

ITEM FOR FINANCE COMMITTEE

HEAD 106 - MISCELLANEOUS SERVICES

New Capital Account Subhead “Contribution to the Seventh Replenishment of the Asian Development Fund”

Members are invited to approve the creation of a new Capital Account Subhead “Contribution to the Seventh Replenishment of the Asian Development Fund” with a commitment of HK\$127 million for a contribution to the seventh replenishment of the Asian Development Fund.

PROBLEM

The Asian Development Bank (ADB) has requested Hong Kong to contribute a total of US\$16.28 million (about HK\$127 million) to the seventh replenishment of the Asian Development Fund (ADF) or ADF VIII.

PROPOSAL

2. We propose that Hong Kong should make a contribution of US\$16.28 million to ADF VIII over seven years from 2001 to 2007.

JUSTIFICATION

3. Members approved contributions to the last four ADF replenishments as follows –

| ADF replenishments | Approval date | Amount (US\$ million) |
|--------------------|-------------------|--------------------------|
| ADF IV | 13 October 1982 | 1.0 |
| ADF V | 11 March 1987 | 1.0 |
| ADF VI | 12 June 1992 | 3.0 |
| ADF VII | 19 September 1997 | 15.39 |

4. Prior to ADF VII, Hong Kong did not participate in the donors' negotiations because by tradition the main participants were the developed country members. Hong Kong's contributions to ADF IV, V and VI were made as additional contributions to supplement the ADF resources. For ADF VII, Hong Kong agreed to participate in the negotiations during which donors agreed on a burden-sharing formula. The formula was a function of a donor's subscribed capital at ADB and per capita Gross National Product (GNP)/Gross Domestic Product (GDP), an example of which is illustrated in Enclosure 1. Out of the then 56 members of the ADB, 24 were donors to ADF VII. The calculated burden share of Hong Kong in ADF VII was 0.57% of the target size of contributions by donors. According to this burden-sharing formula, Members approved at the meeting held on 19 September 1997 (vide FCR(97-98)33) the creation of a New Capital Account Subhead under Head 106 Miscellaneous Services with a commitment of HK\$120.5 million (about US\$15.39 million) for our contribution to the last replenishment.

Encl. 1

Reasons for contribution

5. We consider that Hong Kong should continue its support to ADB and contribute its share to ADF VIII in accordance with the consensus burden-sharing formula for the following reasons –

- (a) ***Hong Kong's commitment to the region*** – the ADF has played a key role in reinforcing national efforts to reduce poverty in the Asia-Pacific region. Since its inception in 1973, the ADF has provided concessional loans totalling US\$22 billion to improve the conditions of the poor by helping them to have better access to basic amenities and social services, such as health and sanitary services, clean water supply and basic education. By far, the largest beneficiaries of ADF loans are Bangladesh, Pakistan, Sri Lanka, Vietnam and Nepal, countries with an average per capita GNP of only US\$450. Given that Hong Kong's per capita GDP, at US\$23,659 in 1999, is among the highest in the region, Hong Kong's continued participation in the worthwhile cause of ADF is consistent with our overall stance to support development efforts in

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the region. In fact, Hong Kong's prosperity is closely linked to the development and prosperity of the region and the openness of their market reforms. Thus, our effort does not only contribute to the development in the region, it also benefits our economy.

