List of Abbreviations

MOA - Ministry of Agriculture
MOCA - Ministry of Civil Affairs
PRC - People’s Republic of China
SOE - State-owned enterprises
UNDP - United Nations Development Programme
WB - World Bank

Note: In this paper, "Y" refers to yuan, the currency of the PRC, and "$" to US dollars.
POVERTY IN THE PEOPLE'S REPUBLIC OF CHINA: RECENT DEVELOPMENTS AND SCOPE FOR BANK ASSISTANCE

Introduction

While the People's Republic of China (PRC) has per capita GNP at a level comparable with some of the poorest countries in the world ($350 in 1989), at present less than 10 per cent of the PRC's population is deemed to be poor.\(^1\) At this percentage level of poverty incidence, the PRC compares favorably with many low- and middle-income developing countries both within and outside Asia. Such an achievement for a country with so low a per capita income has been remarkable; a well-coordinated set of Government policies impacting directly on poverty alleviation and programs being implemented nationwide and in a concerted manner have contributed to the result. A study of the policies the PRC has pursued is of relevance in the design of poverty alleviation strategies and policies for other countries of the developing world.

Despite the impressive results in reducing the incidence of poverty, still about 100 million of the world's poor are found in the PRC. As well, there is some empirical evidence to suggest that progress in reducing poverty has stagnated somewhat since the early 1980s. The remaining pockets of poverty in the country are mostly located in remote and inaccessible mountainous regions in the northwestern and southwestern parts of the country, where it has been difficult to provide adequate infrastructure and social services. In the Eighth Five-Year Plan (1991-1995), the Government has accorded high priority to reducing poverty in these areas. A special set of institutions, policies and programs will be needed to reach those segments of society that in effect have been bypassed during the last several decades of development effort. "Relative poverty" has also emerged as an issue in the PRC. Empirical evidence suggests that during the reform period (since 1978), the provinces in the east have grown at rates faster than the western and central provinces. Moreover, inequality in income distribution increased in the 1980s.

Poverty alleviation has been stressed as one of the three main objectives of Bank's country strategy for the PRC. However, recently it was decided that the PRC would not have access to ADF resources during the ADF VI period (1992-1995). Since it is the policy of the Government to borrow external funds for financing poverty alleviation and social development projects only from concessional sources, there seems to be some divergence between the objective of poverty alleviation as shown in the Bank's country strategy for the PRC and the Government's external debt management strategy. Nonetheless, poverty alleviation continues to be of high priority in the country's development strategy and remains as one of the critical issues to be addressed by the PRC in the 1990s. Therefore, a need to review and redefine the scope for operationalizing the country strategy's objective of poverty alleviation has arisen, within the limitations set by the country's external debt management strategy and the lack of the PRC's access to ADF during the ADF VI period.

The purpose of this paper is threefold. First, the paper describes the current poverty situation in the PRC and discusses the policies of the Government that have contributed to poverty alleviation. Second, it identifies poverty issues to be addressed and presents a broad overview of

the Government's policies and strategy to address the same. Finally, it outlines the scope for extending Bank assistance for poverty alleviation in the PRC within the operational constraints discussed in the previous paragraph. The paper focuses on rural poverty, since the bulk of the poor are rural residents; urban poverty, though increasing in magnitude, at present is much less significant. The paper has benefited from the work done by the World Bank and an earlier ADB staff paper on poverty issues in the PRC.

Rural Poverty in the PRC: Current Situation and Some Policy Developments

Estimates of the Incidence of Rural Poverty

The incidence of poverty in a country is usually estimated against a "poverty line" — an income threshold based on a minimum expenditure budget for food and other essentials. This threshold can be computed on a per capita basis or on a household basis.

In the PRC, there is no official poverty line. However, different income limits have been prescribed by the Government to determine eligibility of individuals to receive benefits under the various poverty alleviation/relief programs of the Government. The actual poverty line that is most often cited in discussions with Government is Y 200 per capita per annum, which was the eligibility threshold for rural income under the "Help-the-Poor" Program initiated by the Ministry of Agriculture in 1986 for minorities and semi-pastoral areas. This limit was set with reference to 1985 prices and since its establishment has not been inflation-adjusted. This Y 200 threshold now probably is not very meaningful in view of the erosion in real value due to high inflation experienced during 1987-1989.

Three 1989 estimates of rural poverty are shown in Table 1, derived by the World Bank (WB), the Ministry of Agriculture (MOA), and the Ministry of Civil Affairs (MOCA). These estimates are not comparable since each is based on a different set of criteria for defining the poverty threshold. The World Bank used an income threshold of Y 262 per capita per annum; MOA, a poverty line of Y 250 per capita per annum at the county level; and MOCA, a comparable set of criteria including income and availability of essential social services. MOCA's estimate is

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4Under this program, a lower threshold was applied for mountainous areas (Y 150) and a higher one for pastoral areas (Y 300).

