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CONFORMED COPY

TF NUMBER 054772
LOAN NUMBER 4832-CHA

European Community Trust Fund Grant Agreement

(Changjiang and Pearl River Watershed Rehabilitation Project)

between

PEOPLE'S REPUBLIC OF CHINA

and

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT
acting as Administrator of Grant Funds
provided by the European Community
represented by the Commission of the European Communities

Dated July 31, 2006

**TF NUMBER 054772
LOAN NUMBER 4832-CHA**

EUROPEAN COMMUNITY TRUST FUND GRANT AGREEMENT

Agreement dated July 31, 2006, between PEOPLE'S REPUBLIC OF CHINA (the "Recipient") and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the "Bank") acting as administrator (the "Administrator") of grant funds provided by the EUROPEAN COMMUNITY represented by the Commission of the European Communities (the "Commission").

WHEREAS (A) pursuant to a Loan Agreement of even date herewith between the Recipient and the Bank (the "Loan Agreement"), for the financing of the Changjiang and Pearl River Watershed Rehabilitation Project described in Schedule 1 to the Loan Agreement and Schedule 1 to this Agreement (the "Project"), the Bank has agreed to provide to the Recipient a Loan in an amount equal to one hundred million dollars (\$100,000,000) (the "Loan") on the terms and conditions set forth in the Loan Agreement, and the Recipient has declared its commitment to the objectives of the Project and has agreed to carry out the Project in accordance with the terms of the Loan Agreement;

(B) pursuant to an agreement dated June 1, 2006, between the European Community represented by the Commission and the Bank (the "Administration Agreement"), the European Community has agreed to make available on a grant basis an aggregate amount of Euro ten million (€10,000,000) (the "EC Funding") to assist in financing part of the costs of carrying out the Project on the understanding that the Bank will: (i) withdraw for its own account directly from the EC Funding an administrative fee in an amount equal to Euro two hundred thousand (€200,000) representing two per cent (2%) of the EC Funding; and (ii) make available to the Recipient the balance of the EC Funding in an amount equal to Euro nine million eight hundred thousand (€9,800,000) (the "EC Grant"), and the Bank has agreed to make available, on behalf of the Commission, the EC Grant under the terms and conditions of this Agreement; and

NOW THEREFORE the Recipient and the Administrator hereby agree as follows:

ARTICLE I – GENERAL CONDITIONS; DEFINITIONS

1.01. (a) The following provisions of the General Conditions (as defined in the Appendix to this Agreement) with the modifications set forth in paragraph (b) of this Section (the General Conditions) constitute an integral part of this Agreement:

- (i) Article I
- (ii) Article II only Sections 2.01 through 2.06 inclusive and Section 2.08
- (iii) Article V only Sections 5.01 and 5.03 through 5.09 inclusive
- (iv) Article VII only Sections 7.01, 7.02(b), 7.02(c), 7.02(d), 7.02(e), 7.02(f), 7.02(h), 7.02(i), 7.02(k), 7.03, 7.04 and 7.09
- (v) Article VIII only Sections 8.01, 8.03 and 8.04
- (vi) Article IX except Section 9.05
- (vii) Article X
- (viii) Appendix, Definitions under paragraphs 1,3,4,5,6,10, 11,12,13,14,30,31,32,33,38,58,59, 60,61,62,64,67,70,72,76,83 and 86.

(b) The General Conditions shall be modified as follows:

- (i) the term “Bank”, wherever used in the General Conditions, means the Bank acting as administrator (the “Administrator”) of grant funds provided by the European Commission represented by the European Communities (“the Commission”), except that in Section 7.02, the term “Bank” shall also include the Bank acting in its own capacity;
- (ii) the term “Borrower”, wherever used in the General Conditions, means the Recipient;
- (iii) the term “Loan Agreement”, wherever used in the General Conditions, means this Agreement;

- (iv) the term “Loan” and “loan”, wherever used in the General Conditions, means the EC Grant; and
- (v) the term “Loan Account”, wherever used in the General Conditions, means the EC Trust Fund Grant Account.

1.02. Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the General Conditions, the Preamble to this Agreement or in the Appendix to this Agreement.

ARTICLE II – EC GRANT

2.01. The Administrator agrees to make available to the Recipient on a grant basis an amount equal to nine million eight hundred thousand Euro (€9,800,000) (“EC Grant”), to assist in financing the project described in Schedule 1 to this Agreement (“Project”).

2.02. The Recipient may withdraw the proceeds of the EC Grant in accordance with Section IV of Schedule 2 to this Agreement.

ARTICLE III – PROJECT

3.01. The Recipient declares its commitment to the objectives of the Project. To this end, the Recipient shall cause the Project to be carried out by the Project Implementing Entities in accordance with the provisions of Article V of the General Conditions.