- (b) ***ADB's support towards Hong Kong*** – Hong Kong was a beneficiary of ADB financial support in 1970s when Hong Kong was relatively underdeveloped. During the period 1972-1980, ADB granted five loans amounting to US\$97 million from its Ordinary Capital Resources to finance several infrastructural projects in Hong Kong¹. These loans were fully repaid by 1987. Moreover, ADB has been playing a supportive role in the development of Hong Kong's bond market. Apart from using Hong Kong to issue HK Dollar bonds and US Dollar Dragon Bonds from time to time, ADB demonstrated its support of and confidence in Hong Kong by issuing in April 1992 a HK\$500 million 7-year bond. This was the first HK Dollar denominated bond issued by an international financial institution that straddled 1 July 1997. Given ADB's past support to Hong Kong, it is appropriate that Hong Kong should reciprocate by offering support to the operation of ADB; and
- (c) ***Hong Kong's commitment to the ADB*** – the ADB is one of the few international financial institutions of which Hong Kong is a full member. Our membership at the ADB is derived from our Associate Membership of the United Nation Economic and Social Commission for Asia and the Pacific (ESCAP). We have been a contributor of the ADF since 1983 (for ADF IV). Hong Kong should be seen to be playing its full part in the ADB's activities. The concessional loan facilities under ADF form a very important arm of the operation of the ADB. As a responsible member, Hong Kong should continue to give full support to the ADB activities. Our contribution will be a solid demonstration of Hong Kong's commitment to the ADB. Our continuous support to ADF will further strengthen Hong Kong's well developed international image.

Sharing basis and amount of contribution

6. The negotiations of ADF VIII, which covers the period from 2001-2004, started in October 1999. After five rounds of discussion, the negotiations were concluded in September 2000. Agreement was reached on a total replenishment size of US\$5.6 billion, of which US\$2.74 billion will come from

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¹ These include Shatin Sewage Treatment Plant Stage 1 (1976), Shatin Urban Development (Housing) Project (1977), Lok On Pai Sea Water Desalting Plant (1972), the Shatin Hospital-Polyclinic Project (1978), and the Second Shatin Urban Development Project (1980).

the ADB's internal pool (e.g. previous ADF loans repayment) while the remaining US\$2.86 billion will be funded by donors' voluntary contributions. The target size of contributions by donors represents an increase of US\$0.16 billion, or 5.9%, from that of ADF VII.

7. Donors agreed that the burden-sharing percentage for ADF VIII should follow that of ADF VII. Based on that percentage, which is 0.57% of the total target size of contributions by donors, Hong Kong's share translates into an amount of US\$16.28 million. The amounts pledged by donors for ADF VIII are set out in Enclosure 2.

FINANCIAL IMPLICATIONS

8. Adopting the exchange rate of US\$1 = HK\$7.8 and allowing 0.01% transaction cost, a commitment of HK\$127 million will be required. ADB will encash the promissory notes issued by the Government of the Hong Kong Special Administrative Region¹ in accordance with a 7-year encashment schedule as shown at Enclosure 3.

BACKGROUND INFORMATION

9. The ADF, established in 1973, is the concessional lending window of the ADB to its most needy members. The objective of the ADF is to promote poverty reduction and improvements in the quality of life in the poorer countries in the region. ADF loans carry a concessional interest rate of only 1% to 1.5% per annum and a loan maturity of up to 32 years. Resources are replenished every three to five years. ADF loans repayment would be pooled to form the ADB's internal resources for future ADF replenishments.

10. Borrower members have to meet certain criteria, such as per capita GNP/GDP², set by the ADB in order to be eligible for the ADF loans. At present, 27 ADB developing member countries are eligible for ADF resources (see Enclosure 4).

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¹ Four promissory notes will be issued to the ADB over four years as undertakings on which ADB will base to commit ADF loans for its borrower members. The first note will be issued by 1 July 2001 and the last one by 1 July 2004. Each note will represent a contribution of HK\$31.75 million. The actual cash outflow of the commitment follows that in the 7-year encashment schedule at Enclosure 3.

² The current benchmark used is US\$925, in 1997 price, but this is not applicable to pacific island developing member economies.

11. Donors' contributions to ADF are on a voluntary basis. Traditional donors include leading industrial countries such as Japan, the United States, Canada, the United Kingdom and Germany. In recent years, newly industrialised economies such as Korea, Hong Kong, Singapore and Taipei, China have been asked to share the funding requirements in accordance with the burden-sharing principle commensurate with their economic strengths.

12. On 21 November 2000, the Chief Executive in Council decided that Hong Kong should contribute its burden share of US\$16.28 million to ADF VIII, subject to the approval of the necessary funds by the Finance Committee of the Legislative Council.

