transportation with large volumes of funds.

17. The project had significant problems with the engagement of women as substantive CEIs and active borrowers who controlled loan proceeds and repayments. Since worldwide women have been shown to be better users of loans, better repayers, and to use profits to benefit the family, lending to them is very important. It is critical that loan officers/CEIs be female, and that at least one of the top three senior officers in a project be female, in order to ensure more women borrowers who actually control the loan. In the absence of a full-time gender consultant, a minimum of bi-annual project review by an external GAD consultant is required to help enforce access for women.

18. The group mechanism has not worked very well in China. There are ways in which it can be improved without sacrificing efficiency, if time costs can be minimised and/or access to microfinance services requires it and/or there are other benefits to attendance. This can include having group leaders confirm all cash transactions between CEIs and group members by being present and signing passbooks; having village business trainers (see point 13 above) come to visit; having CEIs and members do rules pledges (see point 4 above) and cash transactions only at meetings; and scheduling microfinance meetings to dovetail with required village meetings such as Village Council meetings. Regardless of any of these, groups must be formed by themselves alone, without any external interference or guidance, and group members must understand that they are joining not only for loan access but also for cross-guarantees of each other's loans, and this should be strictly enforced.

19. In cases where microfinance is linked to other project components, if synergy is important, check and confirm/reinforce component interaction by having external consultant reviews bi-annually. The PID should provide indicators of cross-component success, which the implementing organisation can measure and provide on as part of quarterly reporting. Quarterly reporting should clearly indicate specific project component locations down to the village level, with maps showing areas where microfinance exists and where it is working with other component inputs.

4 COMPONENT 3 Training and Agricultural Technology Extension

4.1 Purpose

As a community development project, the training of administrative staff at the levels of prefecture, county and township and the promotion of new agricultural techniques through the existing Agricultural Extension Stations constituted an integral component. The project aimed to strengthen institutions in a number of areas to improve living standards in poor villages and to enable technical personnel to deliver appropriate, sustainable agriculture and livestock extension services, and health and education services.

4.2 Verification

Over 14,900 person/days of training were conducted. Training, once delivered, is no longer tangibly identifiable. It is difficult to thoroughly verify that it has been delivered, and even more difficult to determine its contribution to practices that have now evolved. The Team checked hard evidence of manuals, training materials, field reports and photos, and interviewed trainers and trainees. Many of the core trainers had moved, some to higher positions in other townships and neighbouring counties. The PMU was able to arrange for several former core trainers to return for interviews. Typically these now occupied the position of township deputy mayor with special responsibilities for agricultural technology and extension.

The training materials and photographs studied indicate a thorough and professional training program. Particularly impressive are the photographic records of the introductory training at the village level for the microfinancing component. The entire adult population seems to be present, with village leadership and township and county microfinancing specialists presenting and illustrating.

The agricultural extension stations at the township level were visited and found generally to be poorly resourced and managed. It appears that for each of the three counties, special efforts in agricultural extension work was focused on two townships. All six target townships were visited, with others for comparison purposes. Eighteen months after project completion, there was no obvious difference between those that had and had not been targeted.

Random checks with farmers on their memories of project training and subsequent extension work evoked a wide range of responses, from those who claimed to never have seen or heard anything, to those who were full of praise to the "Australian canola" introduced by the project.

4.3 Impact

The Team's assessment is that there has been a revolution between 1992 and 1999 in attitudes towards new ideas, new technologies, and new opportunities of improving living standards. The Chinese Team Leader during project implementation was interviewed and likened the training program to software, which complemented the roads and water supply as hardware. He said that software is intangible, but is manifestly obvious in results.

There are four elements of Component 3, and the impact of each is analysed separately:

1. Institutional strengthening;
2. Agricultural extension;
3. Health and literacy training; and
4. Introduction and training in microfinancing (addressed in Chapter 3).

4.3.1 Institutional Strengthening

Institutional strengthening in this region of western China must be gauged against the low and inert base that was observed during the Project Identification visit of 1992. At the higher levels of prefecture, county, township and village, the government agencies involved in the project were strengthened though the challenge of managing a larger budget, and the higher profile and new levels of accountability to which they were subjected. The Team had the advantage of representation on the 1992 Project Identification visit, and it is observed that the key planning staff met during that visit have all been exposed to the dynamics of an international aid project. The then-leader of that planning team has, by 1999, been promoted to the Provincial Planning Committee.

The opportunity for some staff to travel to neighbouring provinces, and others to travel overseas on two highly effective study tours, according to interviews, seem to have been milestones in opening up new ideas on management and administration.

Unfortunately, at the lower levels in institutions, it was difficult to discern impact. Personnel appointed to some positions may not have had the opportunity or capacity to rise to challenges. Of particular concern is the fact that some outstanding individuals were promoted, and were replaced with inexperienced staff. These latter individuals needed new rounds of training, which now appear not to be programmed.

The Project Implementation Document allotted A$192,375 and A$238,664 for training from the Australian and GOPRC budgets respectively. The Team believes these amounts were spent effectively. Yet the impetus given during this training, including that of training the trainer, was not carried forward after project completion. After June 1998 there was no Australian component of the budget, and it could not be ascertained whether local funding was maintained at the previous level. Furthermore, the benefits of the high profile of foreign inputs (a foreign expert, a vehicle, and officials and interpreters that would necessarily be in attendance) was a one-off input which was not be replicated after project completion.

4.3.2 Agricultural Extension

The clearest success of the training program was in crop introduction. The most notable of these was the introduction of Australian canola, which through its multiple branches could produce an average of 350kg/mu instead of the 200kg/mu of the local single stem variety. At a price of Y2.0–Y2.4 /kg, this is an excellent commercial crop. There were several stories independently volunteered from poor peasants and from agricultural extension officers of how suspicion of the newly introduced Australian canola (one tenth of a mu per trial plot on a farmers field) changed to enthusiasm and a rush to plant more in subsequent years. Sunflower and clover varieties were also introduced, and in two regions with suitable conditions were successfully extended to commercial production.

Much of the training was in very simple technologies, already well proven in more developed regions of China. In 1992, peasants were sowing and spreading chemical fertiliser by hand quite inefficiently. The training program to introduce 2 and 4 row planters showed peasants how to efficiently mix fertiliser and seed and sow optimally, and has been widely accepted. The planters cost Y380, and include a Y100 Poverty Alleviation subsidy. Some farmers paid their Y280 cost from microcredit funds.

Each of 18 Township Agricultural Extension Stations received a walking tractor. Staff were trained in its use and maintenance. While walking tractors are considered to be older technology in eastern China, they were a generational improvement for the poor villages.

The project employed a long term Farming Systems and Extension Specialist (FSES) and the effort made in this area had obvious impact. Unfortunately, some potential was lost because of mis-timing of the FSES term (15 months). This term was spread over one harvest and the next year's planting. It would have been preferable for the term to cover the preparation and supervision of planting and then a harvest in the same year.

4.3.3 Health and Literacy

The delivery and impact of health and literacy training was not found to be as strong as was intended in the design. The Team found little proof of delivery and almost no evidence of impact. The reason for this may be as simple as the fact that the position of short term specialist used in project design was not repeated in implementation—the training fell way almost by default.

4.4 Sustainability

From remarks on verification and impact it is obvious that the training program itself was not sustained after project completion. Some of the benefits of the training and agricultural extension were sufficient for them to be nurtured by end-users and repeated without further project inputs. Ironically, the most successful activity, introducing Australian canola, could not be repeated in successive years because the seeds were so much in demand that they were never given back to seed propagators—they were all used in production for one-off processing for profit.

Component 3 was delivered at considerable cost. These costs included a long term Australian specialist, an imported 4WD vehicle, and budget sufficient for group study tours, and also budget to manage farm trials. Though the results were in part very good, there was never any plan for training momentum at that high level to continue after project completion.

The attempt to introduce Participatory Rural Appraisal as a counterbalance to the ethos of top-down agricultural technology extension also did not seem to fare well after project completion. Any move towards sustained adoption of new methods of dealing with farmers by government will only be gradual. The contribution of this project to that goal is commendable, and in the time frame of three years against the inertia of the traditional system, the lasting influence is as strong as could be expected.

4.5 Conclusions

The project inception ambitiously pictured a two-tiered training program: bureaus in the prefecture and at the county and township levels under them would be strengthened and then they in turn would be able to deliver extension services to the community. The project would have been so successful that this training would be perpetuated after this project had been completed. This did not happen.

The training done was competently delivered, but seems to have stopped with those first rounds of beneficiaries. When the Evaluation Team visited in November 1999, there was almost no evidence of ongoing training programs for microcredit or in agricultural extension. There was even less response to searches for Women's Federation activities planned such as literacy and health.

The Team concluded that coming off a low institutional base, with poor reserves of skilled and trainable human resources, only the first round of direct training could succeed. Those benefiting as trainers almost invariably were promoted out of their institution to higher levels, and to other regions. There were no trainers left to train the replacements filling those positions, or to extend training out to villagers.

