

AGREEMENT

between the

GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA

and the

ASIAN DEVELOPMENT BANK

on a

POVERTY REDUCTION PARTNERSHIP

I. INTRODUCTION

1. The Government of the People's Republic of China (PRC) and the Asian Development Bank (ADB) agree that this Poverty Partnership Agreement¹ (PPA) is intended as a statement of shared intent around an agreed set of broad strategic objectives. The details of future ADB operations in PRC will continue to be developed, in close coordination with the Government, in the context of the formulation of the Country Strategy and Program (CSP) and the annual CSP update missions. In order to achieve the common goal of poverty reduction through closer cooperation, ADB stands ready to support PRC's efforts through the provision of financial resources, knowledge products, staff and consultant (domestic and international) expertise, and experience in other countries. This PPA sets out a long-term vision for cooperation between PRC and ADB, and delineates strategies and interventions within the short and medium terms. It also sets out a mechanism for monitoring, review, and evaluation. The PPA, including its strategic focus, will be reviewed annually and modified depending on achievements and contextual changes.

II. THE LONG-TERM VISION AND APPROACH

2. **PRC's Achievements and Challenges.** Since economic reforms began in 1978, PRC has been successful in reducing the number of absolute poor in rural areas. The international community, as reflected in the Millennium Declaration of the United Nations adopted by the General Assembly in September 2000, has indicated common objectives which the world community is striving to achieve. Because of sustained, rapid economic growth and targeted Government programs, PRC has already achieved the target of halving poverty from the 1990 level and is ahead of schedule in achieving most of the Millennium Development Goals.

3. PRC's success in poverty reduction reflects the impact of sustained rapid economic growth and associated improvements in the standard of living over the past two decades. There is a strong Government commitment to equitable and inclusive development which includes mainstreaming the poverty reduction efforts of a wide variety of actors, programs and funding channels and significant budget allocations for initiating self-help among the poor. PRC's poverty reduction approach is area-focused, with a strong emphasis on social and economic infrastructure provision and creation of employment opportunities. An estimated CNY198 billion (\$23.9 billion)² was targeted to the poor from 1994 to 2000 of which CNY43 billion (\$5.1 billion) was targeted to minorities. In 2001, the Government introduced a new 10-year poverty reduction strategy envisaging investment of over CNY30 billion (\$3.6 billion) a year in poor areas.

4. As confirmed at the National People's Congress in 2003, the Government recognizes a continuing need to address existing and emerging poverty reduction challenges such as (i) maintaining sustained rapid economic growth; (ii) ensuring that the growth is pro-poor and that the benefits of growth are widely shared in society; (iii) targeting the poor living in geographically disadvantaged and environmentally degraded areas; (iv) the need for the private sector to provide alternative job opportunities to help address rising urban poverty associated with enterprise reform and labor retrenchment and rural migration to cities; (v) the growing inequality between the western/central and eastern regions of the country and between urban and rural

¹ The term "Agreement" has multiple translations in Chinese. This "Agreement" should be interpreted as a mutual understanding rather than a legal commitment.

² Inclusive of national and local government funding as well as civil society donations.

areas; (vi) the need for social safety nets to protect the most vulnerable people during economic transition; and (vii) the need to increase poverty program effectiveness through participatory approaches involving local communities.

5. **The Challenge of Inequality.** PRC's income distribution has become more unequal since the mid-1980s, and income inequality is above the international average. Three factors contributed to rising inequality: (i) the growing gap between the wealthy coastal provinces and the poorer interior provinces; (ii) urban incomes have grown faster than rural incomes; and (iii) increasing inequality both in rural and urban populations. To address geographic inequality, the Government launched its Western Region Development Strategy in 1999. The current focus is on improving infrastructure, protecting the environment, and encouraging private sector investment. Experience in other countries shows that, in addition to supporting rural development, rural-urban migration and creation of off-farm employment opportunities can help address urban-rural inequality (urban incomes are about three times rural incomes).