5Even though MOA and World Bank income thresholds appear to be comparable, the two estimates of poverty are based on different sets of data. The World Bank study used household income distribution data based on income-expenditure surveys. The MOA study is based on county-level poverty data.
closest to UNDP's estimate of 7 per cent for rural poverty, as presented in the Human Development Report 1991.⁶

Using inflation-adjusted poverty lines during the PRC's reform period 1978-1990, a recent World Bank Study concluded that the incidence of rural poverty in the PRC declined from 33 per cent in 1978 to 11.5 per cent in 1990.⁷ The analysis showed a rapid decrease in poverty during 1978-1984, when the incidence of rural poverty declined from 33 per cent to 11 per cent, and then stagnation in poverty reduction since 1984.

Table 1: Incidence of Rural Poverty, 1989

<table>
<thead>
<tr>
<th>Source</th>
<th>Population below Poverty Line (in per cent)</th>
<th>No. of Rural Poor (in million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>WB</td>
<td>12.3</td>
<td>103.0</td>
</tr>
<tr>
<td>MOA</td>
<td>6.8</td>
<td>59.6</td>
</tr>
<tr>
<td>MOCA</td>
<td>9.9</td>
<td>86.8</td>
</tr>
</tbody>
</table>

Source: Xiambin Yao, "Poverty Issues Study."

The rapid decline in rural poverty in the first half of the 1980s is attributable mainly to the impact of the household contract responsibility system introduced by the Government in improving farmer incentives and productivity. Moreover, in the early 1980s, the Government reversed the classical Soviet-style doctrine of taxing agriculture to support industrial growth, sharply increasing procurement prices of agricultural commodities. The result was terms of trade turning in favor of the agriculture sector. Since the early 1980s, agricultural growth has slowed, partly as the supply response to the new reform program matured, reaching the maximum realizable limit in the given policy environment. Unfavorable weather conditions that prevailed in several years also contributed to the slowdown in agricultural growth. Reflecting the slackening in the improvement of the terms of trade in favor of the agriculture sector, the differential between the rates of increase in the agricultural output price index and the rural retail price index declined sharply in the post-1984 period.

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⁶However, the basis for the UNDP's estimate is not explained in the Human Development Report 1991.

Poverty Incidence: Some Results and Implications

The steep decline in the incidence of rural poverty during the 1980s has been accompanied by acceleration in the growth of GNP and deceleration in the growth of population. These developments have been documented elsewhere and are not discussed in this paper. One quite distinctive feature of the growth performance during the 1978-1990 reform period is a persisting differential between the high growth rates of eastern provinces, which benefited considerably from economic reforms, and the lower growth rates of central and western provinces, which benefited to a lesser extent. Table 2 presents data on the relative growth performance of the eastern, western and central provinces during the reform period. Macroeconomic policies during the reform period, such as trade liberalization, flexible exchange rate management, market-related access to credit, and price liberalization, benefited more the industrial enterprises, which also enjoyed the locational advantage of being on the seacoast. However, these reforms, though helpful in removing distortions in resource allocation in general, were of lesser significance for the economic activities in the interior provinces.

Table 2: Provincial Growth Performance, 1978-1989

<table>
<thead>
<tr>
<th>Period</th>
<th>REGION</th>
<th></th>
<th></th>
<th>Nation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>East</td>
<td>Central</td>
<td>West</td>
<td></td>
</tr>
<tr>
<td>1978 - 1985</td>
<td>10.0</td>
<td>9.2</td>
<td>8.6</td>
<td>9.5</td>
</tr>
<tr>
<td>1985 - 1989</td>
<td>9.1</td>
<td>7.2</td>
<td>7.9</td>
<td>8.3</td>
</tr>
</tbody>
</table>


Ministry of Agriculture data on the province-wise incidence of poverty in 1989 are summarized in Table 3. These data show that a major result of the high performance in the fast-growing eastern provinces has been the virtual elimination of poverty in these areas. Of the 568 counties in 11 eastern provinces, only 26 counties in three provinces (population of about 8 million) had a per capita income of less than Y 250. Thus, by 1989 in most of the eastern provinces there were no counties with per capita income of less than Y 250.