4.6 Lessons Learned

Key lessons learned are summarised below:

1. Project design in community development programs for poor communities must steer a course between laudable ambitions and the pragmatics of a low and inert foundation. Where target villages have been extremely isolated, and where there have been generations of tacit withdrawal from administrative participation, and illiteracy prevails, then even the townships in such communities may not be able to absorb a two-tiered training component of "training the trainer".

2. Between the inception and implementation stages there was a change in emphasis from training in social issues to technical matters. The 1993 Prefeasibility Study included a WID Specialist whose inputs on women's literacy and health seemed to be subsumed in the implementation by the Farming Systems and Extension Specialist. For WID issues to have been promoted to the extent recommended in the Inception Phase it would have required the inclusion of a short-term WID specialist during the implementation of the training program.

3. Individual poor farmers and officials at levels from township to the prefecture asked if more thought could be given to making Australian

canola seed available. The lesson for the future is that any new technology tried should be available in the next phase in greater volume at a commercial price, should it prove successful.

4. The timing of the assignment for the Farming Systems and Extension Specialist was not ideal. The Specialist arrived in 1995 after planting was complete, then 15 months later left before the harvest of 1996. In hindsight it would have been beneficial to arrive in time to supervise planting, be present for results, and then supervise the next years planting.

5 COMPONENT 4 Management

5.1 Purpose

The purpose of Component 4 was to efficiently and effectively manage the implementation of the Qinghai Community Development Project.

5.2 Verification

The Team interviewed a total of 12 past and present people involved in management and 8 other key project staff. These included a MOFTEC leader who participated in the original 1992 identification mission, both original Australian and Chinese Team Leaders, and drivers and interpreters who had been there at the beginning of project management and were still there in the current PMU.

It was the responsibility of the Evaluation Team to pose the question, with the benefit of hindsight, “how was this project handled?” and to verify the degree of consistency between how it was planned and how it was done.

Prior to implementation, ten missions (of between one and five specialists each) conducted field visits over a period of four years. The inception phase budget totalled A$700,000 and A$261,900 contributed by the Australian Government and the GOPRC respectively. By the time the Project Management Office was established on site in June 1995, considerable understanding of the existing situation and issues had been gained.

The simplest and most expedient components were commenced first. In hindsight this proved to be the correct order. As the roads were done, access to the target villages became better, and considerable goodwill was established allowing opportunities to introduce more complex components.

With respect to microcredit, the most difficult component to introduce, to have accepted by the target groups, and to make successful, the PMO realised there was no existing mechanism and institution in place, and as described in Chapter 3, pioneered many avenues at considerable expense over many months before settling on a workable formula. Even then, one set of villages in one township administration were targeted for a year for trialing prior to the implementation proper.

5.3 Impact

A study of the original 22 proposed requests made in 1992, and measurement of the results in 1999 of the response to these requests in the form of the PID/PCR and field findings, reveals that this project has been well managed. The Team recognises the pioneering work done by the specialists, managers and administrators on both sides, and how they learnt together during the project. At the time of design and inception the road and water proposals in each of three counties were selected, primarily because they were relatively conventional and straightforward. Then the PMO carefully studied the conditions of poverty and put in place a flexible procedure to trial the ideas of community development training, and even more innovative for China, the introduction of microcredit.

There was remarkable good will amongst staff on this project, set in an arduous and poor environment. Special mention must be made of the Australian and Chinese Team Leaders who worked side-by-side throughout the implementation. They showed a high degree of adaptability and willingness to confront new situations, apply techniques, check results, then continue with procedures which they evolved specifically for this project. Their collaboration was unusually strong. Senior Chinese officials particularly praised the Australian Team Leader for his linguistic abilities and understanding of Chinese circumstances and culture as contributory to project success.

The continuity of staff through the life of the project is an impressive feature, making for smooth and successful operations, and at the same time rewarding those participating with a willingness to continue service. It was also noted that there was continuity of the AusAID Desk Officer throughout the life of the project.

The most noticeable achievement from this innovative management was the convincing of the Haidong ABC to manage the microcredit program. The ABC in China conventionally works with township enterprises on much larger loan sizes. Experts from the Chinese side at the national level expressed incredulity that the ABC could be concerned with loans of Y400–1,400 to poor householders, and successfully manage to disburse and collect loans to over 15,000 clients in 3 years.

With respect to the important, general question of whether the project could have been managed more efficiently and effectively, the Team believes the weighting of emphasis amongst the four components was rationally balanced. The roads and water supply were necessary prerequisites for new income generation, training and microfinancing. The CFW programs provided a trigger for leveraged domestic public investment in the region (by a factor of 5, according to local government). The use of local experts and manufactured inputs where possible allowed more to be done at less cost. The microcredit revolving fund occupied half of the total of the Australian budget, with other segments of the budget set to administer and complement it. Once the CFW programs were established the resources of the PMO were primarily dedicated to servicing the microcredit component. Overall the Team assesses that the components were complimentary and managed optimally.

In three counties neighbouring the Haidong Prefecture, the UNDP are implementing a project (with funds of about US$1 million) which is entirely a microcredit rotating fund. There are no other components for rural infrastructure and CFW. They believe roads are already sufficiently suitable. This project may prove a useful comparison for preparing for the overall management—design and implementation—in future projects.

5.4 Conclusions

The project was managed well, both at the executive levels of the two governments in steering the project cycle through to what seems to be a relatively successful closure, and at the operational level of design and implementation, with most goals achieved, and the microcredit activity expanded beyond plans by a factor of four.

This project is the antithesis of a turnkey engineering project, where the blueprints can be drawn up then confidently executed according to design. This was pioneering community development in a strange and changing socio-economic milieu. Design and implementation emphasised caution, flexibility, and gradual progress through trials and errors, rather than rushing to execute a ready-made plan.

In hindsight, the Evaluation Team concludes that many of the specific mechanisms that made this project successful could not have been foreseen, and did require the time and effort that was taken. In hindsight it can be said that given the solid foundation tediously laid out between 1995 and 1998, one more year of implementation would have solved most of the ongoing difficulties that were observed during evaluation. These include problems in maintaining and utilising the MIS, corrections in selection and training for CEI's and in targeting borrowers, and extending the excellent early results in agricultural innovations.

5.5 Lessons Learned

The key lessons learned are summarised below:

1. Conditions should be nurtured to enable those working in the project field area and assessing local conditions the flexibility to alter design in the light of factors encountered. In a project delivering a new poverty alleviation mechanism to a community and attendant institutions which have characteristics not fully understood, those in the field, especially the Australian and Chinese Team Leaders, should be given the opportunity and the responsibility to assess local conditions, and make recommendations accordingly. A corollary to this is that a design team visiting a region that is unique in conditions, culture and tradition should not deliver a design document that locks implementation into a rigid path.

2. There can be a tendency for each side of a bilateral project to put up their "best" person according to certain criteria without both sides considering compatibility of the two leaders. The establishment of a clear working relationship between the two counterpart Team Leaders was one of the key successes of this project, and should be carefully considered and replicated wherever and whenever possible.

3. Despite best intentions and considerable goodwill, the project management team departed with a revolving credit fund managed by an MCO that was not fully trained and committed to original goals of poverty alleviation, and a PMU and BOM not able guide management back to those goals. The transition may have been hurt by the change of Chinese Team Leader precisely at the time that the ABC took over management of the microcredit fund, and the departure of the Australian Team Leader (ATL) soon after. The ABC staff participating in the overseas study tour, who were clearly convinced of the positive features of microfinance in 3 other developing countries did not have continuity of roles in the MCO after transition. The failure to use the MIS is an obvious manifestation of this problem.

