

POVERTY ANALYSIS (SUMMARY)

A. New Trends in Poverty and Inequality

1. More than 3 decades of rapid economic growth has lifted millions of people in the People's Republic of China (PRC) from absolute poverty. As a result, the PRC has achieved the Millennium Development Goal (MDG) of reducing income poverty, and most other MDGs were already met or basically met by 2015.¹ Nevertheless, the PRC still has the second-largest national concentration of extreme poverty globally, after India.² The PRC defines its poverty line in terms of rural populations and their incomes and prepares specific poverty reduction policies and programs, including the Outline for Development-oriented Poverty Reduction for China's Rural Areas 2011–2020. In 2011, the PRC rural poverty line was raised to CNY2,300 per person per annum (at 2010 constant prices) and there were 70.17 million rural poor at the end of 2014.³ The Outline defined poverty geographically in 14 mountainous regions of the central and western PRC,⁴ which are home to significant ethnic minority groups. Millions of people in these harsh and remote areas remain poor or at risk of impoverishment from natural disasters; climatic instability; environmental degradation; lost resource access; medical or education costs; and market failures for which insurance, compensation, rural finance, service institutions, and legal redress remain inadequate. Moreover, income gaps and inequality between social groups and geographic regions remain stark. Official data indicates that the Gini coefficient increased from moderate inequality (0.350) in 1990 to peak at 0.491 in 2008 before falling slightly to 0.473 in 2013 and a still-high 0.469 in 2014. The per capita income of urban households was 2.75 times that of rural households in 2014.³ The main determinants of income inequality are the large gap in social and financial services, education, employment, and income opportunities between rural and urban areas and within cities, together with inadequate reform of the income distribution system. Regionally, gross domestic product (GDP) per capita in the central and western PRC was only 56.9% that of the eastern coastal region in 2013.

2. As a result, newer forms of relative social disadvantage, exclusion, and risk are emerging or gaining attention within the PRC. The PRC does not use a unified national poverty line and its welfare policies are bifurcated between rural and urban programs. However, 18.77 million urban residents in 10.26 million households received minimum social security subsidies (*dibao*) at the end of 2014, an average annual payment of CNY3,432 per person.³ In addition, millions of rural migrants and land-lost farmers live in urban areas, many in substandard rental housing. However, they are mostly ineligible for the social service entitlements and benefits of registered urban residents. Nascent residency system (*hukou*) reforms are being initiated but migrant access to urban social security and child schooling remains limited, particularly in the largest cities, greatly weakening social inclusion. Selective out-migration of the able bodied, together with rapid demographic change, has also left many elderly people more vulnerable, with 20.65 million receiving rural *dibao* at the end of 2014.⁵ Moreover, 60 million children of migrant laborers remained in rural areas in 2014, often without adequate family or social support.

¹ Ministry of Foreign Affairs (MFA) of the People's Republic of China and the United Nations System (UNS) in China. 2015. *Report on China's Implementation of the Millennium Development Goals (2000–2015)*. Beijing.

² World Bank staff estimate for 2014 (\$1.25 purchasing power parity poverty line) updating World Bank. 2009. *From Poor Areas to Poor People: China's Evolving Poverty Reduction Agenda*. Washington, DC.

³ National Bureau of Statistics (NBS) of China. 2015. *Statistical Communiqué of the People's Republic of China on 2014 National Economic and Social Development*. Beijing.

⁴ Of the 592 designated national poor counties, 375 are in the western PRC, 217 are in central PRC, and there are none in the east; 232 are in ethnic minority areas.

⁵ The total number of rural *dibao* recipients in 2014 was 52 million in 29 million households. Ministry of Civil Affairs (MCA). 2014. *Statistical Report on Social Service Development*.

Many women are also economically vulnerable, with an average income only 67% that of employed men in urban areas and 56% in rural areas in 2010. They are also disproportionately represented among urban (59.8%) and rural (65.7%) low-income groups. The needs of these diverse, impoverished or new at-risk populations require increased financial expenditures but also targeted forms of care and support that nascent rural and urban social service systems cannot meet. The government is exploring social service legislation, expansion, upgrading, and outsourcing, including to the private sector and social organizations and/or non-governmental organizations, but the creation of a modern social service sector remains an arduous task.

