

ITEM FOR FINANCE COMMITTEE

HEAD 106 – MISCELLANEOUS SERVICES

New Non-Recurrent Subhead “Contribution to the Eighth Replenishment of the Asian Development Fund”

Members are invited to approve the creation of a new Non-recurrent Subhead “Contribution to the Eighth Replenishment of the Asian Development Fund” with a commitment of HK\$149.7 million.

PROBLEM

According to a consensus burden sharing formula, Hong Kong should contribute a total of US\$19.19 million (about HK\$149.7 million) to the eighth replenishment of the Asian Development Fund (or ADF IX) of the Asian Development Bank (ADB).

PROPOSAL

2. We propose that Hong Kong should make a contribution of US\$19.19 million to ADF IX over ten years from 2005 to 2014.

/JUSTIFICATION

JUSTIFICATION

3. Hong Kong has been a donor of the ADF since 1983¹, and has made contributions according to the consensus burden sharing formula² since ADF VII in 1997. According to this formula, Hong Kong's burden sharing ratio is 0.57% of the target size of contribution by donors.

Reasons for contribution

4. We consider that Hong Kong should contribute to ADF IX for the reasons set out in paragraphs 5 to 9 below.

Recognition of the ADB's contribution to Hong Kong

5. Hong Kong joined the ADB in 1969 and has benefited from ADB operations in the Asia and the Pacific region (the region). In the period from 1972 to 1980, Hong Kong obtained five loans totalling US\$94.5 million from the ADB. These loans were used to finance construction of selected projects in public housing (Shatin Urban Development (Housing) Project (Wo Che Estate and Sha Kok Estate) and the second Shatin Urban Development Project (part of the development of Shatin New Town and the construction of Mei Lam Estate)), sewage treatment (Shatin Sewage Treatment Plant Stage 1), polyclinic (Shatin Hospital Polyclinic Project) and sea water treatment (Lok On Pai Sea Water Desalting Plant). All loans were repaid in full by 1987.

6. The ADB has contributed to the development of the bond market in Hong Kong by being an active bond issuer for both foreign currency and Hong Kong dollar bonds. The principal amount of Hong Kong dollar bonds issued by the ADB totalled HK\$6.1 billion. In particular, the ADB was the first international financial institution which had issued bonds straddling 1997. In 1992, the ADB issued a HK\$500 million seven-year bond maturing in 1999, which demonstrated the ADB's confidence in Hong Kong for a smooth transition and conveyed the "business as usual" message in the run up to 1997.

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¹ Hong Kong contributed to five previous replenishments – US\$1 million each in 1983 (ADF IV) and 1987 (ADF V), US\$3 million in 1992 (ADF VI), US\$15.39 million in 1997 (ADF VII) and US\$16.28 million in 2001 (ADF VIII). Unlike the token donations in ADF IV to VI, the amount contributed by Hong Kong to ADF VII and ADF VIII matched that derived from the consensus burden sharing formula agreed amongst the donors.

² The ADF burden sharing formula is based on a donor member's per capita Gross National Product (GNP) (which reflects the member's financial strength) and adjusted for its shareholding in the ADB. The same burden sharing formula has been adopted since ADF VII. The formula provides very useful guiding principles for donor members to determine their contributions to the ADF.

7. Hong Kong derives indirect economic benefits from the contribution, as firms in Hong Kong are able to bid for ADB projects. According to the ADB, on a cumulative basis up to end-2003, Hong Kong firms have been awarded a total of US\$589 million worth of goods and civil works procurement contracts and US\$46 million worth of consulting services and technical assistance contracts in relation to all ADB sponsored projects.

Hong Kong's commitment to the ADB

8. The ADB is one of the few multilateral financial institutions in which Hong Kong is a full member. As a responsible member, Hong Kong has the obligation, along with other economies from within and outside the region, to support ADB activities as fully as possible. Hong Kong's continued contribution to the ADF is an important practical demonstration of Hong Kong's support to the ADB.

9. Given that Hong Kong's per capita GNP, at US\$26,503³ in 2003, is one of the highest in the region, there is general expectation for Hong Kong, together with the other newly industrialised economies (NIEs)⁴ which have "graduated" from the ADB assistance programme, to assist in poverty reduction efforts in the region. We note that there are still a large population living in poverty with US\$1 per day⁵ in the region which is still home to about two-thirds of the world's poor, and that over 60% of the poor people in Asia are in South Asia⁶. These people are deprived of even the most basic amenities, social services and education. Hong Kong's continued participation in the ADF will be a clear demonstration of our commitment towards poverty reduction efforts.