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4This income threshold has been used by MOA to estimate the incidence of poverty at the county level and is not the official poverty line of the Government.
Table 3: MOA’s Estimates of Incidence of Poverty in Provinces, 1989

<table>
<thead>
<tr>
<th>Region/Province</th>
<th>No. Cnty</th>
<th>Population (million)</th>
<th>Incidence of Poverty (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>National</td>
<td>186</td>
<td>59.64</td>
<td>6.8</td>
</tr>
<tr>
<td><strong>Eastern Region</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hebei</td>
<td>11</td>
<td>2.50</td>
<td>5.0</td>
</tr>
<tr>
<td>Liaoning</td>
<td>4</td>
<td>2.28</td>
<td>10.2</td>
</tr>
<tr>
<td>Guangxi</td>
<td>11</td>
<td>3.36</td>
<td>9.2</td>
</tr>
<tr>
<td><strong>Central Region</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Heilongjiang</td>
<td>2</td>
<td>0.62</td>
<td>3.4</td>
</tr>
<tr>
<td>Inner Mongolia</td>
<td>13</td>
<td>3.11</td>
<td>22.2</td>
</tr>
<tr>
<td>Shanxi</td>
<td>8</td>
<td>1.50</td>
<td>6.9</td>
</tr>
<tr>
<td>Henan</td>
<td>4</td>
<td>1.95</td>
<td>2.7</td>
</tr>
<tr>
<td>Hunan</td>
<td>9</td>
<td>3.94</td>
<td>7.6</td>
</tr>
<tr>
<td>Hubei</td>
<td>6</td>
<td>2.78</td>
<td>6.9</td>
</tr>
<tr>
<td><strong>Western Region</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sichuan</td>
<td>17</td>
<td>9.56</td>
<td>10.3</td>
</tr>
<tr>
<td>Guizhou</td>
<td>27</td>
<td>9.85</td>
<td>35.3</td>
</tr>
<tr>
<td>Yunnan</td>
<td>49</td>
<td>13.05</td>
<td>41.1</td>
</tr>
<tr>
<td>Shaanxi</td>
<td>12</td>
<td>2.63</td>
<td>10.0</td>
</tr>
<tr>
<td>Gansu</td>
<td>4</td>
<td>0.76</td>
<td>4.2</td>
</tr>
<tr>
<td>Ningxia</td>
<td>7</td>
<td>1.72</td>
<td>51.1</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>1</td>
<td>0.02</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Source: Xianbin Yao, “Poverty Issues Study,”
The western and central provinces account for the bulk of the rural poor (160 counties; population of 51.6 million). The incidence of rural poverty is severest in the western provinces, where the country's minority populations are concentrated. The central region, Inner Mongolia, which is also a minority population area, also has a high incidence of rural poverty, at 22 per cent.

In interpreting MOA data, it must be noted that at the county level the entire population is defined as poor if per capita income of that county is less than Y 250. Despite this analytical limitation, two important inferences flow from these data. First, rapid growth results in the quick redress of poverty. Second, and somewhat paradoxically, rapid growth at the national level is not sufficient to address poverty at regional or provincial levels. The latter result suggests that growth at the national level may not suffice as a solution for poverty at the sub-national level. In some poverty areas it is necessary to supplement income generation with programs that address the underlying and region-specific causes of poverty.

### Table 4: Comparative Social Indicators: PRC and Other Countries

<table>
<thead>
<tr>
<th>Year Period</th>
<th>GNP per capita (US$)</th>
<th>Life Expectancy at Birth</th>
<th>Infant Mortality per 1000 Live Birth</th>
<th>Calorie Supply per Person</th>
<th>Access to Safe Water Per Cent</th>
<th>Adult Literacy Per Cent</th>
<th>Babies with Low Birth Weight Per cent</th>
<th>Population per Physician</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRC</td>
<td>330</td>
<td>70</td>
<td>31</td>
<td>2,632</td>
<td>72</td>
<td>60</td>
<td>6</td>
<td>1,010</td>
</tr>
<tr>
<td>India</td>
<td>340</td>
<td>59</td>
<td>95</td>
<td>2,104</td>
<td>57</td>
<td>43</td>
<td>30</td>
<td>2,520</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>430</td>
<td>71</td>
<td>20</td>
<td>2,319</td>
<td>41</td>
<td>87</td>
<td>28</td>
<td>5,420</td>
</tr>
<tr>
<td>Indonesia</td>
<td>500</td>
<td>61</td>
<td>64</td>
<td>2,670</td>
<td>46</td>
<td>74</td>
<td>14</td>
<td>9,460</td>
</tr>
<tr>
<td>Philippines</td>
<td>710</td>
<td>64</td>
<td>42</td>
<td>2,255</td>
<td>n/a</td>
<td>86</td>
<td>18</td>
<td>6,570</td>
</tr>
<tr>
<td>Low Income Economies 0/1</td>
<td>330</td>
<td>62</td>
<td>70</td>
<td>2,331</td>
<td>n/a</td>
<td>56</td>
<td>n/a</td>
<td>5,890</td>
</tr>
<tr>
<td>Lower Middle Income Economies</td>
<td>1,360</td>
<td>65</td>
<td>51</td>
<td>2,738</td>
<td>n/a</td>
<td>74</td>
<td>n/a</td>
<td>2,910</td>
</tr>
</tbody>
</table>

*including PRC.