3. As the MDGs transform into the Sustainable Development Goals and the PRC transitions from rapid, resource-intensive growth toward the New Normal where the PRC focuses on the quality rather than the quantity of economic growth, it confronts two poverty and inequality challenges that may hinder its smooth ascent to developed-country status.

4. The first challenge is intransigent poverty in lagging regions. Earlier success in eliminating widespread poverty has revealed the sort of geographically concentrated, hard core poverty which proves difficult to address, even in advanced economies. The 14 poverty blocks under the PRC rural poverty program often have rich mineral, energy, water, land, scenic, biological, or cultural resources but struggle to spread their environmental benefit streams across local populations. They are frequently fragile mountain ecosystems, sitting astride the headwaters of major rivers that provide millions of downstream domestic and international users with clean water and energy, or arid areas prone to natural disasters and growing climatic instability. Consequently, they have increasingly stringent national environmental protection regulations to constrain resource use. However, these can inadvertently exacerbate poverty. Payment for environmental service schemes—and the PRC has some of the largest in the world—aim to ameliorate impacts of these restrictions on local resource users. Well-designed payment for environmental service programs could contribute to environmental protection *and* poverty reduction. Similarly, work on natural resource taxation, carbon sequestration, green jobs and market chains, environmental and social impact assessment for large development projects and policies in poor areas, community-driven development and village trust funds, nature reserves, pro poor tourism, ecological function zones, and environmental red lines (to name a few examples) could help to address local poverty and also protect global public goods.

5. The second challenge is economic vulnerability arising from inadequate social safety nets and risk insurance. This problem is experienced by (i) populations across the country which oscillate around the poverty line and so risk return to poverty through shock to their livelihoods or labor capacity, e.g., natural disasters or catastrophic illness and treatment costs; (ii) non poor populations entering poverty through unanticipated economic or policy changes;⁶ and (iii) those populations whose rights and entitlements to services and benefits are constrained by residence registration status. Without counterbalancing measures, reforms to restructure and upgrade the economy, increase its efficiency, improve the quality of growth, and promote urbanization and environmental protection can increase the vulnerability of some populations.

B. Government's Poverty Reduction Response

6. **Rural poverty reduction efforts.** The PRC's first poverty reduction program was initiated in 1986 on the basis of work by the Ministry of Agriculture. This expanded into a leading group of 46 national government organizations to address multidimensional aspects of rural

⁶ Poor areas are five times more likely to be hit by natural disasters than the national average (footnote 1).

poverty. A series of decade-long initiatives were also formulated to reduce rural poverty, most recently the 2011–2020 Outline, which covers the proposed country partnership strategy period and ends in the year that the PRC aims to basically eliminate absolute poverty. However, the PRC leadership has already emphasized that the most difficult tasks in achieving its goal of a moderately prosperous society (*xiao kang*) are in poor rural areas.

7. **Key areas of poverty program governance.** In its updated January 2014 form, the 2011–2020 Outline calls for innovation in areas including the following:

- (i) Establishing the mechanism of targeted poverty reduction.
- (ii) Basing the annual assessment of government officials in poor counties on their efforts to reduce poverty rather than on maximizing county GDP growth. GDP targets have been removed but replacement evaluation criteria are required.
- (iii) Developing a poor-household computerized registration and management information system to identify and track improvement in poor households.
- (iv) Improving the management and effectiveness of poverty reduction funds to reduce waste, mis-targeting, and misuse, including through improved agency and public auditing mechanisms, government outsourcing of public services, strengthened legislation, and procurement procedures.
- (v) Developing policies and encouraging diverse rural financial models, such as rural cooperatives, micro credit companies, mutual fund organizations, and commercial financial institutions, to develop new financial products and services, increase credit disbursement and to strengthen agricultural loan guarantee institutions and agricultural insurance in poor areas. Key target groups are family farms, farmer cooperatives, local agro-businesses, youth start-ups, and micro loans to rural women.
- (vi) Expanding the role for enterprises, non-government organizations, foundations, and volunteers within the government-driven poverty reduction program. This includes measures for procurement of social organization services, management of philanthropy, and supportive policies for poor-area enterprise investment. This reflects the third plenum intent to energize and better define roles and boundaries between government, market, and society.

