

## **ITEM FOR FINANCE COMMITTEE**

### **HEAD 106 – MISCELLANEOUS SERVICES**

#### **New Non-Recurrent Subhead “Contribution to the Ninth Replenishment of the Asian Development Fund”**

Members are invited to approve the creation of a new non-recurrent subhead with a commitment of \$206.1 million for making contribution to the ninth replenishment of the Asian Development Fund.

### **PROBLEM**

Hong Kong has to decide whether it should make a voluntary contribution amounting to a total of US\$26.25 million (or HK\$206.1 million) to the ninth replenishment of the Asian Development Fund (ADF X) of the Asian Development Bank (ADB) according to a consensus burden sharing formula.

### **PROPOSAL**

2. We propose that Hong Kong should make a contribution of US\$26.25 million (or HK\$206.1 million) to ADF X over nine years from 2009 to 2017.

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## JUSTIFICATION

3. Hong Kong has been a donor of the ADF since 1983<sup>1</sup>. With the approval of this Committee, we have made contributions according to the consensus burden sharing formula<sup>2</sup> in the last three replenishments 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 X for the reasons set out in paragraphs 5 to 10 below.

### *Expectation of Hong Kong's commitment*

5. Hong Kong joined the ADB in 1969 and has benefited from ADB's operations in the region. In the period from 1972 to 1980, Hong Kong obtained five loans totaling US\$101.5 million from the ADB. These loans were used to finance construction of public housing projects (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)), a sewage treatment plant (Shatin Sewage Treatment Plant Stage 1), a polyclinic (Shatin Hospital Polyclinic Project) and one other infrastructure project (Lok On Pai Sea Water Desalting Plant). All loans were repaid in full by 1987.

6. Hong Kong also derives indirect economic benefits from the contribution to the extent that firms in Hong Kong (as ADF donor) might gain additional scores when they bid for ADB-sponsored projects. According to the ADB, as of end 2007, Hong Kong firms have been awarded ADB loan and technical assistance projects such as consultancy worth US\$847.29 million in total.

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<sup>1</sup> Hong Kong contributed to six 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), US\$16.28 million in 2001 (ADF VIII) and US\$19.19 million in 2005 (ADF IX). Unlike the token donations in ADF IV to VI, the amount contributed by Hong Kong in ADF VII to IX matched that derived from the consensus burden sharing formula agreed amongst the donors.

<sup>2</sup> Although contribution to the ADF is on a voluntary basis, donors have generally made reference to a burden sharing formula in setting their levels of contribution, which is based on the donors' shareholding in the ADB adjusted for its per capita Gross National Product (GNP). The formula provides a useful reference for donor members to determine their contributions to the ADF.

7. Given that Hong Kong's per capita Gross Domestic Product, at US\$29,104<sup>3</sup> in 2007, is one of the highest in the region, there is general expectation for Hong Kong, together with the other Newly Industrialised Economies which have "graduated" from the ADB assistance programme, to contribute to poverty reduction efforts in the region<sup>4</sup>.

### *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 the ADB activities as fully as possible. Our continued contribution to the ADF is an important practical demonstration of Hong Kong's support to the ADB. We note that there is still a large population living in extreme poverty with US\$1 per day<sup>5</sup>, and about two-thirds of these people live in South Asia<sup>6</sup>. These people are deprived of even the most basic amenities, social services and education. The ADB, mainly through the ADF and other concessional lending, has played a key role in supporting efforts to reduce poverty in the Asia-Pacific region. Hong Kong's continued participation in the ADF will be a clear demonstration of our contribution towards poverty reduction efforts in the region.

9. The major regional donors including Japan, Korea, Singapore, Australia and New Zealand have agreed to maintain the same contribution share as in ADF IX, leaving the total share of regional donors largely the same<sup>7</sup>. Even though China is still receiving ADB assistance, it has, for the second time, agreed to contribute US\$35 million to ADF X which is higher than its contribution of US\$30 million in ADF IX.