6. **PRC's Poverty Reduction Strategy.** In May 2001 PRC adopted a ten-year poverty strategy identifying key counties for poverty reduction and development to assist 30 million rural people with incomes under the Government's official poverty line of CNY625 per capita annual income and another 60 million rural people with per capita annual income below CNY865 and vulnerable to falling into absolute poverty. PRC's official poverty line is a rural subsistence line and is low compared to international practice. Provinces can also set their own poverty lines which can be higher than the national poverty line. Priority will be given to remote and mountainous areas, minority areas, and pockets of severe poverty. The focus of the new strategy is on poor household and village activities. Participatory approaches will be used to involve the poor. In addition, the western region development strategy embodied in the Tenth Five Year Plan is using geographic targeting to address inadequate infrastructure; environmental problems such as land degradation, desertification and soil erosion; water resources management issues; weaknesses in the enabling environment for the private sector; and weak human resources. In urban areas, programs are being developed to address poverty through social security reform, income and job generation for laid-off workers, addressing urban pollution (air, water, and solid waste) and creation of off-farm employment opportunities. PRC does not have an official national urban poverty line, but cities have adopted minimum living standards to help the poor.

7. **Constraints to Achieving Poverty Reduction Objectives.** To continue its successes in poverty reduction, the Government recognizes that there are several constraints that need to be addressed over the next five to ten years. These include: (i) budget constraints that limit the reach of poverty assistance; (ii) institutional capacity and human resource constraints limit effectiveness of poverty assistance; (iii) the need to address urban poverty and the lack of a national structure to address it; (iv) uneven coverage of, quality of, and access to health services for the rural poor and lack of a social security system in rural areas; and (v) low enrollment of the rural poor in secondary and post secondary schools and the weak linkage of education to the demands of the market place.

8. **ADB's Approach.** ADB's Poverty Reduction Strategy (November 1999) refocused its work on the overarching goal of eliminating poverty. ADB's long-term strategic framework (LTSF) responds to the development goals included in the Millennium Declaration. The LTSF specifies four operating principles: (i) ensure country leadership and ownership of the development agenda, (ii) take a long-term approach to development assistance, (iii) enhance strategic alliances and partnerships, and (iv) measure development impact. Specifically, the LTSF states: "Investments will be required for the provision of infrastructure and growth-promoting activities, for ensuring sustainable economic growth, inclusive social development, and governance. These investments will need to be accompanied by policy reforms and

institution and capacity building." In addition to investments, ADB will provide knowledge products and services to provide cutting edge advice in areas linked to poverty reduction (such as reforms in social security and pension systems).

9. The Government believes that its lack of access to ADF resources significantly narrows the range of feasible options for ADB's direct involvement in poverty reduction. The Government does not find it appropriate to use OCR to support interventions for direct poverty reduction, education, health, and rural development projects where prospects for timely cost recovery are limited. In these cases, PRC prefers to use domestic funds or bilateral grants. Accordingly, the Government and ADB agree that ADB's focus should be to support pro-poor sustainable economic growth through pro-poor infrastructure and environmental improvement projects, by promoting a vibrant private sector to create the necessary jobs, and undertaking policy studies and other knowledge products and services related to poverty. There are important linkages between these sectors and poverty reduction.

10. **Transport and Poverty Reduction.** The poor have limited mobility beyond their immediate communities because of geographical isolation and the high cost of motorized transport. As a result, they generally view roads as a key infrastructure investment priority. Benefits for poor rural areas include lower transport costs, lower cost of inputs, expanded agricultural support services and therefore improved farming practices, greater access to employment opportunities in urban areas and better access to health, education or social services. Better roads promote the transition from a subsistence farming rural economy to a cash crop and more diversified economy with a higher and more stable income flow to rural households leading to poverty reduction.

11. Transport infrastructure is necessary to create the conditions for economic growth, and growth is necessary to reduce poverty. Good infrastructure is part of the enabling environment for the private sector to flourish. In one ADB survey, when the domestic private sector was asked to identify infrastructure constraints, 21% responded poor roads. The road network is particularly underdeveloped in the poor central and western provinces. Poor infrastructure was also cited in another ADB survey as a major reason that foreign companies do not expand their operations into the poor interior provinces.

12. Railway development in less-developed inland provinces helps to promote growth and reduce poverty. Improved railway transport results in the growth of industry which increases employment opportunities. The shift in employment from agriculture to agro processing, light industry, and services increases employment opportunities for women whose incomes and social status then improve. The tourism industry also develops rapidly. Railway development may contribute to increasing local area per capita GDP, thus helping to raise living standards and reduce poverty.

13. **Energy and Poverty Reduction.** Poor people are often disproportionately exposed to the negative environmental impacts of energy use. The supply of cleaner energy and energy conservation efforts are expected to result in significant welfare gains for the poor. Electricity can dramatically improve the quality of life. For example, small businesses can be set up that use machines with electric motors, children can study at night, and the poor can broaden their horizons through access to a wider world through television and radio. A reliable supply of energy is needed to operate medical equipment in rural areas. As three quarters of the PRC's population live in the countryside, providing a reliable supply of electricity in rural areas is important. Specific poverty-related project components can include rural electrification, provision of energy efficient lighting for the poor, and design of special electricity tariffs targeted on the poor so that they can afford the electricity provided by such projects.