8. **Activities to improve rural infrastructure, incomes and services.** The Outline also calls for improved rural infrastructure, income and services, including

- (i) strengthening service standards and disaster proofing for rural roads, improving circulation of rural commodities, and increasing poor village bus services;
- (ii) increasing tap water access and safe drinking water;
- (iii) extending the village electrification grid and supplementing it with dispersed renewable energy sources, including photovoltaic, wind, and micro hydro;
- (iv) promoting specialty production and marketing by pro-poor farmer cooperatives, market chains, farmer–agribusiness collaborations, and e-marketing to overcome remoteness and information asymmetry;
- (v) poverty reduction-oriented agricultural and rural tourism supported by more policy and financial support, environmental and transport improvements, job creation, and skilling;
- (vi) modern vocational education to support local enterprises and jobs and encourage vocational institutions, groups, or corporations in the eastern PRC to support colleges and students in lagging regions;
- (vii) stronger health care services and delivery; and
- (viii) improved communications to address the “digital divide” via broadband access for villages and schools with electricity access.

9. The Outline also flags a strong role for private sector involvement in these activities.

10. **Future directions in poverty reduction in the People's Republic of China.** The poverty reduction Outline concludes in 2020, the year in which the PRC aims to achieve its target of a moderately prosperous society. Thus, the rural poverty reduction program is under considerable pressure to reduce remaining absolute poverty. It also needs to articulate a role for itself beyond 2020 within the context of the Sustainable Development Goals, the PRC's Going Abroad campaign, and more integrated management of relative poverty. Should it become a lagging-region development authority, streamline rural and urban poverty reduction work, and/or increase engagement in overseas development administration? The PRC will conduct a midterm review of the Outline to explore longer-term issues for the 2020–2030 program.

C. Mitigating Inequality: An Unfinished Policy and Governance Agenda

11. Key long-term drivers of PRC income inequality have been a rising skill premium, a declining share of labor income, increasing geographic inequality and inequality in wealth distribution. Addressing these drivers requires several macro-level policy initiatives. Firstly, Government of the PRC spending on public education, health care, social protection, pensions, and affordable housing is very low by developed country standards at only about 35% of total government revenue or less than 9% of GDP. Secondly, service-oriented governments are reliant on fiscal policy and central government transfers to better balance access to opportunity and support social safety nets. However, PRC revenue from personal income tax was only about 1.5% of GDP in 2013. Instead, local government, which also carries costs for social policy implementation, has funded some obligations through land sales and local bond issue.

12. The creation of more effective and fairer personal income taxes on wage earnings, capital incomes, capital gains, properties, inheritance, and other personal incomes would strengthen social equality and shift focus away from regressive indirect taxes. Associated legislation on income distribution, labor markets, labor relations, natural resource taxes, transparency of asset ownership and fund use, and curtailing corruption would help build an enabling environment. Moreover, nurturing a perception of equality, transparency, and merit-based opportunity and advancement in the emerging aspirational and acquisitive middle class will be important for attaining these fiscal policy objectives.

D. Strengthening State Capacity and Social Policy to Manage Vulnerability

13. Poverty and inequality are found in all societies. However, a hallmark of the modern state is that their magnitude has been reduced and that vulnerability is managed through robust and nationally integrated social policy. Strong social infrastructure would help manage social tensions, move beyond ad hoc responses to sudden shocks, and mitigate drivers of inequality. Policy entry points include expansion of rural *dibao* to trim rural–urban inequality and its fuller integration with other poverty and social protection schemes, financial transfers through the Develop the West program to bolster lagging regions, and greater government investments in tertiary education to boost upward mobility and merit-based advancement between social groups. These are areas where the Government has recently invited ADB to collaborate in policy-oriented research, knowledge creation, and identification of innovations for extension. These initial investments are now poised to yield further policy lessons and learning dividends for the PRC and regionally for Asia and the Pacific.