Attachments

Attachment 1: Schedule of Evaluation Team

Date	Location	Activity	Offices	Persons Met
14-Nov-99	Beijing	K Bate arrival, J Coulter start; review documents		
15-Nov-99	Beijing	B Wilkinson arrival; review documents		
16-Nov-99	Beijing	Meetings AusAID, MOFTEC, Ford Foundation/CASS; C Wong and T Tanaka join team AusAID	Kim Pendreigh,	Second Secretary Frank Ding, Senior Projects Officer Christina Wong, Projects Officer ToshihiroTanaka, Assistant Resident Rep, UNDP Donnelle Wheeler, Counsellor
			MOFTEC	Liu Mingming, Senior Program Officer
			Ford Foundation/ CASS	Sun Ruo Mei, Senior Researcher
17-Nov-99	Qinghai	Confirm arrival, meetings schedule	Xining Airport Liang Fu	Xian, Ju Bang Peng, Executives MCO
18-Nov-99	Pingan	Haidong Prefecture Planning Commission meeting; ABC/MCO office meeting; first round on MIS		Mao Wen Bin, Deputy Governor, Haidong Prefectecture Xu Yan Yun, Director, PMU Jiang Ji Qin, Former PMO Team Leader Xu Xiao Yan, PMU Wang Yu Zhen, PMU
19-Nov-99	Ledu	County leadership meeting; BOABC Gaodian		Lu Qi Xiu, Deputy Mayor, Ledu County Director, County Planning Commission Zhao Jian Rong, Manager, Ledu ABC Yang Ying Shou, Secretary, Planning Commission
		BOABC in Hongshui		
20-Nov-99	Ledu, Tao Hong Ying Township: Tou Zhuang, Xiabango;	Field reviews and interviews		CEI Xiabangou; CEI Shatuxia
		Ledu Electric/Water Supply Bureau		Xu Ru Tai, Director

Attachment 1: Schedule of Evaluation Team (continued)

Date	Location	Activity	Offices	Persons Met
19-Nov-99 (cont)		Ledu Transport (Roads) Bureau	Shen Xiao Dong,	Engineer Liu Zheng Hui, Bureau Director (newly appointed) Li Hong Zhong, Project Officer
	Chengtai Township; Xia Ying Township: Xia Zhu Jia	Field reviews and interviews		Qi Wen Rong, Chengtai Township Chief, Yan Gui Ying, CEI
21-Nov-99	Pingan, Si Tai Township: Zhuangke, Ban Ye Long	County leadership meeting; village interviews in afternoon		Han Rui Wen, Deputy Mayor; Wei Bi De, Engineer, Ma Xiao Long, Water Bureau
22-Nov-99	Huangzhon	County leadership meeting and PADO/county implementing offices;		Xu Wen Jin, Director, PADO Wen Tu Xia, Former Training Supervisor Chen Men Jia, Roads Supervisor Ren De Yan, Water Supply Supervisor
	Tien Jia Zhai BOABC; Danma Township: Dan Ma village; Yang Po, Yin Po	BOABC and village interviews in afternoon		Han Tu Cei, CEI Danma; Ma An Ban, CEI Yin Po; Wei Hu Qi, Director BOABC Tien Jia Zhai, Peng Xiang Chen, Credit Man, BOABC Tien Jia Zhai
23-Nov-99	Huangzhong; Yang Po, Yin Po	Detailed field reviews and interviews		CEIs, villagers
24-Nov-99	Ba Zhang Gou Township: Xia Ma Jia, Xia Guo Er, He Dong			CEIs, villagers
25-Nov-99	review data and methods			
26-Nov-99	Pingan	ABC meetings on finances, structure, views; team meetings	ABC Haidong Prefecture; MCO offices	Zhang Yeng Tu, Deputy Bank Manager/Senior Economist
27-Nov-99	Ledu, Xia Ying Township: Keng Keng, Shang Ying Chengtai: Xiatai, Bakou	Detailed field reviews and interviews	Township ag extension offices and Womens Federation	Yang Shen Yuan, CEI Keng Keng; Zhaom You Bao, CEI Baku, villagers

Attachment 1: Schedule of Evaluation Team (continued)

Date	Location	Activity	Offices	Persons Met
28-Nov-99	Ledu, Yingsheng: Xin Pu Zi, Yang Jia Gang	Detailed field reviews and interviews		Fan Yu Chun, CEI Xin Pu Zi; Yang Wei Hui, CEI Yang Jia Gang, villagers, borrowers
29-Nov-99	Xining	Meeting with 4 BOABCs/PMU; provincial DOFTEC	Hotel; provincial DOFTEC offices	Li Qing, Deputy Division Chief, Foreign Economic Cooperation Division, DOFTEC; Yu Ming Qin, Deputy Director/Senior Economist, DOFTEC
30-Nov-99	Pingan, Xining	Meeting with PMU on details of program; meeting with PADO Qinghai		Former Director,ex-PMO; Li Yu Xun, Deputy Division Chief, Provincial Poverty Alleviation Office
1-Dec-99	Huangzhong, Machang: Jia Ya, Bai Lu Er	Detailed field reviews and interviews		Hai Yu Hua, CEI Jia Ya; Ho Shung Hua, CEI Bai Lu Er, Deputy Mayor, Machang
2-Dec-99	Qinghai-Beijing	Visit PADO Qinghai; draft Aide Memoire		
3-Dec-99	Beijing	Meet AusAID 11 am; drafting of report	CASS	Professor Du Xiao Shan, CASS Rural Village Development
			MOFTEC	Zhao Zhong Yi, Deputy Divion Chief, MOFTEC
4-Dec-99	Beijing	Drafting of report		
5-Dec-99	Beijing	Drafting of report		
6-Dec-99	Beijing	Drafting of report; meeting with AusAID		
7-Dec-99	Beijing	MOFTEC meeting; B Wilkinson departs	MOFTEC	Zhang Ke Ning, Division Chief, MOFTEC
8-Dec-99	Beijing	Drafting of report, K Bate, J Coulter depart		

Attachment 2: Case Studies of Successful Clients

Yi Cheng Zhang met us at the doorway of his home in Yin Po village. He is an old, dignified Hui man, with a slow smile and dusty trousers. We found him mounting a stone on a can, since he liked the design of a face inside the stone. There are five persons in his household - his disabled daughter, son, daughter-in-law, and their son. The family cultivates 12 mu of land, and in a good season gets 1000 kg of oilseed and 1000 kg of grain for food, which is not enough to feed them all. They sell all the canola seed to buy fertilizer and chemicals for the next years crop.

Mr. Yi was traditionally trained as a butcher, but did not have the money to establish this business until the microcredit program started lending. Mr. Yi selected his group members when they formed their group in 1996. He told us that his group members help each other when the payment of interest or principal is due, and one of them does not have sufficient cash. “It’s good to have a group”, he told us. They meet monthly. He sees his CEI regularly.

In 1996 he took his first loan, purchased small chicks, raised and sold the large chickens. He spent his loan of 400 Yuan plus Y100 in savings for 100 chicks and feed. In three months he sold them for Y800. The next year he borrowed Y600 and purchased chicks and feed, this time selling them for Y1200.

But this way was too slow to make money, he told us, and the chickens tied him to his home. So in 1998 he borrowed Y800 and bought three sheep. He slaughtered them, sold the meat to his and three other villages, and made Y300 in four days. He continues this process, buying sheep and selling meat. Mr. Yi kills on average one sheep per week. He sells meat every day in the winter and slightly less often in the summer, and he and his son sell the meat to regular customers in the four villages of the area. A few houses can take credit for up to one week before they pay him.

Yi Cheng Zhang has done well with his income. He paid Y6,000 for his home, which he now owns. He now has a herd of over 20 sheep. He can provide funds for his son and daughter-in-law to go out to work over the summer, and they return with money to pay the coal and food costs of the winter. He now wants a loan of Y2,000-3,000 to expand his business further.

The village of Xia Guo Er is high in the mountains of the Tibetan plateau. Cang Guang Que and his wife live there, in a household with two children in school and one who has been sent out to care for her grandmother in Xining. They cultivate 26 mu of very unproductive land, producing 350 kg wheat, 200 kg beans, and 250 kg oilseed in a good year, not enough to feed the family. They have a donkey, a mule, two pigs, and four sheep. Last year they sold a sheep to pay for spring festival costs.

In 1997 Mr Cang started borrowing from the microcredit program. Their family borrowed for fertilizer. They paid interest by month, and paid the loan off at harvest. His wife goes out to work in other fields, getting income of Y10-15 a day to pay household costs and the loan interest and principal. They had to work very hard to repay their loan. The Cang Family want to borrow next year to fatten sheep, which is a more sure method of earning cash income. They know that their lives can be better, and they want to use this program for that purpose.