3.02. Without limitation upon the provisions of Section 3.01 of this Agreement, and except as the Recipient and the Administrator shall otherwise agree, the Recipient shall ensure that the Project is carried out in accordance with the provisions of Schedule 2 to this Agreement.

ARTICLE IV – REMEDIES OF THE ADMINISTRATOR

4.01. The Additional Events of Suspension consist of the following:

- (a) (i) Subject to subparagraph (ii) of this paragraph, the right of the Borrower to withdraw the proceeds of the Loan made to the Borrower for the financing of the Project shall have been suspended, cancelled or terminated in whole or in part, pursuant to the terms of the Loan Agreement;

- (ii) Subparagraph (i) of this paragraph shall not apply if the Borrower establishes to the satisfaction of the Bank that: (A) such suspension, cancellation, or termination is not caused by the failure of the Borrower to perform any of its obligations under such agreement; and (B) adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

ARTICLE V – EFFECTIVENESS; TERMINATION

5.01. The Additional Condition of Effectiveness consists of the following:

- (a) The Loan Agreement has been executed and delivered and all conditions precedent to its effectiveness (other than the effectiveness of the EC Trust Fund Grant Agreement) have been fulfilled.

5.02. The Effectiveness Deadline is the date ninety (90) days after the date of this Agreement.

5.03. This Agreement shall continue in effect until the EC Grant has been fully disbursed and the parties to this Agreement have fulfilled their obligations hereunder.

ARTICLE VI – REPRESENTATIVE; ADDRESSES

6.01. The Recipient's Representative is the Minister of Finance.

6.02. The Recipient's Address is:

Ministry of Finance
Sanlihe
Beijing 100820
People's Republic of China

Facsimile:

(86-10) 68 55 11 25

6.03. The Bank's and Administrator's Address is:

International Bank for Reconstruction and Development
International Bank for Reconstruction and Development,
acting as Administrator of Grant Funds provided by
the European Community
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423(MCI) or 64145(MCI)	1-202-477-6391

AGREED at Beijing, People's Republic of China, as of the day and year first above written.

PEOPLE'S REPUBLIC OF CHINA

By /s/ Yang Shaolin

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT,
acting as Administrator of Grant Funds provided by
the European Community

By /s/ Hsiao-Yun Elaine Sun

Authorized Representative

SCHEDULE 1

Project Description

The objective of the Project is to assist the Borrower to improve farmers' livelihoods and protect the environment in poor and highly degraded watersheds of the Changjiang and Pearl River Basins by promoting an integrated and replicable model of sustainable rural development.

The Project consists of the following parts:

Part A: Soil and Water Conservation

Carrying out a program of investments to enhance soil and water conservation in selected poor and degraded watersheds of the Changjiang and Pearl River Basins, including:

1. Carrying out of capital farmland investments, including construction of stone wall terraces particularly in areas with thin layers of soil and irrigation.
2. Construction of sediment retention and control structures to regulate the flow of water in the tributary gullies of the major rivers.
3. Afforestation and the provision of vegetative coverage, including planting of trees and shrubs, and the protection of areas for natural re-vegetation.
4. Construction of village infrastructure facilities, including drinking water supply systems, small water reservoirs, improvement of field access roads and field tracks.

Part B: Livelihood Improvements

Carrying out a program to improve the income and livelihood of farmers in selected poor and degraded watersheds of the Changjiang and Pearl River Basins, including:

1. Terracing of slope land through the construction of earth faced terraces.
2. Development of horticulture and fruit and nut trees and other perennial crops of high value.

3. Development of improved fodder production, including establishment of perennial grass land and legumes.
4. Development of livestock production units.
5. Construction of irrigation and drainage facilities based on small-scale tanks and cisterns.
6. Increasing renewable energy supply through small-scale bio-gas production facilities and energy saving ovens.

Part C: Project Management and Support Services

Carrying out a program to strengthen the capacities of selected agencies of the Participating Implementing Entities in the implementation and monitoring of the various activities under the Project and training of Project beneficiaries in selected aspects relating to soil and water conservation and livelihood improvements under Parts A and B of the Project.

SCHEDULE 2

Project Execution

Section I. Grant Allocation Arrangements; Institutional and Other Arrangements

A. Grant Allocation Arrangements.

1. The Recipient shall, under arrangements satisfactory to the Administrator, make available to the Project Implementing Entities as a grant the proceeds of the EC Grant allocated from time to time to Categories (1) and (2) of the table in Section IV of this Schedule, in the following principal amounts to: (a) Chongqing an amount not to exceed in the aggregate □2,308,000 equivalent; (b) Guizhou an amount not to exceed in the aggregate □3,165,000 equivalent; (c) Hubei an amount not to exceed in the aggregate □1,955,000 equivalent; and (d) Yunnan an amount not to exceed in the aggregate □2,372,000 equivalent.