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<sup>3</sup> Source: Census and Statistics Department, HKSARG, Chained (2005) dollars.

<sup>4</sup> Graduation from ADB assistance will be triggered when a country/place reaches a Gross National Income (GNI) per capita benchmark (US\$6,275 in 2006). ADB will then analyse the country/place's readiness for graduation focusing on (i) availability of commercial capital flows on reasonable terms; and (ii) levels of development of key economic and social institutions.

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

<sup>6</sup> South Asia includes Bangladesh, India, Nepal, Pakistan and Sri Lanka.

<sup>7</sup> Japan is the largest donor which accounts for 35% of the donor's contribution.

10. There is a general expectation that Hong Kong, being a regional donor, will maintain its burden share as in the case of its regional peers. Any diminution from the burden-shared contribution will be a conspicuous move and is likely to be met with the following adverse reactions within the ADB and amongst the international community —

- (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, thus damaging Hong Kong's reputation and status as an international financial centre; and
- (b) the reduction of Hong Kong's level of contribution at this time may give the wrong impression that we are worried about our fiscal sustainability in the long term, so much so that we have to scale down or even discontinue our contribution to the ADB. The potential damage to the financial stability of Hong Kong can be significant in the light of the current volatile global economic and market conditions.

### **Amount of contribution**

11. As agreed among ADF donors in May 2008, ADF X will have a replenishment size of US\$11.3 billion, of which about US\$4.61 billion would be provided by donors' contributions and the remaining from the ADB's internal pool of resources. A consensus has also emerged that the burden sharing formula for ADF X should follow that of ADF IX. A total of 29 economies<sup>8</sup>, with details at Encl. 1 Enclosure 1, have pledged their contributions to ADF X.

12. Applying Hong Kong's burden sharing ratio of 0.57% as mentioned in paragraph 3 above to the total target contribution of US\$4.61 billion from ADF donors, Hong Kong's share translates into an amount of US\$26.25 million. The increase of Hong Kong's contribution relative to that of ADF IX (US\$19.19 million) is a result of the burden sharing of an enlarged size of ADF lending operations due to increased demand for assistance and the appreciation of the Special Drawing Right (SDR)<sup>9</sup> versus the US dollar.

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<sup>8</sup> Not including Hong Kong. Hong Kong has indicated the intention to contribute to the ADF X subject to the approval of the Executive Council and the Legislative Council, and with the amount to be confirmed. There are at present 30 donors including Hong Kong.

<sup>9</sup> The SDR is a currency basket (comprising US dollar, Euro, Japanese yen and British pound) in which the ADF is denominated.

## FINANCIAL IMPLICATIONS

13. Adopting the exchange rate of US\$1 = HK\$7.85<sup>10</sup> and allowing 0.01% transaction cost, a commitment of HK\$206.1 million is required to meet Hong Kong's contribution of US\$26.25 million to ADF X. The ADB can draw down Hong Kong's contribution in nine years according to the standard encashment schedule. The ADB also offers donors an Accelerated Encashment Programme under which drawdowns can be made in one, two, four or six years.

Encl. 2

14. Hong Kong has been following the practice of the majority of ADF donors in choosing the encashment schedule. In ADF IX, Hong Kong chose the standard (ten-year) encashment schedule, as in the case of most donors. Subject to Members' approval of the proposed contribution to ADF X, we will opt for the standard nine-year schedule, which is also the choice of the majority of ADF X 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.

15. There will be very moderate additional administrative costs<sup>11</sup> involved in Hong Kong's contribution to ADF X, and they will be absorbed by the operating departments.

## PUBLIC CONSULTATION

16. We consulted the Legislative Council Panel on Financial Affairs on the proposal on 5 January 2009. Members were generally supportive of 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.