Attachment 3: BOABC and MIS Database Comparisons

Date	BoABC Monthly Disbursement No of Loans	BoABC Cumulative Disbursement No of Loans	MIS Monthly Disbursement No of Loans	MIS Cumulative Disbursement No of Loans	Monthly Difference between MIS and BoABC	Cumulative Difference between MIS and BoABC	BoABC Monthly Loans Repaid No of Loans	BoABC Monthly Net Loans Outstanding No of Loans
Aug-96	101	101	101	101	0	0	0	101
Sep-96	176	277	185	286	-9	-9	0	176
Oct-96	225	502	216	502	9	0	6	219
Nov-96	215	717	217	719	-2	-2	17	198
Dec-96	116	833	116	835	0	-2	9	107
Jan-97	112	945	115	950	-3	-5	18	94
Feb-97	32	977	32	982	0	-5	10	22
Mar-97	85	1062	130	1112	-45	-50	4	81
Apr-97	295	1357	476	1588	-181	-231	11	284
May-97	783	2140	806	2394	-23	-254	125	658
Jun-97	949	3089	965	3359	-16	-270	138	811
Jul-97	675	3764	949	4308	-274	-544	38	637
Aug-97	1308	5072	1134	5442	174	-370	144	1164
Sep-97	467	5539	741	6183	-274	-644	129	338
Oct-97	656	6195	719	6902	-63	-707	345	311
Nov-97	1039	7234	1160	8062	-121	-828	818	221
Dec-97	1464	8698	685	8747	779	-49	281	1183
Jan-98	39	8737	39	8786	0	-49	326	-287
Feb-98	1459	10196	1581	10367	-122	-171	497	962
Mar-98	2187	12383	2065	12432	122	-49	448	1739
Apr-98	2028	14411	2042	14474	-14	-63	482	1546
May-98	1564	15975	1343	15817	221	158	474	1090
Jun-98	666	16641	731	16548	-65	93	432	234
Jul-98	846	17487	433	16981	413	506	792	54
Aug-98	1113	18600	321	17302	792	1298	839	274
Sep-98	1333	19933	100	17402	1233	2531	671	662
Oct-98	1260	21193	218	17620	1042	3573	928	332
Nov-98	1721	22914	1529	19149	192	3765	745	976
Dec-98	1567	24481	102	19251	1465	5230	1591	-24
Jan-99	1917	26398	0	19251	1917	7147	1551	366
Feb-99	1846	28244	1846	21097	0	7147	1323	523
Mar-99	2147	30391	0	21097	2147	9294	1218	929
Apr-99	1676	32067	1676	22773	0	9294	1968	-292
May-99	1648	33715	1038	23811	610	9904	1574	74
Jun-99	1719	35434	929	24740	790	10694	1849	-130
Jul-99	783	36217	76	24816	707	11401	1015	-232
Aug-99	1340	37557	1340	26156	0	11401	1519	-179
Sep-99	1190	38747					1270	-80
Oct-99	984	39731					1161	-177

Net BOABC	BoABC						
Cumulative Net Loans Outstanding No of Loans	Monthly Disbursements in Yuan	Cumulative Disbursements in Yuan	Monthly Repayments in Yuan	Cumulative Repayments in Yuan	Cumulative Loans Outstanding in Yuan	Average Amount of Loan in Yuan	Average Outstanding Loan Amt in Yuan
101	43200	43200	210	210	42990	428	426
277	72600	115800	209	419	115381	413	417
496	93600	209400	2381	2800	206600	416	417
694	91800	301200	11793	14593	286607	427	413
801	50200	351400	38696	53289	298111	433	372
895	46400	397800	12152	65441	332359	414	371
917	17400	415200	7192	72633	342567	544	374
998	44300	459500	8027	80660	378840	521	380
1282	164694	624194	12479	93139	531055	558	414
1940	403300	1027494	75237	168376	859118	515	443
2751	472390	1499884	49080	217456	1282428	498	466
3388	320600	1820484	32181	249637	1570847	475	464
4552	606606	2427090	79745	329382	2097708	464	461
4890	376900	2803990	93460	422842	2381148	807	487
5201	427900	3231890	177782	600624	2631266	652	506
5422	575700	3807590	319343	919967	2887623	554	533
6605	360500	4168090	256278	1176245	2991845	246	453
6318	133400	4301490	232169	1408414	2893076	3421	458
7280	777200	5078690	232107	1640521	3438169	533	472
9019	1146490	6225180	220432	1860953	4364227	524	484
10565	973040	7198220	268766	2129719	5068501	480	480
11655	727850	7926070	275012	2404731	5521339	465	474
11889	506350	8432420	247580	2652311	5780109	760	486
11943	509600	8942020	392963	3045274	5896746	602	494
12217	720050	9662070	463041	3508315	6153755	647	504
12879	837750	10499820	348458	3856773	6643047	628	516
13211	1009300	11509120	992550	4849323	6659797	801	504
14187	1079540	12588660	760855	5610178	6978482	627	492
14163	996750	13585410	902410	6512588	7072822	636	499
14529	1220540	14805950	773900	7286488	7519462	637	518
15052	1092150	15898100	686105	7972593	7925507	592	527
15981	1304180	17202280	633730	8606323	8595957	607	538
15689	1096840	18299120	1195807	9802130	8496990	654	542
15763	1161820	19460940	1021467	10823597	8637343	705	548
15633	1280200	20741140	1263785	12087382	8653758	745	554
15401	531190	21272330	541410	12628792	8643538	678	561
15222	980275	22252605	921220	13550012	8702593	732	572
15142	875110	23127715	728052	14278064	8849651	735	584
14965	700690	23828405	637010	14915074	8913331	712	596

Attachment 4: MCO Operational and Financial Sustainability Levels

Pro Forma Income Statement
Micro Credit Office
Agriculture Bank of China, Haidong Prefecture
as of 1 December, 1999

	3/99–9/99 (6 months actuals)	10/99–9/2000 (MCO projection)
Income	in Yuan	in Yuan
Loan interest	148,828	1,080,000
BoABC interest on funds held*	39,875	93,463
Total Income	188,703	1,173,463
Expenses		
CEI salaries and fees	104,760	200,000
MCO staff salaries and expenses	82,500	90,000
MCO staff benefits	9,900	20,000
Office running costs**	37,573	50,000
PMU management fee, 1% of loan fund	78,300	123,400
BoABC processing fee	78,734	200,000
Default reserve, 1% of outstandings	42,250	90,000
Audit fee, external audit	8,625	10,000
Depreciation***	20,951	70,000
Entertainment/Board meetings	19,000	20,000
Total Expenses	482,593	873,400
Residual of income over expenses	-293,890	300,063

Source: MCO accountant.

Notes: * BoABCs pay 2.89% on unlent funds allocated to branches for onlending under MCO program

** Office running costs includes vehicle insurance, maint, running costs; stationery costs; electricity and telephone costs

*** Depreciation includes 2 vehicles at 10 year life, furnishings at 20 yr life; understated

Costs not included involve office rent (free from ABC), imputed cost is Y10,000/year; training or meeting costs when borne by PMU, imputed value equal to expense to PMU Income projections assume of total of Y12.34 million loan fund, Y9 million will be outstanding at all times.

Attachment 5: Terms of Reference

Evaluation of the Qinghai Community Development Project (927 G07)

Activity to be evaluated

This evaluation will focus on the Qinghai Community Development Project (927 G07) undertaken in the Pingan, Huangzhong and Ledu counties of Haidong prefecture in the east of Qinghai province, China.

Background

Location

The Pingan, Huangzhong and Ledu counties are situated on the boundary of the Tibet–Qinghai plateau and the loess plateau of northern China. The physical environment is harsh and the region susceptible to natural disasters, particularly frost, drought and hailstorms. As such the poverty experienced by the people of Pingan, Huangzhong and Ledu counties is characterised by:

- small cropped area per capita
- limited or no irrigated land
- no draft animals
- no off farm income
- little or no farm cash income
- no access to credit
- low fertiliser use
- indebtedness from natural disaster or family tragedies
- poor health

Chronology

The Qinghai Community Development Project developed out of a Poverty Projects Identification Mission undertaken by AusAID in China in May 1992. This mission identified a poverty alleviation activity in Qinghai province as the highest priority. It was recommended that, should such an activity go ahead, it consist of income generation activities and the construction of community water supplies and rural roads.

A prefeasibility study was conducted in March/April 1993 resulting in the Terms of Reference for the Inception Phase which began in early 1994. Hassall & Associates Pty. Ltd and CARE Australia were appointed Australian Managing Contractors for this phase.

At the end of June 1995 the Implementation Phase began under the management of Hassell & Associates Pty. Ltd. The project was completed three years later in June 1998 with a total cost to the Australian government of A$4,496,438. A further A$2,238,513 was contributed by the Government of the People's Republic of China.

The total cost of this activity to the Australian Government, including the Identification mission, prefeasibility mission, inception phase and implementation phase was approximately 5.4 million.

Goal

The goal of the project was to improve the living standards of poor households in identified townships in the Pingan, Huangzhong and Ledu counties by improving rural infrastructure, identifying opportunities for households to improve their incomes, increasing access to credit and strengthening government services to poor farmers in the project area.

Project Description

The project was implemented through four components.

Component 1 *To establish income generating activities among local poor households through cash-for-work programs which will improve access roads and water supply for households.*

This component consisted of cash-for-work programs which constructed access roads and water supply systems. The Australian contribution comprised of cash paid in wages to workers from target villages. The Chinese contribution comprised materials, equipment, engineering design and the supervision of activities. The project planned to build 63km of road and 8 drinking water supply systems.

Component 2 *To assist poor households to participate in farming and non-farming income generation activities by improving their savings and access to credit.*

Component 2 focused on the implementation of farming and non-farming income generation activities through providing access to credit for a proposed 9,830 households. The credit fund was to be operated by the Agricultural Bank of China, drawing on A$2,155,652 provided by the Australian government.

Component 3 *To improve community development through training service institutions associated with improvement of living standards in poor villages, and to enable technical personnel to deliver appropriate agriculture and livestock extension, credit services, health and education services.*

This component was concerned with providing training to those government and non-government services responsible for providing extension services to poor households at both the county and township levels.