14. **Water and Poverty Reduction.** Assistance for wastewater, water supply, and water resources management sectors benefits people who are adversely affected by polluted water. These people are often the poor. Improving sanitation and public health benefits from improved access to safe drinking water and wastewater treatment can strengthen poverty reduction impacts. Tariffs can be structured to ensure the poor can access these services and to implement improved environmental and water quality management.

15. **Environment and Poverty Reduction.** The poor are most vulnerable to environment-induced diseases and are least capable of paying for adequate medical attention for the associated illnesses. About 90% of the officially-designated rural poor live on moderately to severely degraded land and in remote areas along PRC's borders. Addressing environmental problems is critical for sustainable development and reducing the adverse impact of the environment on the poor.

16. **Private Sector and Poverty Reduction.** The private sector will be the engine for economic growth, productivity increases, job creation, and increased incomes that are necessary to lift people out of poverty. There are links between growth and private investment and between job creation in the private sector and poverty reduction. International experience shows that higher growth rates are associated with a higher ratio of private investment to GDP and that private firms create four to eighty times more jobs than public sector firms, depending on the country. In PRC, for every 1% increase in the share of private employment, there is an estimated increase of CNY164 (\$20) in per capita GDP. Developing an enabling environment so the private sector can grow and prosper will contribute to poverty reduction.

III. STRATEGIC FRAMEWORK (2003-2005) FOR PRC-ADB SUPPORT TO POVERTY REDUCTION

17. In accordance with ADB's Medium-Term Strategic Framework, ownership and leadership of the development agenda is related to a poverty reduction agenda based on a strategy that is fully owned and supported by the PRC. The assistance of ADB will be based on the national development plan and poverty reduction strategy. To enhance ownership, the CSP cycles for PRC will be aligned with its medium-term planning and public investment cycle. Over the near to medium term, PRC and ADB strategies related to the issues below will be reflected in ADB operations in PRC:

18. **Pro-poor Economic Growth through Infrastructure Provision.** Public investment in physical infrastructure (e.g., roads, railways, energy, water supply, and sanitation), is important for raising productivity and realizing long-term economic growth. Good infrastructure is also necessary to create the conditions for the private sector to thrive and enable markets to operate efficiently. In PRC (i) 3.2 poor people are lifted out of poverty for every CNY10,000 invested in roads; (ii) for every 1% increase in kilometers of road per capita, household consumption increases by 0.08%; (iii) every 1% increase in irrigation expenditures is associated with a 0.41% increase in agricultural output per worker and leads to a 1.13% decrease in poverty incidence; and (iv) 2.3 poor people are lifted out of poverty for every CNY10,000 invested in power. ADB infrastructure interventions will largely be located in poor inland areas and designed to spread the benefits of such investments to the poor. Some examples would be including local roads, rural electricity, or rural water supply (financed, depending on local capacity, by Government, ADB, or both) in the overall design of ADB-financed infrastructure projects. Around two thirds of PRC's ADB-financed lending volume will be targeted to the poorer western and central areas. For infrastructure lending in eastern areas, efforts will be made to design projects to disproportionately benefit the low-income population.

19. **Supporting Private Sector Development:** PRC needs to create 15 to 28 million jobs annually to absorb new labor market entrants, absorb the more than 10 million workers made redundant by the reform of State Owned Enterprises who have not been re-employed and employ some of the 150 million surplus rural workers. International experience shows that creating a pro-business environment helps to increase wealth and jobs. ADB will work in partnership with the PRC to develop the private sector. Examples of such activities could include (i) promoting the rule of law by strengthening the legal and regulatory framework and judicial system; (ii) revising the taxation system to convert legitimate fees and charges into taxes and abolishing illegal and arbitrary fees; (iii) removing infrastructure bottlenecks; (iv) revising the administrative laws and regulations to increase transparency and reduce the red tape faced by businesses; (v) removing barriers to inter-provincial trade; (vi) improving accounting and auditing standards and practices; and (vii) increasing the access of the private sector, particularly small and medium enterprises, to credit and other key resources.