## BACKGROUND

17. The ADF, established in 1973, is a concessional lending window of the ADB available to the most needy members in the Asia-Pacific region to support poverty reduction and improve the quality of life. These include various infrastructure projects for road improvement, power distribution, water supply and sanitation, etc. in the poorest countries of the region, and the total ADF assistance amounted to US\$34.6 billion since its inception to the end of 2007. At present, 29 ADB developing member countries, with details at Enclosure 3, are eligible for ADF resources. Among them, Bangladesh, Pakistan, Vietnam, Sri Lanka and Nepal are by far the largest beneficiaries of the ADF.

Encl. 3

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<sup>10</sup> This is the upper bound of convertibility zone of 7.75-7.85 under the Linked Exchange Rate system.

<sup>11</sup> The administrative costs referred above are the staff costs involved in the process.

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

19. On 9 December 2008, the Executive Council endorsed that subject to the funding approval of this Committee, Hong Kong should contribute US\$26.25 million (or HK\$206.1 million) to the ADF X over a nine-year period.

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Financial Services and the Treasury Bureau  
February 2009

## Overview of the Financing and Burden Sharing of ADF X

	ADF X Contribution		ADF IX	Difference (%)
	Amount (USD mn)	Burden share (%)	Burden share (%)	
<b>Non-regional members</b>				
Austria	42.1	0.91	0.87	0.04
Belgium	33.2	0.72	0.72	0.00
Canada	207.2	4.50	4.66	-0.16
Denmark	19.8	0.43	0.89	-0.46
Finland	33.2	0.72	0.50	0.22
France	160.2	3.48	4.41	-0.93
Germany	222.1	4.82 <sup>1</sup>	5.78	-0.96
Ireland	41.2	0.90	0.83	0.07
Italy	138.2	3.00	3.90	-0.90
Luxembourg	4.6	0.10	0.10	0.00
Netherlands	107.7	2.34	2.90	-0.56
Norway	44.6	0.97	1.11	-0.14
Portugal	27.6	0.60	0.60	0.00
Spain	128.9	2.80	2.00	0.80
Sweden	63.1	1.37	1.37	0.00
Switzerland	47.9	1.04	1.23	-0.19
Turkey	6.4	0.14	0.16	-0.02
United Kingdom	221.1 <sup>2</sup>	4.80	6.00	-1.20
United States	461.0	10.01	13.70	-3.69
<b>Sub-total</b>	<b>2,010.0</b>	<b>43.65</b>	<b>51.73</b>	<b>-8.08</b>
<b>Regional members</b>				
Australia	298.9	6.49	6.49	0.00
Brunei Darussalam	5.6	0.12	0.28	-0.16
China, People's Republic of	35.0	0.76	0.89	-0.13
<b>Hong Kong, China</b>	<b>26.25</b> <sup>3</sup>	<b>0.57</b>	<b>0.57</b>	<b>0.00</b>
Japan	1,611.8	35.00	35.00	0.00
Korea, Republic of	154.3	3.35	3.35	0.00
Malaysia	6.0	0.13	0.15	-0.02
New Zealand	32.2	0.70	0.70	0.00
Singapore	5.5	0.12	0.12	0.00
Taipei, China	21.7	0.47	0.54	-0.07
Thailand	3.6	0.08	0.09	-0.01
<b>Sub-total</b>	<b>2,200.9</b>	<b>47.79</b>	<b>48.18</b>	<b>-0.39</b>
<b>Total Actual Contribution</b>	<b>4,210.9</b> <sup>4</sup>	<b>91.44</b>	<b>99.91</b>	<b>-8.47</b>
<b>Target size (basis for burden sharing)</b>	<b>4,605.3</b>	<b>100.00</b>		

<sup>1</sup> Germany may increase its burden share subject to parliamentary approval.

<sup>2</sup> The United Kingdom indicated its willingness to make a supplementary contribution afterwards based on benchmarks to be agreed with ADB management.

<sup>3</sup> Hong Kong has indicated the intention to contribute to the ADF X subject to the approval of the Executive Council and the Legislative Council, and with the amount to be confirmed.