The limitations of using an income criterion as a poverty threshold for policy/program interventions are also revealed. There is a non-income dimension to poverty captured more precisely by analysis of the underlying causes of poverty rather than by a mere classificatory and tautological approach to defining the poor according to an income level. It is in this context that the more generalized approach of the Ministry of Civil Affairs of examining non-income dimensions of poverty while identifying the poor appears to have more policy relevance.

A discussion of the progress in social development in the PRC is relevant while considering the non-income dimensions of poverty. Along with the dramatic reduction in poverty in the PRC, the PRC has also made considerable progress in social development. Social indicators from the PRC are comparable more to lower-middle-income economies than to the group of low-income economies to which the PRC belongs. Comparative social indicators for PRC, some select DMCs, and a group of lower-middle-income economies are presented in Table 4.

In the PRC, the quality of social services delivered is not uniform across all parts of the country. It is generally perceived that in the isolated and inaccessible areas, where the incidence of poverty continues to be high, the social conditions of the poor did not improve much during the reform period. This implies that the underlying causes of poverty may be found in the lack of social development, particularly since the pattern of asset distribution under the PRC’s socialist framework is generally egalitarian. For example, it is estimated that 35 per cent of the rural labor force is illiterate and that adult illiteracy is even higher – 60 per cent – in the poor minority areas. Infant and maternal mortality levels in the poor counties are much higher than the national average; more than 95 per cent of the poor counties suffer from at least one infectious or endemic disease; the children of the poor tend to be malnourished and suffer from vitamin deficiency; and safe drinking water is not abundantly available in these deprived areas. All these factors contribute to low productivity of labor, a sense of increasing deprivation among the affected population, and the perpetuation of poverty.

While Government funding of social services increased substantially in real terms in the 1980s and contributed effectively to the acceleration of social development in general, most of such expenditure probably provided more benefit to urban and better-off rural areas. Social services in the poor areas in general still lack adequate central or provincial government support and are financed by and large from the resources of the village or township concerned, with such resources in most cases being severely limited. As a consequence, a considerable part of the health and education expenditure in poor areas is shouldered by the poor. Given their low income levels, this burden is often unsustainable, resulting in poor attendance in schools and neglect of health care. A recent UNICEF study showed that 70 per cent of the absentee school children in the western province of Ningxia⁹ were absent because school costs were too high or because employing the child at home was more attractive financially.

The higher costs of social services that beneficiaries in the poor areas must bear are all the more burdensome because of the comparatively poor quality of the services that are delivered. For example, in Inner Mongolia some 50 per cent of townships have no primary schools and about 25 per cent of school age children (7-14 age group) did not attend school due to the absence of necessary infrastructure. The lack of adequate resources at the local level has been a significant

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⁹According to MOA data, in 1989 Ningxia had a poverty incidence of 51.1 per cent (see Table 3).
reason for the underdevelopment of essential social infrastructure in the poor areas. The Foundation for the Development of Poor Areas under MOA recently accorded high priority to targeting resources for the social development of these disadvantaged groups.

During the 1950s and 1960s, as the rural sector underwent extensive collectivization, inequality in the distribution of income and wealth is generally perceived to have declined drastically. According to estimates of the State Statistical Bureau, the Gini coefficients of rural income increased steadily during the reform period. In 1978, the Gini coefficient for rural income was a low 0.21. However, with the introduction of market-based reforms in agriculture and the growth of rural enterprises, the reform period has also witnessed increasing inequality in income distribution in the rural sector. By 1984, the Gini coefficient for rural income rose to 0.26, and by 1990 the index had risen to 0.31. While some increase in inequality in income distribution should be expected in a liberalizing regime in which there is a closer linkage between reward and performance, the trend of increasing inequality also suggests that the benefits of development have accrued more to the comparatively better-off segments of society rather than those at the bottom of the income distribution structure. Combined with the lack of improvement in the provision of social services to the poor, the trend towards a more skewed pattern of income distribution in the reform period has implied that the sharing of benefits of development has been uneven among the different segments of society. Nevertheless, the Gini coefficient of rural income distribution in PRC is low in absolute terms compared with most other DMCs.

Issues in Poverty

Need for Better Linkages

Pockets of poverty in the PRC have endured despite policy and program interventions. This suggests that new approaches and strategies as well as more vigorous implementation of programs to address poverty alleviation will be needed to effectively reduce poverty. Further a major challenge in policy planning is to find ways to improve linkages between growth centers – typically the coastal cities and the special economic zones – and the hinterlands, where most of the remaining poverty groups reside. Improved linkages include the development of infrastructure facilities in relatively inaccessible areas and promotion of systematic subcontracting arrangements between raw material producers in the hinterlands and processing centers in the coastal areas.