Sharing basis and amount of contribution

10. For all previous ADF replenishments, the non-regional members contributed more than 50% of the total donors' contribution. The non-regional donors are pressing the regional donors, especially the NIEs, to contribute more to the ADF. Any diminution from the burden-shared contribution from Hong Kong is likely to be met with adverse reactions within the ADB and amongst the international community -

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³ Source: Census and Statistics Department, HKSARG, Constant (2000) market price.

⁴ The NIEs are South Korea, Singapore, Taiwan and Hong Kong.

⁵ The World Bank uses "living on US\$1 per person per day" as the international benchmark for defining the poverty line.

⁶ South Asia includes Bangladesh, India, Nepal, Pakistan and Sri Lanka.

- (a) it can be misinterpreted as a sign of Hong Kong backtracking its commitment to poverty reduction efforts in the region and not shouldering the obligation that comes with its membership at the ADB; and
- (b) there can be misunderstanding that Hong Kong is experiencing very serious fiscal difficulties. In 2001, we were able to contribute our full burden share to ADF VIII at a time when Hong Kong was still suffering from the aftermath of the Asian financial crisis. It would be difficult to justify a decrease in our burden-shared contribution when Hong Kong is now experiencing a robust economic growth forecast at 7.5% in 2004.

11. As agreed among ADF donors in May 2004⁷, ADF IX will have a replenishment size of US\$7.17 billion, of which at least US\$3.37 billion would be provided by donors' contributions and the remaining from the ADB's internal pool made up of loans repayment into ADF. A consensus has also emerged that the burden sharing formula for ADF IX should follow that of ADF VIII. The great majority of the donors have agreed to adhere to the burden sharing formula. A total of 27 economies⁸ from all over the world have pledged their contributions to ADF IX, as shown at Enclosure 1.

Encl. 1

12. Applying Hong Kong's burden sharing ratio of 0.57% (paragraph 3 above) to target contribution of US\$3.37 billion from ADF donors, Hong Kong's share translates into an amount of US\$19.19 million. The increase of Hong Kong's contribution relative to that of ADF VIII (US\$16.28 million) is a result of the burden sharing of an enlarged size of ADF lending operations due to increased demand for assistance, appreciation of the Special Drawing Right⁹ versus the US dollar, and the introduction of grants.

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⁷ The agreement comprised two parts. First, donors agreed to a total replenishment size of US\$7.17 billion, of which at least US\$3.37 billion will be provided by donors' contributions on a burden-shared basis. The target size of contributions by donors represents an increase of 17.8% from that of donors' contribution in ADF VIII. Secondly, there will be provision of grants set at a level of 21% of the total ADF IX operations.

⁸ Not including Hong Kong. There are at present 28 donors.

⁹ The Special Drawing Right is a currency basket (comprising USD, Euro, Japanese Yen and British pound) in which the ADF is denominated.

FINANCIAL IMPLICATIONS

13. Adopting the exchange rate of US\$1 = HK\$7.8 and allowing 0.01% transaction cost, a commitment of HK\$149.7 million is required to meet Hong Kong's contribution to ADF IX. The ADB can draw down Hong Kong's contribution in ten years according to the standard encashment schedule. The ADB also offers donors an Accelerated Encashment Programme under which drawdowns can be made in one, four or seven years. In ADF VIII, Hong Kong opted for a seven-year encashment schedule, as in the case of many donors. Subject to Members' approval of the proposed commitment for ADF IX, we will opt for the standard ten-year schedule, which is also the choice of the majority of ADF IX donors. The schedule is set out at Enclosure 2. We will make sufficient provision in the Annual Estimates to meet the cash flow requirements in relevant years.

Encl. 2

14. There will be very moderate additional administrative costs¹⁰ involved in Hong Kong's contribution to ADF IX, and they will be absorbed by the relevant operating departments.

BACKGROUND INFORMATION

15. The ADF, established in 1973, is a concessional lending window of the ADB available to the most needy members in the region to support poverty reduction and improve the quality of life. The ADF aims to help its most needy members to eradicate key barriers to human development – poverty, hunger, disease, infant mortality, illiteracy, environmental degradation as well as discrimination against women. The ADF resources are used to improve the conditions of the poor by helping them gain better access to basic amenities and social services. At present, 29 ADB developing member countries are eligible for ADF resources (see Enclosure 3). By far, the largest beneficiaries of ADF loans are Bangladesh, Pakistan, Sri Lanka, Vietnam and Nepal¹¹.