Financial Services Bureau
December 2000

Illustration Showing the Computation of Burden Sharing

The amount of donors' contribution is say US\$3,000 million and the newly industrialised economies (NIEs) have to contribute say 5% of the total. Following is the computation –

| | I | II | III | IV | V | VI | VII |
|--------------------|---|---|--|---|--|---|---|
| NIE members | Per Capita GNP 1994 – nominal (US\$) | Per Capita GNP – normalised* | Number of ADB shares subscribed by member | Adjusted shares (II x III) | Adjusted shares in percentage terms | Percentage of contribution among NIEs (V x 5%) | Amount of contribution (US\$ million) (VI x US\$3,000 million) |
| A | 4,500 | 1.00 | 38 000 | 38 000 | 6.36 | 0.32 | 9.55 |
| B | 5,000 | 1.11 | 45 000 | 49 950 | 8.37 | 0.42 | 12.57 |
| C | 21,000 | 4.67 | 100 000 | 467 000 | 78.21 | 3.91 | 117.32 |
| D | 3,000 | 0.67 | 55 000 | 36 850 | 6.17 | 0.31 | 9.22 |
| E | 2,000 | 0.44 | 12 000 | 5 280 | 0.89 | 0.04 | 1.34 |
| Total | n/a | n/a | n/a | 597 080 | 100.00 | 5.00 | 150.00 |

* Country A is designated as a “reference donor” and its per capita GNP is assigned a value of 1.0. Column II reflects the proportion in Column I. The outcome of the computation at Columns V or VI is independent of the choice of the ‘reference donor’.

Overview of the Financing and Burden Sharing of ADF VII and ADF VIII

| | ADF VII US Dollar (mn) | ADF VII Burden sharing % | ADF VIII US Dollar (mn) | ADF VIII Burden sharing % |
|-----------------------------------|---------------------------|-----------------------------|----------------------------|------------------------------|
| Non-regional donor members | | | | |
| Austria | 23.49 | 0.87 | 24.85 | 0.87 |
| Belgium | 19.44 | 0.72 | 20.57 | 0.72 |
| Canada | 125.82 | 4.66 | 133.14 | 4.66 |
| Denmark | 24.03 | 0.89 | 25.43 | 0.89 |
| Finland | 13.50 | 0.50 | 14.29 | 0.50 |
| France | 135.00 | 5.00 | 126.00 | 4.41 |
| Germany | 177.12 | 6.56 | 165.10 | 5.78 |
| Italy | 108.00 | 4.00 | 111.43 | 3.90 |
| Netherlands | 65.61 | 2.43 | 82.85 | 2.90 |
| Norway | 24.30 | 0.90 | 27.14 | 0.95 |
| Portugal ¹ | -- | -- | 17.14 | 0.60 |
| Spain | 13.50 | 0.50 | 28.57 | 1.00 |
| Sweden | 36.99 | 1.37 | 39.14 | 1.37 |
| Switzerland | 33.21 | 1.23 | 35.14 | 1.23 |
| Turkey | 15.12 | 0.56 | 5.00 | 0.18 |
| United Kingdom | 102.60 | 3.80 | 137.14 | 4.80 |
| United States | 400.00 | 14.81 | 412.00 | 14.42 |
| Sub-total | 1,317.73 | 48.80 | 1,404.93 | 49.18 |
| Regional donor members | | | | |
| Australia | 175.23 | 6.49 | 185.42 | 6.49 |
| Japan | 948.51 | 35.13 | 1,003.66 ² | 35.13 |
| New Zealand | 17.55 | 0.65 | 18.57 | 0.65 |
| Hong Kong | 15.39 | 0.57 | 16.28 ³ | 0.57 |
| Korea, Rep. of | 54.27 | 2.01 | 81.41 ⁴ | 2.85 |
| Malaysia ⁵ | 10.00 | 0.37 | -- | -- |
| Singapore ^{1,6} | -- | -- | 4.00 | 0.14 |
| Taipei, China | 14.58 | 0.54 | 15.43 | 0.54 |
| Thailand ⁷ | 4.00 | 0.15 | 2.64 | 0.09 |
| Sub-total | 1,239.53 | 45.91 | 1,327.41 | 46.46 |
| Total ⁸ | 2,557.26 | 94.71 | 2,732.34 | 95.64 |

¹ Portugal and Singapore did not contribute to the ADF VII.