During the Eighth Plan period (1991-1995) the Foundation for the Development of Poor Areas has emphasized the provision of essential infrastructure to the chronically poor areas in order to improve linkages of these areas to the coastal region. The Government has stressed strengthening of subcontracting linkages in the special economic zones. While available data suggest that subcontracting between manufacturers and raw material suppliers has increased in frequency and regularity, it is not clear whether substantial pecuniary advantages have been passed on to the latter through favorable pricing arrangements by the manufacturers. Under a new scheme, the Government has also encouraged large state-owned enterprises (SOEs) to assume the patronage of economically backward areas. However, apparently no fiscal or financial incentives have been provided to support this scheme. Since there is no legal obligation or financial advantage to the SOE from this activity, there is some doubt whether this scheme could be implemented successfully.
The development of infrastructure in backward areas may be viewed from several perspectives. First, there seems to be some conflict between investment in capital-intensive, long-gestation infrastructure projects and the improvement of social services, which is required by the poor immediately. From the point of view of profitability of investment, infrastructure projects yield measurable results, while benefits from social services are less quantifiable. However, as discussed earlier, it is important to address the underlying causes of poverty through accelerated social development in backward areas. To the extent that both these aspects could be addressed simultaneously, poverty alleviation could be accelerated. However, the resources of the State are constrained, especially due to the policy of subsidizing urban consumers and loss-incurring SOEs. A review of the Government's fiscal policies would be necessary to identify scope for allocating more resources both for infrastructure development and for improvement of social services in poverty areas. In this regard, while enlargement of state revenues will contribute to the easing of the resource constraint, it will be equally important to reprioritize public expenditures and improve efficiency of public expenditures.

At the same time, it is likely that the financial viability of many infrastructure projects located in backward areas would be low, given the present market conditions prevailing in these areas. This would drastically reduce the projects' attractiveness for investment. In terms of financial viability and strong demand-pull, infrastructure projects located in the fast-growing areas in the coastal region are much more likely to be attractive. However, given the large social gains resulting from the reduction of poverty, it seems necessary that an investment strategy that would help expand the flow of resources to poverty areas for infrastructure development be identified. In such a strategy, the role of multilateral development agencies that extend low-cost, long-term loans and that address strategic priorities and take a more comprehensive view of a project's economic and financial viability rather than a strictly commercial approach seems quite important.

Finally, it is desirable that major infrastructure investments in the poverty areas be linked to the development and economic utilization of natural resources in those areas that might have been neglected in the past. This would require close coordination of investments in the industrial/mining/natural resources sector and in infrastructure investment. In the Eighth Five-Year Plan (1991-1995), the Government's development strategy for poverty areas also emphasizes the economic and sustainable exploitation of natural resources found in these areas. In line with this strategy, it would be appropriate that well-coordinated plans for industrial and infrastructure development be developed at the regional, provincial and county levels, so that the externalities in investment could be more fully realized.\(^\text{11}\)

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\(^{10}\)The Economic and Trade Office (earlier known as the Production Office), headed by Vice Premier Zhu Rongji under the State Council, has been tasked with the reduction of these losses under a time-bound program.

\(^{11}\)As far as agricultural development strategy in poor areas is concerned, the Government has placed more emphasis on the achievement of self-sufficiency in food in these areas, rather than the generation of marketable surpluses in agriculture. Of course, the availability of infrastructure will help widen the markets for agricultural goods produced in these areas.
Macroeconomic Issues

While provision of adequate infrastructure in backward areas would help address the issue of market failure that has resulted from the concentration of infrastructure facilities in the already-well-developed areas, it would also be necessary that macroeconomic policies be oriented to address the strategic objective of poverty reduction. Given the large population base and the limits to the capacity of land to absorb labor, it continues to be necessary that a high growth rate be maintained so that the additions to the labor force could be employed productively. A slackening of growth performance, even for a limited period, could have serious implications for the employment situation. Increases in unemployment will be reflected immediately in a higher incidence of poverty.

However, if growth is to be sustained, it is important that it be achieved in a technologically and economically efficient manner. That growth is unsustainable without economic efficiency was one of the major lessons of the pre-reform period. Inefficiency in resource allocation is particularly costly to a capital-short country such as PRC, which can not afford resource wastage. It is therefore necessary that economic reforms, particularly in the areas of price liberalization and enterprise ownership and management, continue to be pursued actively. In the PRC's development strategy, the agriculture sector rightly occupies a high priority. Since the rural sector continues to be the major employer in PRC, it is necessary that domestic terms of trade be managed in such a way that farmer incentives are not impaired. Liberalization of agricultural prices and further reduction in state procurement orders for agricultural commodities will contribute to improved incentives for farm investment.