Encl. 3

16. Contributions to the ADF by ADB members are on a voluntary basis and the ADF is replenished once every three to five years.

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¹⁰ Administration costs refer to the staff cost involved in the process.

¹¹ These countries have an average per capita GNP of only US\$454 in 2002. (Source: Asian Development Outlook 2004)

17. We briefed the Legislative Council Panel on [Financial Affairs on 6 December 2004](#) on the proposed contribution to ADF IX. Members expressed support to the proposed contribution according to the consensus burden sharing formula on the consideration that Hong Kong should shoulder its international obligation to assist in poverty reduction efforts in the region.

Financial Services and the Treasury Bureau
December 2004

Overview of the Financing and Burden Sharing of ADF IX

| | ADF IX US Dollar (mn) | Contribution as a % of total | ADF VIII Burden Sharing % as per Formula | Difference |
|-----------------------------|---------------------------|----------------------------------|--|--------------------|
| Non-regional members | | | | |
| Austria | 29.28 | 0.87 | 0.87 | 0.00 |
| Belgium | 24.24 | 0.72 | 0.72 | 0.00 |
| Canada | 156.86 | 4.66 | 4.66 | 0.00 |
| Denmark | 29.96 | 0.89 | 0.89 | 0.00 |
| Finland | 16.83 | 0.50 | 0.50 | 0.00 |
| France | 148.44 | 4.41 | 4.41 | 0.00 |
| Germany | 194.55 | 5.78 | 5.78 | 0.00 |
| Italy | 131.27 | 3.90 | 3.90 | 0.00 |
| Luxembourg | 3.57 ¹ | 0.10 | n.a. | 0.10 |
| Netherlands | 97.61 | 2.90 | 2.90 | 0.00 |
| Norway | 37.36 | 1.11 | 0.95 | 0.16 |
| Portugal | 20.20 | 0.60 | 0.60 | 0.00 |
| Spain | 67.32 | 2.00 | 1.00 | 1.00 |
| Sweden | 46.11 | 1.37 | 1.37 | 0.00 |
| Switzerland | 41.40 | 1.23 | 1.23 | 0.00 |
| Turkey | 5.50 | 0.16 | 0.18 | -0.02 |
| United Kingdom | 201.96 | 6.00 | 4.80 | 1.20 |
| United States | 461.00 | 13.70 | 14.42 | -0.72 |
| Sub-total | 1,713.46 | 50.90 | 49.18 | 1.72 |
| Regional members | | | | |
| Australia | 218.45 | 6.49 | 6.49 | 0.00 |
| China, People's Republic of | 30.00 | 0.89 | n.a. | 0.89 |
| Japan | 1,178.10 | 35.00 ² | 35.13 ² | -0.13 |
| New Zealand | 23.56 | 0.70 | 0.70 | 0.00 |
| Hong Kong, China | 19.19 ³ | 0.57 | 0.57 | 0.00 |
| Korea, Rep. Of | 112.76 | 3.35 | 2.85 | 0.50 |
| Malaysia | 5.00 | 0.15 | n.a. | 0.15 |
| Singapore | 3.80 | 0.12 | 0.14 | -0.02 |
| Taipei, China | 18.18 | 0.54 | 0.54 | 0.00 |
| Thailand | 3.03 | 0.09 | 0.09 | 0.00 |
| Sub-total | 1,612.07 | 47.90 | 46.51 | 1.39 |
| Total | <u>3,325.53</u> | <u>98.80</u> ⁴ | <u>95.69</u> | <u>3.11</u> |

¹ Includes a supplementary contribution of \$200,000 which Luxembourg agreed to provide on the condition that such supplementary contribution will not be taken into account in calculating relative percentage share for the purpose of negotiating future ADF replenishments.

² Japan considers its burden share to be remained at the first assigned level of 33.69% despite its historically higher contribution share.

³ Hong Kong has indicated the intention of contributing to the Replenishment subject to the approval of the Executive Council and the Legislative Council, and with the amount to be confirmed.

⁴ The remaining gap (compared against target contribution of US\$3.37 billion from donors) is to be filled by additional contributions and/or internal resources.