<sup>4</sup> The remaining gap is to be filled by additional contributions and/or internal resources.

<sup>5</sup> Figure may not add up due to rounding.

## ADF X Encashment Schedule

Fiscal Year	Drawdown Rate %	Note Encashment		
		US\$	US\$ Total	HK\$ equivalent*
<b>FY 2009/2010</b>				
Jul-09	3.30	866,000		
Feb-10	3.50	919,000	1,785,000	14,013,651
<b>FY 2010/2011</b>				
Jul-10	3.50	919,000		
Feb-11	5.50	1,444,000	2,363,000	18,551,405
<b>FY 2011/2012</b>				
Jul-11	5.50	1,444,000		
Feb-12	7.60	1,995,000	3,439,000	26,998,850
<b>FY 2012/2013</b>				
Jul-12	7.60	1,995,000		
Feb-13	7.95	2,087,000	4,082,000	32,046,904
<b>FY 2013/2014</b>				
Jul-13	7.95	2,087,000		
Feb-14	7.70	2,021,000	4,108,000	32,251,025
<b>FY 2014/2015</b>				
Jul-14	7.70	2,021,000		
Feb-15	6.85	1,798,000	3,819,000	29,982,148
<b>FY 2015/2016</b>				
Jul-15	6.85	1,798,000		
Feb-16	5.45	1,431,000	3,229,000	25,350,185
<b>FY 2016/2017</b>				
Jul-16	5.45	1,431,000		
Feb-17	3.80	997,000	2,428,000	19,061,706
<b>FY 2017/2018</b>				
Jul-17	3.80	996,974	996,974	7,827,029
<b>Total</b>	<b>100</b>	<b>26,249,974</b>	<b>26,249,974</b>	<b>206,082,902</b> <b>say 206,100,000</b>

\* US dollar amounts are converted into HK dollars using the exchange rate of US\$1 = HK\$7.85, being the upper bound of the convertibility zone of 7.75-7.85 under the Linked Exchange Rate system, plus 0.01% transaction cost.

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## Overview of Eligible ADF X borrowers

## ADF Loans, 1973 - 2007

<u>Borrowers</u>	Per Capita GNP in 2006 (US\$)	Loans (US\$ mn)
Bangladesh	480	6,699.3
Pakistan	770	6,627.4
Viet Nam	690	3,861.0
Sri Lanka	1,300	3,137.4
Nepal	290	1,886.6
Lao PDR	500	1,163.1
Cambodia	480	987.8
Afghanistan	218 <sup>a</sup>	800.8
Mongolia	880	684.9
Kyrgyz Republic	500	640.4
Papua New Guinea	770	390.4
Tajikistan	390	383.9
Bhutan	1,420	172.2
Uzbekistan	600	139.2
Samoa	2,270	131.6
Maldives	2,670	93.5
Micronesia, Fed. States of	2,380	71.2
Armenia	1,930	68.8
Marshall Islands	3,060	62.4
Azerbaijan	1,850	59.3
Solomon Islands	680	57.2
Vanuatu	1,710	50.8
Tonga	2,170	46.6
Kiribati	1,230	14.0
Tuvalu	2,516 <sup>a</sup>	8.3
Timor leste	840	-
Georgia	1,560	-
Nauru	2,640	-
Palau	7,990	-
Regional projects	-	1.6
<b>Total</b>		<b>28,239.9</b>

Note :

- (1) India is also eligible for ADF but had not received any ADF loans during the specified period.
- (2) Cook Islands, Indonesia, Kazakhstan, Myanmar, Philippines and Thailand are no longer eligible for new ADF assistance but they still have outstanding ADF loans with ADB.
- (3) As at end-2007, outstanding ADF loans totalled US\$24.02 billion

<sup>a</sup> Per capita GNI in 2005

Sources: ADB Annual Financial Statements 2007, Key Indicators 2007 and ADF X Donors' Report