Component 4 *To efficiently and effectively manage the implementation of the Qinghai Community Development Project.*

This component was concerned with strengthening the capability of the participating agencies and organisations in project planning, management and monitoring to allow the project to be managed entirely by the Chinese staff for the last 16 months of the project.

Implementing Agencies

The Chinese implementing agency for the project was the Provincial Department of Foreign Trade and Economic Co-operation (DOFTEC). The Haidong Planning Commission coordinated the involvement of the participating agencies at the Haidong Prefectural Level.

The infrastructure construction activities were the responsibility of the Road and Water Bureaux of each of the target counties. Between August 1996 and March 1998 the day-to-day operation of the microcredit program was managed by the Project Management Office while the financial management was the responsibility of the Agricultural Bank of China (ABC) at the Prefecture level, and Business Offices of the ABC at the township level. Since April 1998, the ABC has been fully responsible for the operation of the microcredit program. The agricultural extension training was undertaken by the township extension stations and the health and literacy training was undertaken by the All China Women's Federation in Haidong Prefecture.

Existing Performance Information Sources

A list of the project reports lodged in the AusAID library are located at Attachment I. A mid-term review was not undertaken during the project however a number of reviews were undertaken of particular components/ programs. For example, two reviews were undertaken of the microcredit program. A final project completion report was provided to AusAID in October 1998.

Throughout the life of the project monitoring systems were maintained, one for each of the four components. The most sophisticated of these was the database developed for the microcredit program which contains details of every borrower joining the program and every loan disbursed. Borrower information incudes household characteristics such as number of people, able-bodied labour, education, gender, nationality, family income, the amount of irrigated and non-irrigated land and the number and type of animals owned. The database has continued to be maintained by the Agricultural Bank of China.

In October 1999 an audit of the microfinance program was also undertaken by AusAID.

Purpose of the Evaluation

The evaluation of the Qinghai Community Development Project forms an important element of PIA's program of ex-post evaluations for 1999–2000 and complements the section's current focus on the effectiveness of microfinance as a tool for sustainable poverty alleviation.

The evaluation will contribute to AusAID's collection of lessons learned concerning poverty alleviation through the provision of microfinance for rural communities. The Agency may draw on the evaluation's findings in developing options for the microfinance initiative seed fund, announced in the 1999–2000 budget. In addition, these lessons will be important as the Mingxian and Zhangxian Rural Development Project moves into the design phase in the next financial year.

In addition to the interest AusAID has in this project, a number of international donors, such as CGAP and the UNDP, are also interested in the implications of the model for sustainable microfinance in China.

The purpose of the evaluation is to assess the effectiveness of the project in meeting its objectives and the impact of the project activities in contributing to the broad outcome of poverty alleviation. The evaluation will specifically focus on the following:

- the appropriateness of the goal and purpose of the project in the context of recipient government needs and priorities, AusAID's relevant Country Strategy and AusAID's objectives;
- the extent to which the activity has achieved its stated goal and objectives;
- the outcomes and impact (both intended and unintended) of the project;
- the efficiency of project implementation; and
- the sustainability of the benefits, including the extent to which the ABC's provision of microfinance services has covered its costs.

In assessing the effectiveness of the project, the evaluation will look in particular at the microcredit program to assess its impact and how it contributed to meeting the project's goal and objectives.

The evaluation will also identify the major lessons learned from the activity at each stage of implementation.

Evaluation Questions

The Evaluation Team will examine, assess and report on:

Design

The quality of the design including:

- project rationale;
- the design process and analysis; and
- design flexibility.

Policy

The extent to which the project conformed to or departed from the relevant AusAID policies.

Impact

The project's impact on intended beneficiaries, including women and minority groups, both beneficial and adverse, economic and non-economic.

The project's impact on poverty within the target communities, including an assessment of whether this impact would have been greater if the grant funding used for microcredit has instead been used to provide further infrastructure, of basic health and education services.

Sustainability

The sustainability of the project's benefits on the target populations including the sustainability of the:

- the impact on poverty;
- institutional strengthening of the target institutions;
- skills transfer to poor farmers;
- the microcredit program, taking into consideration such issues as i) the financial performance of the Haidong prefecture branch of the ABC; ii) the ABC management's view of the role of this program in the future of their organisation; the current schedule for incremental loan sizes; iv) competing sources of credit; and
- the roads and drinking water supply systems, including their use by the community, condition and management.

Participation

The level of participation of the target communities in determining project priorities, technologies and maintenance arrangements.

Gender disaggregated data on the involvement of women and men in project activities including training, cash for work programs, the maintenance of facilities and in the microcredit program.

Management

Implementation arrangements and management procedures, including the performance of the Australian managing contractor and partner government agencies involved in implementation, and their impact on project performance.

Quality of the monitoring systems developed for the project and how this contributed to the projects impact.

Financial and economic performance of the project and of relevant institutions.

The implementation schedule and how it contributed to or hindered the attainment of the project's goal and objectives.

Evaluation Method

The evaluation study design, methodology and work plan will be prepared by the Team Leader based on a review of all the available project reports and data. A brief document will be prepared which contains an outline of the evaluation framework/methodology, including:

- the issues that require investigation/clarification;
- identification of the data sources and methods of data collection;
- delineation of all persons and organisations with whom the study should consult;
- discussion of the study's approach to measurement, including relevant indicators for impact measurement and strategies for data collection against these indicators in the time available to the study team;
- an itinerary and schedule of meetings and data collection for the field component;
- a briefing and report preparation schedule.

Prior to departing for the field a 1/2–1 day's briefing will be conducted in AusAID, allowing the evaluation team to familiarise itself with the evaluation method and discuss the evaluation program with China program officers, microfinance specialists and other relevant AusAID staff.

The field component will be conducted according to the itinerary developed by the Team Leader.

Team Composition and Participation

The evaluation team will need to contain specialist expertise in the design and evaluation of microfinance and human resources/rural development programs. They will also need to have skills in gender analysis. Experience in China and Chinese language skills are also desirable.

The evaluation team will consist of two consultants and an AusAID officer. One consultant will be engaged as Team Leader and will have responsibility for the conduct of the evaluation and for the preparation and finalisation of the evaluation report.

The Team Leader will be required for approximately 35 days, up to 3 days preparation for the mission and up to 10 days following the field component to finalise the report. The second consultant will be required for up to 27 days, including up to 2–3 weeks in the field.

Relevant Chinese personnel will accompany the evaluation team. The participation of a UNDP staff member on the evaluation team is also under consideration.

Procedures: Schedule and Logistics

The evaluation will be conducted over a period of 4–5 weeks with up to 2–3 weeks in the field. It is proposed that the evaluation begin in the third week of November. Pre-departure briefing of the team will be undertaken over a period of 1/2 to 1 day prior to departure for the field. Finalisation of the report will occur within four weeks from returning from China.

Reporting and Dissemination Requirements

A draft report will be submitted to AusAID within two weeks of the return of the evaluation team. The draft will be circulated for comment in AusAID, and a final draft prepared following the receipt of comments.

The evaluation team will also prepare a seminar to be presented to AusAID staff members in February 2000.

Guidelines for the preparation of Ex-post Evaluation Reports can be found in AusGUIDE.

Attachment 6: An Input to the Evaluation Mission of AusAID Qinghai Community Development Project

Name	Project	Date of Visit	Place Visited
Toshihiro Tanaka ARR, UNDP China	AusAID 927 G07	17–23 November 1999	Qinghai Province Haidon Prefecture Pingan, Ledu, Huanzhong Counties

I. Background

UNDP and AusAID in China have been close development cooperation partners in China, particularly in areas of poverty alleviation and environment. Upon a request from UNDP, AusAID, Mr. Richard Moore, development economics and poverty alleviation specialist, participated in UNDP China Country Review in May 1999. AusAID has also been a regular member of the UN Poverty Task Force as well as the UN Microcredit Working Group, which is a sub-group of the UN Poverty TF. UNDP in partnership with the State Council's Office for Poverty Reduction and the China International Center for Economic and Technical Exchanges (CICETE) has also established the Advisory Board on Poverty in August 1999, of which members include PBC, ABC, RCC, the Ministry of Finance, the Ministry of Agriculture, AusAID, CIDA, WFP, UNICEF, World Bank, Asian Development Bank and Ford Foundation. UNDP poverty alleviation programme currently covers 48 poor remote counties, and 6 districts of Tianjin City, which is supported by AusAID. Microfinance is the major component of the poverty alleviation programme of UNDP under the current Country Common Framework 1996–2000.

In light of the above close cooperation and common interests, particularly in areas of poverty alleviation through microfinance, with UNDP, AusAID invited UNDP to participate in the evaluation mission of the Qinghai Community Development Project. Due to the very important role the AusAID project has played in introducing the microfinance to China, UNDP nominated Mr. Toshihiro Tanaka, ARR and the Cluster Manager of the UNDP Poverty Alleviation Programme, to join the evaluation mission.