Enclosure 2 to FCR(2004-05)33

Ten-year Encashment Schedule for ADF IX

| Note Encashment | | | | |
|-----------------|--|---------------------|-----------------------------|-----------|
| Year/Month | Drawdown Rates as a % of Total Contributions | Amount (US\$) | Financial Year Total (US\$) | |
| 2005 | 3.6 | | | |
| July | | 691,000 * | | |
| 2006 | 5.8 | | | |
| February | | 716,000 * | 1,407,000 | FY2005-06 |
| July | | 397,000 | | |
| 2007 | 9.8 | | | |
| February | | 1,100,000 * | 1,497,000 | FY2006-07 |
| July | | 781,000 | | |
| 2008 | 14.0 | | | |
| February | | 1,502,800 * | 2,283,800 | FY2007-08 |
| July | | 1,183,000 | | |
| 2009 | 14.6 | | | |
| February | | 1,401,000 | 2,584,000 | FY2008-09 |
| July | | 1,401,000 | | |
| 2010 | 15.9 | | | |
| February | | 1,525,000 | 2,926,000 | FY2009-10 |
| July | | 1,525,000 | | |
| 2011 | 15.0 | | | |
| February | | 1,439,000 | 2,964,000 | FY2010-11 |
| July | | 1,439,000 | | |
| 2012 | 11.0 | | | |
| February | | 1,055,000 | 2,494,000 | FY2011-12 |
| July | | 1,055,000 | | |
| 2013 | 6.9 | | | |
| February | | 662,000 | 1,717,000 | FY2012-13 |
| July | | 662,000 | | |
| 2014 | 3.4 | | | |
| February | | 326,000 | 988,000 | FY2013-14 |
| July | | 325,400 | 325,400 | FY2014-15 |
| Total | 100.0 | 19,186,200 | 19,186,200 | |
| | | say 19.19 million | 19.19 million | |
| | | (HK\$149.7 million) | (HK\$149.7 million) | |

* Including the amount to be transferred to the Technical Assistance Special Fund in the first four years of the drawdown.

Overview of Eligible ADF borrowers

ADF Loans, 1973 - 2003

| <u>Eligible / Existing Borrowers*</u> | <u>2002 Per Capita GNP (US\$)</u> | <u>Loans during the period (US\$ mn)</u> |
|--|---------------------------------------|--|
| Bangladesh | 360 | 6,643.4 |
| Pakistan | 410 | 6,625.3 |
| Sri Lanka | 840 | 2,906.5 |
| Vietnam | 430 | 2,501.0 |
| Nepal | 230 | 2,020.7 |
| Indonesia ^a | 710 | 1,327.9 |
| Philippines ^b | 1,020 | 1,105.2 |
| Lao PDR | 310 | 1,038.2 |
| Cambodia | 280 | 718.0 |
| Mongolia | 440 | 568.7 |
| Myanmar | 164 ^c | 524.3 |
| Kyrgyz Republic | 290 | 512.7 |
| Afghanistan | 191 ^d | 407.1 |
| Papua New Guinea | 530 | 378.0 |
| Tajikistan | 180 | 180.9 |
| Samoa | 1,420 | 116.6 |
| Bhutan | 590 | 111.2 |
| Maldives | 2,090 | 83.7 |
| Solomon Islands | 570 | 79.3 |
| Rep. of Marshall Islands | 2,350 | 74.1 |
| Thailand ^b | 1,980 | 72.1 |
| Kazakstan ^b | 1,510 | 60.0 |
| Tonga | 1,410 | 57.8 |
| Fed. States of Micronesia | 1,980 | 56.1 |
| Vanuatu | 1,080 | 51.3 |
| Cook Islands | 6,321 ^{d, e} | 26.7 |
| Azerbaijan | 710 | 22.0 |
| Uzbekistan ^b | 450 | 20.0 |
| Kiribati | 810 | 15.1 |
| Tuvalu | 1,431 ^d | 5.8 |
| Regional loans to a group of borrowers | - | 282.0 |
| Total | | <u>28,591.7</u> |

Data Source: Asian Development Outlook (2004)

* People's Republic of China, India and Nauru are also eligible for ADF but had not received any ADF loans during the specified period.

^a Indonesia is on watchlist for graduation from ADF.

^b These borrowers 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.

^c Only per capita GDP at current market prices are available.

Data source: IMF, World Economic Outlook Database, September 2004

^d Only per capita GDP at current market prices are available.

Data source: Asian Development Bank - Key Indicators 2004

^e While the per capita GDP of Cook Islands is well above the threshold for ADF loans, its debt repayment capacity is weak. It is difficult for the country to access to commercial capital, a key factor that supports the ADB's view that Cook Islands is still eligible for ADF.