Trade policies have important implications for poverty alleviation. A high tariff barrier for industrial goods adds to manufacturing costs and helps turn the domestic terms of trade against the rural sector. In the implementation of the policy of trade liberalization, priority can be given to the lowering of tariff barrier for those raw materials and inputs that are significant for the rural sector.

In the area of exchange rate management, the systematic correction of overvaluation of the domestic currency during 1988-1990 helped improve export prices in yuan terms and thereby farmer incentives. On the other hand, depreciation of the yuan has also meant higher import prices. To the extent that agricultural imports have been liberalized, this would have helped improve competitiveness of domestic agricultural goods. However, higher import prices of manufactures would have the effect of turning the terms of trade against the rural sector. It is generally perceived that the depreciation of the yuan in real terms during 1988-1990 benefited the rural sector by improving farmer incentives. A further liberalization of the agriculture sector accompanied by trade liberalization will render agriculture sector development more responsive to exchange rate policy.

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12As a consequence of concentrating infrastructure development in the East, the central and western parts of the country suffer from a lack of adequate infrastructure facilities. This has hindered mobility in product and factor markets, resulting in the failure of the market mechanism to allocate resources efficiently.
Financial Sector Reforms and Poverty Reduction

For channeling credit to the various sectors of the economy, the Government is gradually withdrawing from direct interventions in credit allocation and is placing greater reliance on the banking sector. During the Seventh Five-Year Plan (1986-1990), the Central Government allocated about Y 4 billion annually to special schemes for channeling credit to poverty areas. Some of these schemes carried concessional rates of interest. With the increasing autonomy of the banking sector and the "hands-off" approach of the Government in credit allocation, the preferential access to credit enjoyed by backward areas in the past could gradually dry up. In the absence of offsetting policy adjustments and strengthening of credit institutions in the poverty areas, lack of institutional credit could emerge as a serious constraint to the economic development of these areas. In order to offset the higher costs of investment resulting from Government and market failures for a reasonable period of time, a measure of budget support for well-designed economic projects in poverty areas appears to be an appropriate policy response. Such an approach will also help quantify the social cost of these failures and appropriately place the burden of financing this cost on the budget rather than the banks. Institutional strengthening of credit institutions in poverty areas, such as the Agricultural Bank of China and China Agribusiness Development Trust and Investment Corporation, should address such issues as collective collateral, the role of nongovernment organizations (NGOs), training of banking staff in project preparation and appraisal, and cost-effective methods of delivering credit to a large number of small borrowers.

Rural Technology Development and Poverty Alleviation

In a labor-surplus economy, economic policies must be geared to promote technologies that are skill- and labor-intensive rather than capital-intensive. Such technologies should be applied in the production of goods and services that utilize locally available factors and inputs as well as in the development of infrastructure. The Government has issued guidelines for the use of labor-intensive technologies in poverty areas, but due to the low productivity of labor usually implied by the use of such technologies, it is arguable whether such a policy will have a lasting impact on eradicating poverty, even though in the short term it might support employment. Government agencies such as the Science and Technology Commission and the Academy of Sciences give high priority to the development of technologies that favor high labor use and promote enhanced labor productivity. These efforts must be intensified and the results quickly disseminated and applied in the field if the policy objective of orienting science and technology for the alleviation of poverty is to be effectively addressed. The Government's Spark Program is such an effort.

Inequality in Income Distribution and Relative Poverty

The trend since the late 1970s of increasingly greater inequality in the pattern of income distribution has implications for fiscal policy management with regard to both revenue mobilization and public expenditures. From the revenue mobilization point of view, the increase in inequality of income distribution implies that there is some scope for taxing the relatively better-off segments of society that have reaped the benefits of the economic reform program. Such an approach to taxation policy would also be appropriate from the equity point of view. From the expenditure side, to alleviate the increasing inequality in income distribution, the social services provided to the relatively worse-off segments of society may be improved in quality and coverage. A consistent
approach to fiscal policy would be to tax the sections of society that have benefited more from the economic reform program and improve the delivery of social services to those who have received comparatively fewer benefits. However, the taxation structure should be suitably designed so as not to excessively tax the productive sectors of the economy and thereby impair incentives.

Demographic Trends, Economic Transformation and Implications of Social Security Safety Nets

A substantial part of the poor includes the old, the indigent, and the handicapped. As the PRC's population growth rate slackens while life expectancy at birth continues to increase, the country will have to take care of increasing numbers of aged people. Health care costs for the aged will in particular be heavy. Housing needs of an ageing population can also be expected to increase. At present, social security safety nets are provided by the State-owned enterprises and the Government. Recent social security reforms envisage that the responsibility of providing social security safety nets to employees would be devested from SOEs through institution of pooled and centralized security funds. As the economy diversifies further and as the role of the private sector expands, it will be necessary to strengthen social security arrangements to include private sector employees.