II. Inputs to the Evaluation Mission

(1) Complex and vertical institutional arrangement for project implementation

The project aims to provide rural infrastructure, training and microfinance as an integral package for poverty alleviation of rural communities. It did so through utilizing existing vertical Government structures for the implementation of each component, which was efficient in terms of time and costs involved. But, it also resulted, to a certain degree, in non-integrated planning and fragmented implementation of each component, and thus loosing opportunities to maximize the impacts particularly in terms of promoting the participatory cross-sectoral approaches at the institutional and community levels. The project had two distinctly separate decision-making and reporting structures: one of the AusAID including the subcontractor, and the other of the national counterpart agency, MOFTEC and local Government, which might have affected the timely and efficient decision making and operation of the project activities.

(2) Ambiguity in the distribution of the responsibility and the authority among the participating organizations in post-project operation, monitoring and decision-making

The current post-project management structure is much simpler but remains hierarchical. ABC is now the only implementing agency of the microfinance under the guidance of the BoM, to which PMU serves as the secretariat and the reporter. But, it is not clearly understood whether PMU should play some direct roles in the management of the microfinance operations or remain only as a monitoring and reporting organization for BoM. In other word, PMU serves as a liaison between ABC and BoM, and their monitoring results seem to be going up to the BoM for decisions rather than feeding back to ABC for immediate correction or improvements.

ABC's participation is a positive and constructive step to ensure the outreach and sustainability of the microfinance activities. But, it does not guarantee that the participation and benefits of the poor and women will be prioritized and protected under the microfinance operation. PMU's role in this regard is important and needs to be enhanced in this transition phase. BoM may still need to be the highest decision-making body, but it is obviously not the optimal body to take any managerial role of the project. Should representatives of agencies concerned need to be involved in the management of this microfinance operation, it needs to be formed at the prefecture level sometime in future, probably replacing part of the role of BOM and the PMU. Regular monitoring role of microfinance operation currently undertaken by PMU should gradually be absorbed by ABC.

Difficulties exist in monitoring and evaluation of the performance of CEIs (community extension intermediaries) in terms of the process and their ethical behavior. ABC can monitor their performance based on the amount of disbursement and the repayment, but the aspects of clients-satisfaction, empowerment of the poor and women, fair and pro-poor targeting tend to be neglected as parts of criteria for evaluating CEIs. This aspect should be looked into by PMU during the transition phase, and establish certain code of conduct and monitoring mechanism within ABC and more importantly by participating households themselves. Collecting information from non-participating households in the village will also provide information on the CEIs' performance for cross-checking.

(3) Institutionalization of the Achievements and the Impacts of the Project

In addition to the direct benefits given to the individual villagers and poor communities, it is important to make strategic interventions, which bring about changes in the institutional attitude and behavior toward the community development and poverty alleviation. Because this is the area that the external support will be most needed and have comparative advantages.

The project made contribution to the road and water supply, which are of critical importance for remote needy villages. It seems that the local government has ability to built those infrastructure with local inputs and state or provincial subsidies. AusAID contribution in this component had been in average of 15–35% of the total costs. Given the fact that the Government policy requires 15–20% of the costs to be covered by the community contribution, the AusAID contribution for "cash-for-work" was mostly meant to take the burden off from the shoulder of the poor community members. The project had an excellent idea of using this cash-for-work to enable poor farmers to start savings. Unfortunately, it was not materialized due to the different timeframe and institutional arrangement for the implementation of the two components.

A Huanzhong County Official explained that without AusAID inputs, they might not have implemented the road construction for those targeted villages for even 5–10 years. And due to the AusAID project the Provincial Government decided to allocate on priority basis the matching funds. According to the local authority, the Haidong Prefecture receives 100 million yuan from the State Government for rural infrastructure of the poor area. The integrated community development does require rural infrastructure building, and it can be argued that in support of the multi-sectoral rural community development, the donor agency can influence the timing and the way the rural infrastructure will be constructed and maintained by integrating rural infrastructure components in the project design. And it is necessary for such a project to include some budget for rural infrastructure mainly to ensure that all multi-sectoral components will be implemented in the project target villages, at the most appropriate timing, and in a participatory and integrated manner. But, to make it happens in planning and implementation, a strong leadership and/or commitments from all the institutions involved is the key.

Regarding the participatory approach for maintenance of the road and water supply, the impacts or changes made by the project are less visible at this point of time (two or three years after the construction) at the institutional level and at the community level. For example, villagers are not organized for the maintenance of water supply and are not consulted to determine the level of the water fee. Local Government Bureaux i.e. the Transport and the Water Supply, have an established procedures and regulations on the construction and management of the rural roads and water supply system including maintenance and fee collection. Traditionally and institutionally, the community labour contribution for road and water supply construction are common practices in most rural areas. And the people's contribution is rather encouraged as a part of the development strategy of the Government of China.

At least, at the community level, a water technician and a group of volunteers can be organized to maintain the water supply system, and a community consultative mechanism can be put into practice with regards to determination of the water fee per households in a village. PMU should take a monitoring role on this aspect and make recommendations to BoM and the Prefecture Government for consideration.

(4) People's Participation, Organization and Empowerment

People's participation is the core of community development and poverty alleviation because it is the people themselves who will be benefited/affected by and ultimately be held responsible for all the outcomes produced by the project activities. Although the link with ABC is an appropriate choice and is working, it seems that the elements of people's participation and organization for further empowerment were left behind in the transition. This is understandable because the main strategy here is to build on the existing structure of the rural finance in China creating the extended arms and means through the creation of CEIs, and not necessarily creating a new structure or an organization of the poor households.

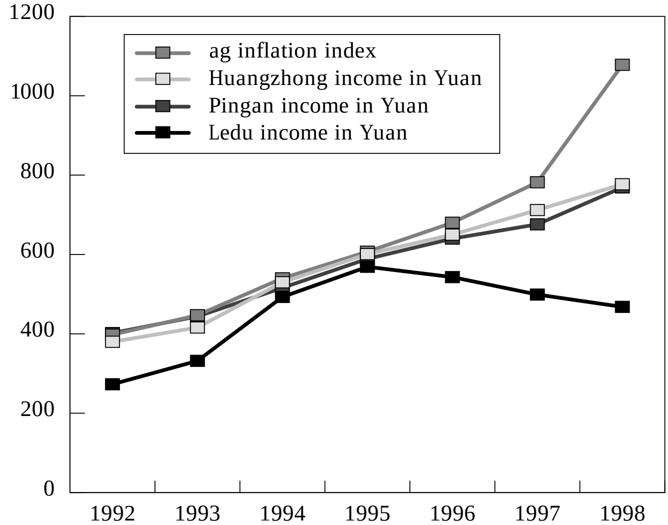
Instead, the project has provided a tremendous flexibility to the farmers in terms of loan products i.e. three different types of loans. This is a big challenge not for borrowers but for MFIs handling these products, and a lot of lessons can be learned from this experiment.

However, it should be noted that there is an overwhelming trend for the borrowers to take only one type of loan, the term loan with one time repayment, which is more traditional banking type of loan. Of course, for ABC and CEIs, the term loan is much easier to handle and much less labour intensive and less time-consuming. It is natural for people to believe that the term loan is easy to handle and less trouble for them because they do not need to worry about repayment on weekly or monthly basis. But, it is exactly why the idea of frequent installments was born. The frequent installment and center/group meeting will remind people to plan carefully, invest productively, and check and learn from what others are doing.

In this aspect, there is a scope for AusAID and UNDP to collaborate in exploring the ways and means to link two distinct approaches: institutionalization of microfinance within the existing financial institutions and creation of self-organizing association of and for the poor. Both approaches have its strengths and weaknesses, many of which are complementary, and a lot of scopes exist for mutual enhancement.

Attachment 7: Average Per Capita Income 1992–98 and Inflation

Figure 2: Agricultural Inflation and Incomes



Year	Agricultural inflation index	Huangzhong Income in Yuan	Pingan Income in Yuan	Ledu Income in Yuan
1992	273	380	398	402
1993	332	416	447	444
1994	493	530	540	516
1995	569	601	607	589
1996	543	650	680	640
1997	499	712	782	676
1998	468	777	1078	769

Agricultural inflation index from Qinghai Statistical Yearbook 1999 p.158.

Represents rise in basket of agricultural products.

Income in Yuan is average annual per capita income for all agricultural community in each county.

Source: Qinghai Pado tables

Comment

This data answers the question: To what extent is the rise in incomes caused by inflation?

There was severe inflation '94 and '95 throughout the Chinese economy, and its effects are shown even in Qinghai farm products index. Some farm products are commercial, so the effect may not have been as severe on remote, poor peasant villages.

The important fact is that the rise in per capita income in agricultural households grew after 1995 against decreasing inflation. That is, the rise in incomes is real.