B. Institutional Arrangements.

1. The Recipient shall maintain throughout the implementation of the Project:

(a) the Central Project Leading Group within its Ministry of Water Resources, chaired by the Vice-Minister, MWR, for purposes of providing overall policy support and guidance on Project implementation at the central level, coordinating as needed with other Recipient's line Ministries and agencies at the central level, and disseminating the lessons learned through the implementation of the Project.

(b) the Central Project Coordination Office within its Ministry of Water Resources, headed by a qualified and experienced officer at Director level and assigned with such powers, funds, staffing and other resources as shall be required to enable the CPCO to coordinate at the central level the decisions taken by the Central Project Leading Group.

(c) the Central Project Implementation Office within its Changjiang Water Resources Commission, headed by a qualified and experienced officer at Director level and assigned with such powers, funds, staffing and other resources as shall be required to enable the CPIO to coordinate the overall implementation of the Project.

Section II. Project Monitoring, Reporting, Evaluation

A. Project Reports.

1. The Recipient shall monitor and evaluate the progress of the Project and prepare Project Reports in accordance with the provisions of Section 5.08 of the General Conditions and on the basis of the indicators set forth in Annex 1 to this Schedule. Each Project Report shall cover the period of one calendar semester, and shall be furnished to the Administrator not later than one month after the end of the period covered by such report.

2. For purposes of Section 5.08(c) of the General Conditions, the report on the execution of the Project and related plan required pursuant to that Section shall be furnished to the Administrator not later than September 30, 2012.

B. Financial Management, Financial Reports and Audits.

1. The Recipient shall maintain or cause to be maintained a financial management system in accordance with the provisions of Section 5.09 of the General Conditions.

2. The Recipient shall have its Financial Statements audited in accordance with the provisions of Section 5.09(b) of the General Conditions. Each audit of the Financial Statements shall cover the period of one fiscal year of the Recipient. The audited Financial Statements for each such period shall be furnished to the Administrator not later than six months after the end of such period.

Section III. Procurement

A. General.

1. **Works.** All works required for the Project and to be financed out of the proceeds of the EC Grant shall be procured in accordance with the requirements set forth or referred to in Section I of the Procurement Guidelines, and with the provisions of this Schedule.

2. **Definitions.** The capitalized terms used below in this Section to describe particular procurement methods or methods of review by the Administrator of particular contracts refer to the corresponding method described in the Procurement Guidelines.

B. Particular Methods of Procurement of Works.

The following table specifies the methods of procurement which shall be used for works. The Procurement Plan shall specify the circumstances under which such methods shall be used.

Procurement Method
(a) Shopping
(b) Community Participation

C. Review by the Administrator of Procurement Decisions.

Except as the Administrator shall otherwise determine by notice to the Recipient, all contracts shall be subject to Post Review by the Administrator.

Section IV. Withdrawal of the EC Grant Proceeds

A. General.

1. The Recipient may withdraw the proceeds of the EC Grant in accordance with the provisions of this Section and such additional instructions as the Administrator shall specify by notice to the Recipient to finance Eligible Expenditures as set forth in the table in paragraph 2 below.

2. The following table specifies the categories of Eligible Expenditures that may be financed out of the proceeds of the EC Grant (“Category”), the allocation of the amounts of the EC Grant to each Category, and the percentage of expenditures to be financed for Eligible Expenditures in each Category inclusive of taxes. The table also includes, for information purposes, the amount of the Bank Administrative Fee to be deducted by the Bank for its own account directly from the EC Funding.

<u>Category</u>	<u>Amount of the EC Grant expressed in Euro</u>	<u>% of Expenditures to be Financed</u>
(1) Civil works:		
(a) under Part B.1 of the Project for:		
(i) Chongqing	141,000	10%
(ii) Guizhou	194,000	
(iii) Hubei	120,000	
(iv) Yunnan	145,000	
(b) under Part B.4 and B.6 of the Project for:		
(i) Chongqing	1,655,000	20%
(ii) Guizhou	2,270,000	
(iii) Hubei	1,403,000	
(iv) Yunnan	1,702,000	
(2) Grant Option for the Poor for:		
(i) Chongqing	512,000	
(ii) Guizhou	701,000	100% of
(iii) Hubei	432,000	amounts
(iv) Yunnan	525,000	disbursed
Total EC Grant:	9,800,000	
Bank Administrative Fee	200,000	
Total EC Funding	<u>10,000,000</u>	

B. Withdrawal Conditions; Withdrawal Period.

1. Notwithstanding the provisions of Part A of this Section no withdrawal shall be made:

- (a) for payments made prior to the date of this Agreement.
- (b) in respect of expenditures under Category 1 to be made on the basis of output unit costs set forth in the Annex 2 to this Schedule,

unless the Recipient, through the relevant Financial Bureau of each Project Implementing Entity, has certified in a manner satisfactory to the Bank of achievements of one or more of the output units listed in the said Annex.