In the area of social security reform, two issues seem to be of high priority. One is the mobilization of sufficient resources to finance a robust social security program. Since this program would need to address an ageing population with a low earning capacity, the fiscal burden of the program on the rest of the society could be substantial. In any event, the case of vulnerable groups will continue to be the responsibility of the State. A second issue is the development of an adequate network of social security institutions that can design and implement a cost-effective social security program.

Sustainability of Achievements in Poverty Reduction

A major weakness of the poverty line approach in identifying the incidence of poverty is the absence of information on the differences in the magnitude of poverty among the sub-poverty line groups and the differences in affluence among the non-poor. It is estimated that about 100 million people in the rural areas are vulnerable to drought and flooding. When seasonal conditions turn adverse, a large segment of this vulnerable population, which in normal circumstances is above the poverty line, could go under the line. It is therefore necessary that the vulnerability of such groups to seasonal conditions be reduced through measures such as flood control and water conservation projects as well as through diversification of employment opportunities. The impact of such projects would be more by way of preventing the marginally non-poor groups from lapsing into poverty when season conditions turn adverse, rather than pulling up segments of population that are below the poverty line.

Urban-Rural Migration and Rural Poverty

In the past, with the rigid enforcement of restrictions on migration, urban areas generally could be kept insulated from the impact of rural poverty. With the gradual relaxation of these
restrictions, the unemployed and underemployed in the rural areas may be expected to migrate increasingly to urban areas in the quest of job opportunities. There are no firm data on the "floating" population in urban areas. During the severe flooding of 1991, rural population did migrate in large numbers to nearby urban areas. The effect of this migration could be seen even in Beijing and Shanghai. If the floating population in urban areas is correctly estimated and added to the urban unemployed, the size of urban unemployment could turn out to be much more substantial than what it is now generally perceived. As economic liberalization accelerates, migration from rural to urban areas is expected to increase due to the prevailing wage differentials between agriculture and industry. As a consequence, urban unemployment could assume more significant proportions in the future. Improved employment opportunities and betterment of living conditions in rural areas as well as orderly development of rural industries will help alleviate the migration pull to urban areas. If this strategic approach is adopted, the focus of anti-poverty policies could continue to be kept on the rural sector.

Scope for Bank Assistance for Poverty Alleviation in the PRC

Despite the country's impressive achievements in reducing poverty and improving the social conditions of most of the masses, the PRC remains a developing country with lower per capita income and a large population that is poor. The Government's strategy of poverty reduction and poverty alleviation in the Eighth Five-Year Plan focuses on targeting "hard-core" poverty groups through integrated social and infrastructure development, improved inter-regional cooperation, and greater institutional efficiency. It is necessary that the success in reducing poverty over the last decade be sustained and consolidated. Many groups in society, particularly those residing in far flung and inaccessible mountainous areas and in farming communities, are perennially vulnerable to the vagaries of seasonal conditions and continue to deserve policy and program support, to lift them above the poverty line or to prevent them from falling below it. Within the operational limitations of the Government's external debt management strategy and the constraints imposed by the lack of access of PRC to ADF resources during the ADF VI period (1992-1995), it continues to be important that the Bank explore innovative avenues for assisting poverty groups.

The Government's external debt management strategy represents a limiting factor in extending direct Bank assistance for poverty reduction projects in the PRC. Another significant problem is that the chronically poor reside in mountainous and inaccessible areas. Many of these poor are also ethnic minorities. Projects designed for the economic uplift of these groups involve a large element of local cost financing and also carry deep socio-cultural implications. In view of the sensitiveness of the beneficiaries involved and the uniqueness of local conditions, considerable effort would be needed to develop and design poverty reduction projects in these areas. It is also the approach of the Government to maximize the use of domestic resources for such projects.

Accordingly, in the absence of concessional funding and in view of the complexities and difficulties in designing and implementing poverty reduction projects in the remote and mountainous parts of the country, the scope for Bank involvement in addressing poverty seems to be more in the area of policy and institutional support and implementing development projects with a strong secondary impact on alleviating poverty. However, if the financial returns are adequate the Government may allow borrowing from external sources on non-concessional terms for projects that are designed primarily to benefit the poor. Projects based on economic utilization of natural
resources and which have high export-earning potential could prima facie yield high financial returns. If allowed by the Government, such projects could avail of non-concessional financing. Effort should be directed towards identifying these projects so that Bank assistance can be extended. There may be scope to co-finance some of these projects with the concessional funds provided by other donors, in order to make the terms of borrowing more attractive.