Attachment 8: Inventory of Major Reports

Document Name	Author	Date
Project Identification Report	AusAID	May 92
Prefeasibility Vol 2 Working Papers	AusAID	May 93
Community Development and Gender	Pamela Tan	Jun 94
Project Implementation Document	Hassall and Associates	Jun 95
Finance & Banking	Enjiang Cheng	Oct 95
Small Credit Group Operations	Robert Hickson	Oct 95
Microspecialist Report Interim Review 2	Robert Hickson	Dec 96
Microcredit Programme Review	Hassall and Associates	late 96
Microspecialist Report Interim Review 3	Hassall and Associates	Jun 97
Savings & Credit—Training/Implement.	Robert Hickson	Jul 97
Microcredit Programme Review 2	Hassall and Associates	Oct 97
Microcredit Prog.Management Info Sys	Hassall and Associates	Mar 98
Final Project Completion Report	Hassall and Associates	Oct 98

Attachment 9: Qinghai Community Development Project Statistical Summary

Country	1993 Population	Project Target Population	Km of Project Roads	Villages Benefiting from Project Water Supply	1992 County income per capita (Y)	1998 County income per capita (Y)	No. of MC loans
Huangzhong	107,200	19,500	16.5	14	380	777	8,978
Pingan	292,800	37,060	19.0	12	398	1078	6,792
Ledu	444,500	70,850	35.5	15	402	69	9,502

Budget Components[1]
A$

	Inception	Component 1	Component 2	Component 3	Component 4	Implementation Total
Australia	700,000	786,349	2,692,247	194,375	685,626	4,496,438
China	261,900	1,502,384	273,011	238,664	224,454	2,238,513

1 A$ values actual at time of disbursement. Some disaggregated data only available as forecast.
Qinghai Community Development Project Ex-Post Evaluation

Attachment 10: Microfinance Schemes: A Basic Primer

Robert Hickson, Microfinance Services Pty. Ltd.
Betty Wilkinson, IRIS Center, University of Maryland

1 Overview

While there is a long history of informal small savings and credit services around the world, over the last twenty years a more systematic external approach has emerged, which is called microfinance. Microfinance schemes were developed to give poor people access to savings and credit services at a reasonable cost, where such services were not being supplied by the formal financial system. Despite great initial scepticism, microfinance institutions (MFIs) have managed not only to defy their critics in the formal banking sector, but to out-perform commercial banks in the areas of volume lending and on-time repayment.

Microfinance programs differ considerably from banks in terms of their operating methodologies. MFIs attempt to work exclusively with the poor, offering a service that is adapted to meet the particular circumstances of such households. The conditions of poor families include a lack of mortgagable assets, relatively low levels of technical skills, lack of formal employment, small size of usual business transactions, and strong risk adversity. Microfinance programs accordingly establish small, manageable savings deposit and loan repayment amounts. They use peer influence among clients, and provide positive incentives for repayment among other motivational mechanisms.

Microfinance institutions vary greatly in terms of both their organisational structure and governance. Most programs are operated by social service-oriented non-government organisations (NGOs), although privately-owned MFIs exist, and cooperatives (popularly known as credit unions) sometimes serve this client group. NGO managements place heavy stress on concurrent developmental and poverty alleviation objectives, rather than profit. Credit unions operate solely to serve the interests of their defined membership. The motivations of investor-based financial institutions differ from those of NGOs and credit unions. Consequently even where the economic climate is highly conducive to the success of microfinance, such profit-driven financial institutions are only slowly entering this market. Corporate structures and those where ownership is clearly defined are becoming more preferable to regulators and to investors, as MFIs become larger, more influential, and thus increasingly visible to financial system supervisors.

Microfinance programs in most countries target poor households with insufficient land or capital resources to be self-sufficient. The households make their meagre living from wage labour, processing farm produce, or work in the semi-skilled service sector. These households generally have small but reasonably regular cash income during the year[1]. Accordingly, they like programs with small periodic savings or loan repayments. Here lies one of the most critical components to microfinance programme success. Regular small instalments, or payments made after the sale of a loan-based asset such as a pig, are manageable to poor households. Microfinance programs with small frequent loan repayments or repayments immediately after major cash transactions effectively enforce a discipline of regular thrift. Any surplus funds above those absolutely essential for survival are set aside to pay the loan instalment or agreed-upon savings. These funds help build family security, and are not used for small luxuries or forced away by friends and relatives who may create pressure on poor households to use any surplus cash.

Characteristics of Successful Microfinance Schemes are:

- The service is both useful and responsive to member's needs.
- Clients enjoy positive incentives for participation in savings schemes and for timely loan repayment.
- Services are provided at or near client's homes or workplaces.
- The cost of microfinance services enables prices that are able to undercut the existing informal money market (e.g. traditional moneylenders).
- Physical, mortgagable collateral is not required.
- Programs offer a schedule of manageable repayments on loans.
- Financing terms and conditions are tailored to suit individual needs as much as possible. This is becoming particularly important in areas where microcredit supply is high and programs begin to compete for clientele.
- Transparency: objectives are clear, and significant efforts are made to ensure that the rules are known to all, as well as being universally and consistently applied. Thus, staff and members must have same understanding of program objectives and regulations.
- Because of the large number of small transactions, the organisational operating procedures are simple and efficient in order to control costs and keep clients satisfied
- MFI professionals provide effective monitoring and evaluation.

1 For some areas, such as rural China or isolated areas such as Zambia, cash income may be more sporadic and lumpy, and barter trade may still be relatively common. In such cases, savings and loan repayments may be structured around likely high cash volume periods such as before festivals. In both Africa and Asia, rice or other grains may act as cash substitutes for small savings or loan repayments.

2 Socio-economic and Political Operating Environment

Micro finance programs have proven to be most successful in environments where:

- There is a high and unsatisfied demand for small amounts of credit and/or savings services.
- There is a shortage of capital and abundance of relatively cheap labour. In these circumstances it is possible for borrowers to achieve very high returns on capital investments.
- The implementing agency can operate in accordance with client priorities rather than those defined by another authority. Programs need to be flexible so they can effectively respond to market demand (client credit and savings needs).
- Many opportunities exist to start microenterprises. Due to the short length of most microfinance loans, businesses with high cash turnover are particularly popular among borrowers. The best example of this is petty trading. Fixed asset investments (e.g. livestock) often require a secondary income source to cover repayment obligations.
- Clients have sufficient market access to have regular cash income at least once per month.
- The legal and regulatory environment allows for new MFIs to open, operate responsibly with few or no restrictions, and freely charge interest rates and fees which cover the costs of a) operations, b) loan funds, c) loan losses, d) inflation, and e)profits.

3 Implementing Agencies

Implementing agencies should have:

- Strong social motivation or financial incentive.
- Leaders with commitment, vision and a willingness to experiment (village economies are poorly understood and many opportunities still exist).
- A detailed understanding of the disabling environment of the poor.
- Management capable of responding quickly and effectively to problems in the field.
- The ability to effectively monitor and analyse the performance of the program, efficiency of fund management (e.g. fund turnover rate), targeting, credit efficiency, usefulness of service and opportunities for improvement.

- A legal, operational, and financial structure that enables full operations, growth, and sustainability.

4 Target Households

Target households of most microfinance programs are either rural poor villagers or urban poor slum dwellers. These households depend upon wage labour, cash from various income-generating activities or a microenterprise for their earnings.[2]

Women borrowers are preferred, as worldwide evidence suggests that they are more reliable in loan repayment. Women have also been found to be more responsible with investments. They use proceeds of investments for priority family needs such as children's education, health, and nutrition. Finally but of equal importance, women are identified as an underprivileged group in most countries.

Poverty in every country has markers which help MFIs identify and talk to potential clients. The most common ones include the amount and productivity of land owned or controlled, the physical condition and materials of the house, ownership of animals, and level, sources, timing, and diversity of income. For example in the Grameen Bank model, households are selected by program staff on the basis of having less than 1/5 acre of land, total assets worth less than US$ 1,000 and income below the poverty line. An idealised example may be a destitute widow who uses credit to start a small tea shop.

5 Minimalist or Credit-Plus: Context for Microcredit Provision

Currently there are two forms of microfinance service provision: minimalist, and comprehensive or "credit-plus". Both approaches recognise that provision of microfinance may not be enough to alleviate poverty; they differ in the ways that other services should be provided. The minimalist approach advocates the provision of microfinance services from a separate, autonomous body, with the addition of other services (such as business training) from other agencies with separate funding and systems. By contrast, "credit-plus" argues for the provision of microfinance with other non-financial services from the same agency in the field. There is not yet significant enough information on both MFI performance and poverty alleviation under both models to determine which is more effective. However, minimalist-based MFIs have tended to be more financially sustainable.

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2 In recent work by James Edgerton, a poor household income hierarchy has been suggested with wage labour as the lowest level. The next step for a poor household would be income-generating activities (IGAs) involving the individual and/or household labour along with minimal capital. A microenterprise tends to be informal, household-based, focused on one or two activities, and is likely to operate over longer periods of time than an IGA and involve more value-added and more capital. All three of these levels would be served by microfinance institutions.