² The amount does not include (a) a contribution of US\$9.65 million which Japan has agreed to make to fill part of the funding gap arising from the inability of some donors to honour their full burden shares; and (b) a special contribution of US\$48.06 million.

³ The amount is subject to the approval of the Finance Committee of the Legislative Council.

⁴ Korea has voluntarily increased its burden share from 2.01% to 2.85%.

⁵ Malaysia will not contribute to the ADF VIII.

⁶ Singapore's burden share should be 0.38% under the burden sharing principle, but Singapore has only pledged to contribute 0.14%.

⁷ Thailand has reduced its burden share from 0.15% to 0.09%.

⁸ The burden share percentages of both ADF VII and VIII do not add up to 100% as some of the donor members are unable to make contributions in accordance with the burden-sharing formula agreed in the ADF VII negotiations.

Enclosure 3 to FCR(2000-01)54

**Encashment Schedule
(% of Total Contribution)**

| Year | Amount to be encashed US\$ million | % of total contribution |
|-------------|---|--------------------------------|
| 2001 | 0.62 | 3.8 |
| 2002 | 1.25 | 7.7 |
| 2003 | 2.04 | 12.5 |
| 2004 | 3.04 | 18.7 |
| 2005 | 3.19 | 19.6 |
| 2006 | 3.29 | 20.2 |
| 2007 | 2.85 | 17.5 |
| | <hr/> | <hr/> |
| | 16.28 | 100.0 |

Overview of Eligible/ Existing ADF Borrowers**ADF Loans, 1973 - August 2000**

| Eligible / Existing Borrowers ^a | 1999 Per Capita GNP (US\$) | Loans (US\$ million) |
|---|---------------------------------------|---------------------------------|
| Bangladesh | 370 | 5,755.0 |
| Pakistan | 470 | 5,480.7 |
| Sri Lanka | 820 | 2,376.9 |
| Vietnam | 370 | 1,665.4 |
| Nepal | 220 | 1,630.1 |
| Philippines ^a | 1,020 | 1,105.2 |
| Indonesia | 580 | 857.5 |
| Lao PDR | 280 | 810.7 |
| Myanmar | 102 ^c | 524.3 |
| Mongolia | 350 | 452.4 |
| Kyrgyz Republic | 300 | 422.2 |
| Cambodia | 260 | 370.0 |
| Papua New Guinea ^a | 800 | 341.5 |
| Samoa | 1,060 | 99.1 |
| Afghanistan | - ^b | 90.0 |
| Bhutan | 510 | 85.2 |
| Thailand ^a | 1,960 | 72.1 |
| Solomon Islands | 750 | 69.3 |
| Kazakstan ^a | 1,230 | 60.0 |
| Maldives | 1,160 | 55.2 |
| Rep. of Marshall Islands | 1,560 | 52.3 |
| Vanuatu | 1,170 | 51.3 |
| Tajikistan | 290 | 45.0 |
| Tonga | 1,720 | 42.9 |
| Fed. States of Micronesia | 1,810 | 35.1 |
| Cook Islands | 4,862 ^c | 24.5 |
| Uzbekistan ^a | 720 | 20.0 |
| Kiribati | 910 | 15.1 |
| Tuvalu | 1,378 ^d | 4.0 |
| China, People's Republic of | 780 | - |
| India | 450 | - |
| Nauru | 2,895 ^d | - |
| Regional loans to a group of borrowers | - | 197.0 |
| Total | | 22,809.9 |

^a Existing borrowers marked with "a" are no longer classified as "eligible" borrowers for new ADF resources. The loan amounts shown for these economies are loans approved in past ADF programmes.

^b No data available

^c GDP figure

^d 1998 GDP figure