2. For purposes of the table above the term “Grant Option for the Poor” means the financing in the form of a grant up to RMB500 per household to off-set in part or in total the repayment obligation of the poorest households under the Project, as such households are selected in accordance with procedures established by the Participatory Watershed Manual.
3. The Closing Date is June 30, 2012.

Annex 1

Performance Indicators

Outcome Indicator	Baseline	Target Values	
		Year 3	Year 6
Farmer income:			
Net income (RMB/year/capita)	1,567	1,600	2,150
farm land productivity (RMB/ha)	8,550	5,347	16,724
Outreach/equity to population in project area:			
percentage of beneficiaries out of total households in project areas	0	20%	60%
percentage of ethnic minority beneficiary households out of total minority households	0	22%	66%
Erosion reduction by the reduced amount of silt inflow in downstream river systems (million tons/annum)	0	1.0	5.2
Total amount of carbon sequestered through increases in the amount of biomass (million tons)	0	0.14	0.58
Replicability and sustainability			

Annex 2

Unit Costs and Disbursement Rates

Output Units	Unit	Output Unit Cost US\$	Disbursement from EC Grant in % of unit cost	Disbursement from EC Grant in US\$ per Unit
B.1 Earth Terraces	ha	1,231	10%	123
B.4 Livestock Household Units				
Cattle	HH	525	20%	105
Cross-breeding Calf	HH	758	20%	152
Sheep/Goats (pen-fed only)	HH	778	20%	156
Pig	HH	292	20%	58
B.6 Renewable Energy				
Biogas pits	No.	172	20%	34
Energy saving oven	No.	41	20%	8

HH means Household; ha means Hectare; No. means Number of units

APPENDIX

Section I. Definitions.

1. “Bank Administrative Fee” means the amount equal to Euro two hundred thousand (€200,000) representing two per cent (2%) of the EC Funding to be deducted by the Bank for its own account directly from the EC Funding pursuant to the Administration Agreement entered into between the Bank and the European Community dated June 2, 2006.
2. “Category” means a category set forth in the table in Section 2 of Schedule IV to this Agreement, except the Bank Administrative Fee set forth therein.
3. “Central Project Coordination Office” and the acronym “CPCO” mean the office established within the Ministry of Water Resources on September 15, 2004, and to be maintained according to the provisions of paragraph B.1(b), Section I, Schedule 2 to this Agreement.
4. “Central Project Implementation Office” and the acronym “CPIO” mean the office established within the Borrower’s Changjiang Water Resources Commission on April 13, 2005, and to be maintained according to the provisions of paragraph B.1(c), Section I, of Schedule 2 to this Agreement.
5. “Central Project Leading Group” and the acronym “CPLG” mean the group established within the Ministry of Water Resources on September 15, 2004, and to be maintained according to the provisions of paragraph B.1(a), Section I, Schedule 2 to this Agreement.
6. “Chongqing” means the Recipient’s Municipality of Chongqing, and any successor thereto.
7. “Euro” and “€” each means the lawful currency of the European Community.
8. “Financial Bureau” means collectively the Chongqing Finance Bureau of Chongqing Municipality, the Department of Finance of Guizhou Province, Finance Bureau of Hubei Province and Finance Bureau of Yunnan Province.

9. “General Conditions” means the “International Bank for Reconstruction and Development General Conditions for Loans”, dated July 1, 2005.
10. “Guizhou” means the Recipient’s Province of Guizhou and any successor thereto.
11. “Hubei” means the Recipient’s Province of Hubei, and any successor thereto.
12. “Ministry of Water Resources” and the acronym “MWR” means the Recipient’s ministry of Water Resources or any successor thereto.
13. “Procurement Guidelines” means the “Guidelines for Procurement under IBRD Loans and IDA Credits” published by the Bank in May 2004.
14. “Procurement Plan” means the Recipient’s procurement plan for the Project, dated April 24, 2006, and referred to in paragraph 1.16 of the Procurement Guidelines and paragraph 1.24 of the Consultant Guidelines, as the same shall be updated from time to time in accordance with the provisions of said paragraphs.
15. “Project Agreement” means the agreement between the Bank and Chongqing, Guizhou, Hubei and Yunnan, and any successor thereto of even date herewith, as the same may be amended from time to time; and such term includes all schedules and agreements supplemental to the Project Agreement.
16. “Project Implementing Entities” means Chongqing Municipality, Guizhou Province, Hubei Province and Yunnan Province.
17. “Renminbi Yuan” and “RMB” each means the lawful currency of the People’s Republic of China.
18. “Yunnan” means the Recipient’s Province of Yunnan, and any successor thereto.