Some microfinance programs operated by NGOs are seen to be only one component of a "comprehensive" approach to the socio-economic uplift of the poor. These NGOs may provide additional services such as advice on health and sanitation, supply of trees for reforestation, political conscientisation, family planning, literacy and vocational training. Such services may be provided within the same organisation without physical and financial separation, or by separate offices. The non-financial services may be provided as an option for the poor, or they may be required as part of a full package of mandatory services. Where non-financial services are mandatory, poor households may not particularly want them, but usually they participate reluctantly in order to gain access to the microfinance services on offer. The critical step is to empower poor people by giving them the choice to use individual services as they wish, rather than forcing them to use their time engaging in activities which they do not value in order to access those services which are important to them.

Many NGOs use the formation of village groups as an organisational mechanism to empower the poor to effectively fight oppression by the local (and even national) power structure. This can be valuable, and has been a powerful force for change in some areas. Often the goal is to institutionalise these groups into secondary and tertiary umbrella organisations, to more effectively challenge government bureaucracies and powerful vested interests in the village. Unfortunately this empowerment process does not often occur in a sustained, unsupported manner, and when entangled with microfinance can be damaging to the sustainability of financial services to the poor.

In contrast "minimalist" programs only offer financial services. Grameen Bank has a minimalist approach. Fundamentally, its success is based on assisting its members to fund traditional village-based income-generating activities for which they already have skills. Where additional skills are required in order to make microfinance services effective, minimalist programs are less effective and must await the completion of such programs. However, minimalist-based MFIs tend to be more financially sustainable, and to respect the wishes and options of clients in more fundamental ways by enabling the poor to make their own investment and time choices.

6 Loan Terms and Conditions

Common loan terms and conditions include the following:

- Loan is for up to one year, only one loan at a time until the client is well-proven (five years or more).
- Repayment is usually in equal periodic instalments payable at or near their homes on fixed dates.

- Interest varies from 10 to 120% p.a. depending on local conditions and costs.
- The maximum loan size is small for the first loan (often less than $100), increasing with subsequent loans.
- Loan size may also be linked to size of average monthly savings deposits prior to taking loan. This is used to assess borrowers' existing capacity to mobilise savings and therefore repay loans from existing income sources. This flies in the face of the popular perception that the poor have no potential to mobilise savings.
- Borrowers sign a simple document that states the loan amount, any fees or conditions, the repayment rate and timing, the interest rate and cost of interest, and penalties for late payment or default.
- Borrowers in groups guarantee that they will pay the loan of defaulting group member, or not have access to future loans.

7 Delivery Systems

Most programs involve periodic visits by program staff to villages to collect savings deposits and loan repayment instalments from members. Members are organised into small primary groups, which can be collected again under the auspices of an umbrella village organisation. Funds collected are deposited into a single account held by a branch office with a local bank. Loans are disbursed directly from the branch office or by field officers in the borrower's area.

All transactions are recorded in individual savings passbooks and loan record books. All collections should be acknowledged with the signature of the field staff.

Funds are transferred to branch offices from head offices as required. Often branch offices are expected to be individual cost centres. They become financially independent by borrowing funds from their head office and gradually repaying this principal and interest, as well as their operational expenses, from their own profits.

8 Loan Security

8.1 Positive Incentives Instead

In place of physical collateral, microfinance programs have a number of other important strategies for securing loan repayment and therefore financial viability. First, and most important in environments of high unsatisfied credit demand, is a mechanism by which 100% loan repayment is rewarded with the immediate eligibility for another larger loan. This is particularly attractive for small off-farm enterprises, which have the ability to expand their scale of their operation by increasing stocks for traders, increasing labour and inputs for processors, or expanding service provision.

The second mechanism used by microfinance schemes to secure loan repayment is the use of what is usually known as group collateral. This requires all members of a particular group to repay their loans fully before any are eligible for further loans. Peer group pressure is used to encourage member compliance to her or his loan responsibilities. This condition is most appropriate in schemes using uniform loan schedules. In a scheme with flexible loan terms, the condition may be modified so group members continue to be eligible for loans so long as no group member is in arrears or has defaulted.

8.2 All or Nothing

While the group security technique can be effective in maintaining strict credit discipline by reducing tardiness in periodic repayments, it has also resulted in some dramatic collapses of repayment discipline. At a certain point when one member falls too far arrears in her loan payments, other members realise that their creditworthiness is lost and decide that there is no point in continuing their own instalments. Often this break in discipline in one group spreads to other groups, causing widespread default. In Bangladesh this phenomenon has been referred to as unzipping[3] and although deliberately not publicised by microfinance agencies, it has occurred a number of times with very alarming consequences. Nevertheless the advantages of the group approach out-weigh the dangers, particularly for borrowers who are new to microfinance programs and have not inculcated a habit of regular household savings.

8.3 Savings as Collateral?

Occasionally it is suggested that member savings be used as 'collateral' to secure loans. However, this is not the usual practice of microfinance programs.[4] The risk of losing a relatively small amount of savings is not likely to outweigh the financial advantage of retaining the much greater loan amount. Therefore, securing the loans using these savings systems is insufficiently strong motivation by itself to ensure on-time repayment

MFIs do set up systems that require a certain amount of savings to be provided, either in terms of total amounts or of regular, small savings in minimum payments However, the funds are not generated to completely cover the loan amount. Instead, microfinance programmes often set this system up to

3 A term coined by Stuart Rutherford, an independent researcher into financial services for the poor in Bangladesh.

4 Credit unions are the most significant group providing credit services under these conditions, and usually lend in some multiple of savings, such as two or three times the savings held by the member.

determine the amount a member can regularly save, and to establish a practice of regular savings among members. The amount saved is used as an indication of the amount a client could repay as a loan instalment.

8.4 Risk Funds

Finally, many microfinance programs deduct an amount from the loan disbursement, which is deposited into a "risk fund" for use in case of default by individual members. While this provides a small safety net to cover occasional default, it does not in itself encourage individual repayment. Older microfinance programs have tended to move unused risk funds into the savings funds, or refunded the money to clients.

9 Monitoring and Evaluation

The purpose of program monitoring is to enable better planning for program needs in both financial and operational areas, to catch problems early so they can be resolved before they become damaging, and to locate successes so they can be expanded and enhanced. Overall program monitoring utilises information coming from operation and impact monitoring to analyse the quality of services being offered, and how it may be improved to better meet the needs of members and the sustainability and growth of the MFI.

Program operation information usually includes member characteristics and financial data relating to the savings and credit operations. This may involve[5]:

- Member numbers and characteristics such as base assets, gender, location, group participants.
- Number, gross amount, and average amounts of active savings deposits and loans.
- Portfolio performance and efficiency, including credit fund turnover rates, loan delinquency over 30 days, portfolio at risk, loan losses and loss reserves.
- Financial information such as debt/equity, level of operational and full financial self-sufficiency, and net income per unit lent.
- Productivity measures such as number of active loans per loan officer, total administrative expense per average gross portfolio, loan officers as a percentage of total staff, and staff retained over 12 months.
- Checks against cash management and fraud by staff, e.g. calculation of expected account balances cf. Actual, cash holdings on-site vs. in bank.

5 The authors are indebted to the MicroBanking Bulletin produced by Calmeadow and funded by CGAP for some of these indicators, particularly in the productivity area.

- Forward planning of cashflow, particularly credit fund requirements, and projections of movements to and from Head Office and distribution mechanisms.

Some microfinance programs perform impact monitoring. This requires the measurement of the benefits being experienced by members. It is done using routine household surveys or specific ad hoc studies. While this does not necessarily effect the efficiency or sustainability of an MFI, it can help with targeting and provision of appropriately designed savings and credit products.

Quality Assurance Series No. 21

Qinghai Community Development Project

The Qinghai Community Development Project focused on the provision of rural infrastructure and mircrofinance facilities to communities living in an extremely harsh and remote region of China. From 1995 to 1998 the Australian Government and the Government of the Peoples Republic of China contributed over $A6.7 million to the implementation of the project. Australia's support was directed into two main areas; 'cash-for-work' for both village roads and water supplies, and about half of the total budget supported a revolving microcredit fund.

This evaluation focussed on the microfinance aspect of the project, and assessed the use of microfinance as a community development mechanism. Its findings reveal some valuable lessons for the design and implementation of projects in this field. Key among these is the critical importance of community consultation and involvement in the delivery and management of credit provision. In addition, when direct benefits are given to individual villagers or poor communities, the evaluation found that it is important to make strategic interventions which bring about changes in institutional attitude and behaviour towards community development and poverty alleviation.

The Microcredit fund was implemented through the Agricultural Bank of China and the project was instrumental in shifting the focus of the Bank in that region towards smaller lending packages.

The report notes that there is scope to explore more effective means to link two distinct approaches; the institutionalisation of microfinance within the existing financial institutions, and the creation of self-organising associations of the poor.