20. **Environment and Poverty Reduction:** Addressing desertification, water shortages, air pollution, soil erosion, forestry, wetlands, and water pollution are particularly pro-poor environmental initiatives. PRC and ADB will continue to cooperate on a broad range of activities related to policy and regulatory reform and capacity building in the environment sector and support selected projects to address environment problems. Projects will be designed so that the poor capture some of the environmental benefits. To sharpen the poverty focus of environmental work, PRC and ADB will begin to address land degradation and better target poor areas by supporting the implementation of the 10-year (\$150 million, grant-financed) PRC-GEF Partnership for OP12 to address policy, institutional, technical and financing issues related to land degradation. The PRC-GEF Partnership aims to reduce poverty, arrest land degradation, and restore dry land ecosystems in the western region.

21. As urbanization accelerates the demand for urban infrastructure and services will increase. To enhance the development impact, future lending program should explore the possibility of undertaking an integrated approach to support the urban development programs and projects. ADB will help PRC develop a set of urban-oriented environment improvement projects in selected cities, including water supply, wastewater and solid waste treatment, air quality improvements, urban transport and city environmental rehabilitation projects.

22. **Regional Cooperation:** PRC and ADB will enhance regional cooperation as a means to help promote economic growth and reduce poverty. This will be done, with ADB support, by (i) facilitating cooperation and policy dialogue among the countries to improve the policy environment and stimulate economic activity and cross-border trade; (ii) advancing implementation of priority subregional projects to stimulate growth in border areas; (iii) encouraging partnerships in public-private sector project finance; and (iv) building local capacity to manage regional cooperation programs. Many of PRC's poorest minority groups live in border areas. Promoting trade and stimulating economic growth and private sector development in these areas will help provide employment opportunities for the poor communities.

23. **Pro-Poor Policy Analysis:** PRC will strengthen governance in the areas of predictability, accountability, participation and transparency with ADB assistance through both operational and analytical work. Examples of areas where ADB will cooperate with PRC include legal/regulatory reform, accounting and auditing, fiscal reform, corporate governance, and promoting an enabling environment for the private sector. The poor will benefit from these initiatives. To sharpen the poverty focus of such efforts, PRC and ADB will look for ways to help in such areas as reforming the delivery and planning system for poverty reduction, improving local level planning for service delivery to the poor, developing poverty reduction-focused provincial development plans, strengthening the fiscal position of poor counties, strengthening

legal assistance to the poor, reducing inequalities between eastern and western/central and rural and urban areas, creating an enabling environment for small and medium enterprise development to increase employment opportunities, developing social safety nets (social security and pension reform), enhancing flood control and integrated river basin management, and promoting participation of the poor in designing and implementing development projects.

24. **Special Initiatives: Poverty Reduction Funds.** ADB has established poverty funds supported by DFID and the Netherlands. ADB will work with the PRC to identify suitable poverty reduction-related projects meeting the criteria for using the fund. Projects will be identified to help deepen the poverty reduction impact of PRC infrastructure and environment loans financed by ADB and to support strategic poverty-related policy formulation of nationwide importance. Around \$14 million will be available from these funds through 2006. In addition, the PRC-GEF Partnership mentioned above (see para. 20) is closely related to poverty reduction. ADB will continue to actively try to mobilize additional concessional resources to finance poverty reduction interventions in PRC.

IV. MONITORING AND EVALUATION ARRANGEMENTS

25. An effective monitoring system to generate statistics and track key indicators is critical to identify PRC trends in poverty reduction, assess ADB's impact on poverty reduction, and provide an objective basis for future programming choices. Both the income and non-income dimensions of poverty need to be monitored to compare actual achievements with targets. ADB will use available poverty reduction grant funds to work with the Government to identify, develop, and periodically update appropriate monitoring indicators at the project level. There will be annual reviews of the progress made in implementing the PPA. The annual reviews will examine: (i) overall progress of PRC in meeting the Millennium Development Goals; and (ii) progress in sectors in which PRC and ADB cooperate to ensure project benefits reach the poor.

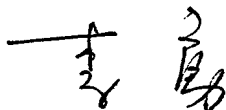
V. IMPLEMENTATION ARRANGEMENTS

26. Impact assessment and the status of the implementation of poverty reduction interventions will be reviewed during annual Country Strategy and Program Missions in the context of the Government's strategy for poverty reduction. Progress in achieving the Millennium Development Goals and the progress of ADB in mobilizing funds for poverty reduction will be discussed and representatives of target populations of the country program will be consulted.

SIGNATURE

This Poverty Partnership Agreement was signed in Beijing on 29 September 2003.

**For the
Government of the People's Republic of China**



Li Yong
Vice Minister of Finance

**For the
Asian Development Bank**



Joseph B. Eichenberger
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