Agriculture continues to provide livelihood support for the bulk of the poor. In its poverty alleviation activities in the country, it would be appropriate that the Bank give priority to the agriculture sector. In particular, such activities should include investment projects in areas susceptible to frequent droughts and floods, technical assistance for institution building, and support to sector and macroeconomic policies geared towards promoting agricultural investment and productivity.

An effective way to improve the attractiveness of investment and lower production costs in poverty areas is to strengthen infrastructure and institutions in these areas. In the design of infrastructure projects, service to poverty groups should be carefully considered and included whenever possible. Scope for such an approach may exist in highway and railway projects. Moreover, in infrastructure development, high priority should be given to economically and financially viable projects located in poverty areas.

Another way of indirectly helping poverty groups is to channel Bank assistance to projects already located in backward areas, to address aspects such as technology modernization, energy conservation, and environment improvement. The benefits from such projects would flow to the poor residents in these areas, through creation of employment opportunities and larger market demand for locally produced goods and services. Environmental improvement in poverty areas is of particularly high priority since it would lessen the social burden these disadvantaged groups have to bear due to the exposure to pollution from these projects.

Using the Bank's technical assistance facility for institutional strengthening of agencies involved in addressing poverty in the country is an important aspect of Bank involvement in poverty alleviation. This approach is particularly attractive when it is difficult to directly assist poverty groups due to operational constraints. Institutional strengthening activities include the preparation of master plans for infrastructure and economic development of backward areas, in addition to preparation of policy research studies that would help guide strategic planning and programming in the poverty-stricken areas. Bank involvement in the preparation of such studies and master plans would help forge closer links between the Bank and the PRC institutions involved in poverty alleviation and would prepare the ground for a more intensive participation of the Bank in poverty alleviation activities, when operational conditions are more conducive.

In the area of fiscal policy reform, it is crucial that the efficiency of public expenditure be increased and that the taxation structure be oriented to improve revenue mobilization. This would facilitate enlargement and qualitative improvement of social services to the disadvantaged. The

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13 Including rural industries.

14 For example, TA No. 1356 - PRC: Integrated Rural Development of Selected Provinces in Southwest China ($597,000), approved on 17 August 1990.
Bank's policy dialogue in the macroeconomic and project specific context should therefore stress elimination of subsidies to inefficient firms and urban consumers. The Government has already started moving in this direction and Bank support to these policies will help accelerate the pace of reform. Price liberalization and reduction of state orders, in combination with corporatization and increased autonomy of SOEs in economic decision-making, will be among the important areas for exchange of views on the issue of efficiency of public expenditures.

The cost and institutional implications of social security reform would also need to be looked at carefully. The "cradle-to-grave" responsibility now cast on SOEs to provide social security safety nets to labor has obviated the need for developing a sophisticated social security infrastructure. The Government also has not felt the urgency or need to consider the avoided cost of the social burden of providing such support. In the reform program of the present decade, the development of a suitable set of social security institutions that would implement schemes based on cost sharing between the employer, society and the individual, will be of high priority. The Bank's technical assistance window could be used to support institution building and strengthening in this area. This assistance will also support enterprise reform and improvement in efficiency.

In the context of increasing delegation of economic functions and administrative responsibility to the local governments, it will be necessary to review the present center-local government fiscal relationships and to examine the scope for improving the revenue elasticities at the local government level. Bank technical assistance could be utilized for preparing policy research studies in this area, so that policymakers would be better informed of the alternative policy choices available to them and the implications of these choices.¹⁵

Conclusion

There are two dimensions of poverty in PRC. There is a "hard core" population of about 100 million living under conditions of absolute poverty, mostly located in the central and western provinces of the country. As well, there are segments of population that live in relative poverty in comparison with those who have improved their incomes substantially during the economic reform period. A large part of the rural population is also vulnerable to adverse seasonal conditions and may slip into poverty when a natural calamity strikes, even though under normal conditions they would be above the poverty line.

This paper has identified several issues in addressing poverty in PRC. Keeping these issues in view, as well as some operational constraints in PRC, scope for channeling Bank assistance for poverty alleviation has been outlined. Even though further dramatic reduction in poverty incidence accompanying the growth process seems somewhat difficult to achieve given the enormity of the task of reaching out to the segments of population located in distant, inaccessible and mountainous regions of the country, within this decade the Government is determined to make a sizeable dent on the problem of remaining poverty. Bank assistance in support of such an effort would not only augment the resources mobilized for poverty alleviation, but, equally importantly, would also help build appropriate institutional mechanisms and policy approaches for accomplishing the task efficiently.

¹⁵Recently approved Technical Assistance to the Development Research Center (TA No. 1696 - PRC: Development Research Council of the State Council, in the amount of $568,000, approved on 24 April 1992) is a step in this direction.